

## Satyam 2Q: Rupee depreciation boosts PAT

### First Look

Breaking news, market events and company announcements

November 10, 2011

<b>Rating</b> Remains	<b>Reduce</b>
<b>Target price</b> Remains	INR 620
<b>Closing price</b> November 9, 2011	INR 602

#### Satyam 2Q ahead of expectations; Maintain Reduce on TechM

Mahindra Satyam (SCS IN, not rated) reported US\$ revenue growth of 3.2% q-q, EBITDA margin improvement of 50bp q-q to 15.3%, and PAT of Rs2.38bn. The revenue growth rate was slightly lower than our expectation (of 5%), although the standalone entity grew faster at 4.3% q-q. The results were ahead of our expectation on margins and PAT driven by 1) higher rupee realized rate of 47.8 (compared to average USD/INR rate of 45.8 for 2Q); and 2) higher other income. We expect marginal revisions to our Tech Mahindra FY13F estimates. Tech Mahindra owns 42.7% of Mahindra Satyam.

#### Muted margin improvement despite gains in rupee realization

Satyam's EBITDA margins improved by only 50bps q-q despite 6.6% q-q benefit from the rupee realized rate (47.8 for 2Q compared to 44.8 in 1Q). While gross margins improved by 410bps q-q, a 360bp q-q increase in operating expenses (as a percentage of revenues) offset a large part of the gains. Management attributed the rise in operating expenses to 1) travel/visa/conveyance related expenditure; 2) hardware and software license-related costs; and 3) provision for bad debts. In 2Q, there was about Rs250-300mn in costs related to deployment of hardware and software licenses.

#### Salary hikes expected to impact Satyam's 3Q margins by 250-300bps

For 3Q, management expects wage hikes (12% offshore and 2.5% onsite), which kicked in from 1 October, 2011, to have an impact of 250-300bps on margins. Employee pyramid optimization and utilization improvement are some of the levers the company would use to soften the margin impact of wage hikes. The employee pyramid has seen good improvement; the 0-3 year experienced employee proportion of the employee base increased by 900bps to 27% in 2QFY12.

#### Pipeline improves, but large deals are getting delayed, especially in Europe; no pressure on pricing

- Satyam has seen an improvement in deal pipeline, with more large deal invitations over the past 2-3 quarters. However, management expressed concern over delays in progression of large deals from stage to stage. Large deals, in Europe especially, are getting delayed according to management. The delays in large deals are mostly in the transformational programs where the payback period is long. Many such deals are being split into smaller deals, with shorted payback periods.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

- The sweet spot for Satyam are deals with total contract value (TCV) of US\$25-40mn, according to management. Currently, the company is not seeing deals of the US\$200-300mn size.
- On pricing, Satyam is not seeing pricing pressure at this point of time. Contract renewals have seen marginal price improvements

### Growth led by BFSI, TMT and US

Sequential growth was led by BFSI (16% q-q) and Technology, Media and Entertainment (7.4% q-q) among verticals, while the US region (7% q-q) led growth among geographies. Manufacturing grew by 3% q-q, while revenue from Europe increased by 3% q-q.

### Focus on top accounts yielding results

Satyam has seen uniform growth from its top clients – revenues from top 10 clients grew by 5% q-q and top 20 clients by 6% q-q. The company initially focussed on its top 30-40 clients and has now broadened the focus to top 110 clients. Management expects healthy contribution from the top 100 clients going forward.

### Other highlights

- Cash and cash equivalents at Rs26bn; excluding the pending payment to Upaid and other settlements, the cash would be lower at Rs18.6bn.
- Satyam added 654 people (2.1% q-q growth), taking its total headcount to 32,092. About 1,000 campus hires were added in 2Q.
- Attrition moderated to 16% from 17% in 1QFY12.
- DSOs dropped by 2 days q-q to 99 days in 2Q.

