

Mahindra Satyam

Satyam saga unveils...

Mahindra Satyam reported its FY2009 and FY2010 numbers, which underperformed the market's expectations. The company reported revenue of US \$1.1bn for FY2010, which was in line with our estimates. The company's revenue slumped by 38%, whereas the headcount dropped by 40% yoy. The company also lost 194 clients, with majority of them in the BFSI space; however, it managed to add 44 clients in FY2010. Post the break out of the Satyam scam in January 2009, the company experienced heavy churn in clients asking for outright termination. However, in 1HFY2010, the company continued to service some of these clients due to contractual obligations. Thus, we believe the revenue run rate for 1HFY2010 would be on a higher side as opposed to 2HFY2010. Hence, we take the implied recurring revenue to be lower at ~Rs4,600cr, which is with an assumption of billing rates ~20% lower than Infosys and with an employee base of ~27,000. With the management focusing on reincarnating the operational matrix over the next 18 months, we expect the company to register a revenue CAGR of 15% over FY2010–FY12E.

A turnaround story: Tech Mahindra took the reins of Satyam in its hands in April 2009 and, indeed, turned around the company by scaling up its EBITDA margins by 491bp yoy despite exorbitant client attrition, which led to a 38% yoy revenue decline. We believe the exodus of clients that began in 1HFY2010 must have left the profitability spiral downwards and any pick up would have taken place only in 2HFY2010. Thus, the average EBITDA margins for 2HFY2010 would have been higher than the reported 8.3% in FY2010. The company still has huge headroom to refurbish its operating parameters. We believe the company will be able to scale up its EBITDA margins to 16% and PAT margin to 12% by FY2012.

Switch to Tech Mahindra: Mahindra Satyam has rallied by over 23% in the past month in anticipation of revenue run rate of over US \$1.2bn and EBITDA margin of 15–18% for FY2010. The stock is currently trading at 16.0x FY2012E EPS of Rs6.2, which is on a higher side. On a risk-reward basis, Tech Mahindra, the parent company, looks attractive when valued on an SOTP basis i.e., at 12x FY2012E EPS of Rs53.2, and adding value of stake in Mahindra Satyam with holding discount of 25% to its current market cap (discounting the over optimism). **Hence, we recommend a switch from Mahindra Satyam to Tech Mahindra for an upside of 19%.**

Valuation for Tech Mahindra (SOTP basis)

(Rs cr)	FY2012E
Fully diluted EPS for Tech Mahindra (standalone) (Rs)	53.2
Target P/E(x) for Tech Mahindra	12
Target Mcap for Tech Mahindra (ex-Satyam)	7,865
Market value of stake in Mahindra Satyam	4,966
Holding discount to Mahindra Satyam's stake (%)	25
Target Mcap of stake in Mahindra Satyam	3,725
Target Mcap for Tech Mahindra (incl. Satyam)	11,590
Target price (incl value of stake in Satyam) (Rs)	942

Source: Company, Angel Research

NEUTRAL

CMP	Rs99
Target Price	-
Investment Period	-

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Exhibit 1: Reinstated Profit & Loss statement

Rs cr	FY2008*	FY2009	FY2010
Income from operations	8473.50	8812.60	5481.00
Expenditure			
Employee cost	5259.50	6073.70	3981.10
Cost of software & hardware sold	2.30		
operating & administration expense	1376.80	2437.20	1043.00
EBITDA	1834.90	301.70	456.90
as % to sales	21.70	3.40	8.30
Depreciation	163.60	326.30	214.40
EBIT	1671.30	(24.60)	242.50
as % to sales	19.70	(0.30)	4.40
Interest & Financing charge	20.20	62.10	32.90
Other Income	267.20	63.10	105.60
PBT	1918.30	(23.60)	315.20
Exceptional item		7992.00	416.90
PBT(after exceptional item)	1918.30	(8015.60)	(101.70)
Tax	230.40	159.00	22.20
PAT	1687.90	(8174.60)	(123.90)
Minority interest		2.20	0.70
Adj PAT	1687.90	(8176.80)	(124.60)
EPS	25.20	(121.50)	(1.10)

Source: Company, Angel Research; Note: * indicates published accounts

Exhibit 2: Details of exceptional expenditure

Rs cr	FY2009	FY2010
Expenses related to restructuring /right sizing		93.4
Expenses related to forensic investigation and litigation support	83.2	106.8
Provision for doubtful debts ,advances, impairment of assets	419.1	
Erosion in value of assets in subsidiaries	771.9	216.7
Provision for contingencies	475	
Prior period items	6,242.8	
	7,992.0	416.9

Source: Company, Angel Research

Exhibit 3: Reinstated balance sheet

Rs cr	FY2008*	FY2009	FY2010
Share capital	134.1	134.8	235.2
Share application money pending allotment	1.8		0.1
Reserve and surplus	7,103.3	1,609.7	4,394.7
Minority interest		19.5	20.1
Loan funds	216.7	814.2	42.2
Deferred tax liability		4.8	3.9
	7,455.9	2,583.0	4,696.2
Amount pending investigation suspense account (net)		1,230.4	1,230.4
Total capital employed	7,455.9	3,813.4	5,926.6
Fixed assets	1,279.4	1,238.8	986.5
Investments			626.8
Deferred tax assets	87.2	6.5	6.5
Current assets, loans and advances			
Inventories	0.1	1	
Sundry debtors	2,370.3	1,551.6	923
Cash and cash balances	4,502.4	500.9	2,176.8
Other current assets	272.5	291.3	495.6
Loans and advances	391.9	466.3	384.5
Less: Current liabilities and provision			
Liabilities	897.7	1,389.2	881.8
Provision	550.2	1,478.3	1,540.4
Miscellaneous expenditure			
Profit and loss account	0	2,624.5	2,749.1
Sub total	7,455.9	3,813.4	5,926.6
Unexplained differences suspense account (net)			
Total capital deployed	7,455.9	3,813.4	5,926.6

Source: Company, Angel Research; Note: * indicates published accounts

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Disclosure of Interest Statement	Mahindra Satyam	Tech Mahindra
1. Analyst ownership of the stock	No	No
2. Angel and its Group companies ownership of the stock	Yes	Yes
3. Angel and its Group companies' Directors ownership of the stock	No	No
4. Broking relationship with company covered	No	No

Note: We have not considered any Exposure below Rs 1 lakh for Angel, its Group companies and Directors.

Ratings (Returns):	Buy (> 15%) Reduce (-5% to 15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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