Fig. 1: Mahindra Satyam quarterly results

Satyam: Cons. P&L (Rs mn)	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12
<b>Revenues</b>	<b>12,424</b>	<b>12,793</b>	<b>13,753</b>	<b>14,339</b>	<b>15,777</b>
Personnel Expenses	9,136	9,089	9,927	10,135	10,502
Other operating expenses	2,553	2,885	2,043	2,078	2,858
<b>EBITDA</b>	<b>735</b>	<b>819</b>	<b>1,783</b>	<b>2,126</b>	<b>2,417</b>
Depreciation	429	381	443	380	396
<b>EBIT</b>	<b>306</b>	<b>438</b>	<b>1,340</b>	<b>1,746</b>	<b>2,021</b>
Other Income	313	873	1,024	982	967
Financial expenses	25	23	24	45	20
Exceptional items (EI)	84	533	5,715	0	0
PBT	510	755	-3,375	2,682	2,968
Tax	270	159	-115	426	578
Net profit before MI	240	596	-3,260	2,257	2,390
Minority interest	7	7	10	6	8
PAT	233	589	-3,270	2,251	2,382
<b>Adj. PAT (excl. EI)</b>	<b>317</b>	<b>1,122</b>	<b>2,445</b>	<b>2,251</b>	<b>2,382</b>
Wt'ed avg no. of shares	1,175	1,177	1,177	1,177	1,177
<b>Adjusted EPS (Rs)</b>	<b>0.27</b>	<b>0.95</b>	<b>2.08</b>	<b>1.91</b>	<b>2.02</b>
<i>Gross Profit Margin</i>	26.5%	29.0%	27.8%	29.3%	33.4%
<i>SGA as % of sales</i>	20.5%	22.6%	14.9%	14.5%	18.1%
<i>EBITDA margin</i>	5.9%	6.4%	13.0%	14.8%	15.3%
<i>EBIT margin</i>	2.5%	3.4%	9.7%	12.2%	12.8%
<i>Tax rate</i>	52.9%	21.1%	3.4%	15.9%	19.5%
<i>Adj. PAT margin</i>	2.6%	8.8%	17.8%	15.7%	15.1%

Note: Satyam restated its 1QFY12 operating expenses and other income figures. There is no impact at the PAT level.

Source: Company data, Nomura research

# Appendix A-1

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Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Tech Mahindra	TECHM IN	INR 602	09-Nov-2011	Reduce	Not rated	

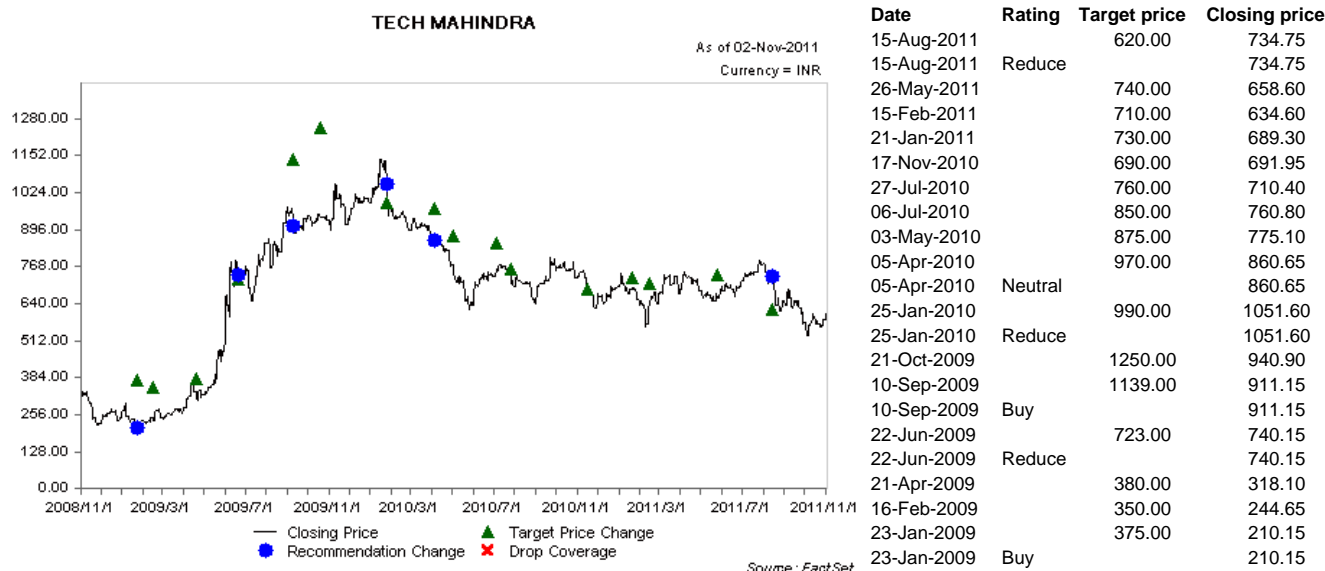
## Previous Rating

Issuer name	Previous Rating	Date of change
Tech Mahindra	Neutral	15-Aug-2011

### Tech Mahindra (TECHM IN)

INR 602 (09-Nov-2011) Reduce (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** Our target price of INR620 is based on 11x FY13F consolidated EPS (INR56.5). The 11x multiple is 25% lower than Tech Mahindra's average one-year forward P/E multiple, on account of greater revenue and margin uncertainty.

**Risks that may impede the achievement of the target price** Upside risks include higher-than-anticipated revenue ramp-up in Mahindra Satyam and early announcement of a merger with Satyam.

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### Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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