

NEUTRAL

Price	Rs459
Target Price	-
Investment Period	-
Stock Info	
Sector	IT
Market Cap (Rs cr)	30,728
Beta	0.7
52 WK High / Low	522 / 305
Avg Daily Volume	589205
Face Value (Rs)	2
BSE Sensex	16,739
Nifty	5,037
BSE Code	500376
NSE Code	SATYAMCOMP
Reuters Code	SATY.BO
Bloomberg Code	SCS IN
Shareholding Pattern (%)	
Promoters	8.7
MF/Banks/Indian FIs	11.7
FII/ NRIs/ OCBs	69.7
Indian Public	9.9

Abs.	3m	1yr	3yr
Sensex (%)	(4.9)	20.4	165.7
Satyam (%)	23.6	(3.6)	131.5

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Performance Highlights

■ **Volume growth continues to lead peers, powers Top-line:** Satyam reported an impressive 10% qoq growth in consolidated Top-line for 4QFY2008, primarily driven by volume growth of 8.8% qoq (standalone). Pricing also saw continued upside, with offshore rates growing by 0.5% qoq and onsite rates by 0.6% qoq. This is the seventh consecutive quarter in which Satyam has achieved 8%-plus sequential volume growth. In fact, in five of these seven quarters, sequential volume growth exceeded 9%. This is the fifth consecutive quarter when the company has outperformed its larger top-tier peers in terms of volume growth. On a yoy basis, consolidated Topline grew by an outstanding 35.8%, powered by volume growth of over 42% and pricing-related increases of 6.8% onsite and 5.5% offshore. Due to the significantly lower realised Rupee rate (down 9.8% yoy), growth in Rupee terms was considerably lower than that in Dollar terms (49% yoy).

In terms of a Service line break-up, the company's bread-and-butter Application Development & Maintenance Services (ADMS) business grew the fastest this time round, clocking an impressive 10.8% qoq growth (standalone). On a yoy basis, it registered growth of nearly 30%. The major Consulting & Enterprise Business Solutions (CEBS) business continued to witness strong growth, clocking a 9.9% qoq growth (43.5% yoy). Extended Engineering Solutions (EES) grew by 8% qoq and by 30.1% yoy.

■ **Lower Personnel costs, higher Offshore drive Margins:** During 4QFY2008, Satyam's EBITDA Margins rose by a strong 131bp qoq. This performance was driven mainly by lower Salary costs as a percentage of Sales (60.8% v/s 62.9% in 3QFY2008). The company also increased the offshore proportion of Revenues during the quarter by 57bp qoq, further boosting Margins. Rupee depreciation during the quarter also helped the Margin profile to an extent. Utilisation rates also surged to 81.8% (offshore with trainees), which also powered Margins higher.

■ **Forex losses result in lower Bottomline growth:** During 4QFY2008, Satyam clocked Bottom-line growth of 7.7% qoq, which was slower than Top-line and EBITDA growth. This was in spite of the strong Margin expansion witnessed and was mainly due to forex losses of Rs46cr, leading to Other Income during the quarter falling by a substantial 67.4% qoq.

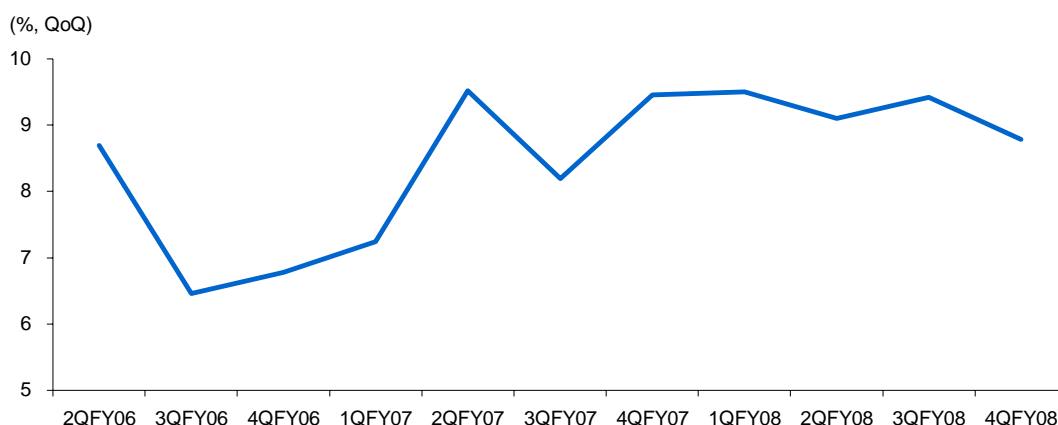
Exhibit 1: Key Financials (Consolidated)

Y/E March (Rs cr)	FY2007	FY2008	FY2009E	FY2010E
Net Sales	6,485	8,473	10,586	12,761
% chg	35.3	30.7	24.9	20.5
Net Profit	1,405	1,688	1,994	2,162
% chg	43.1	20.2	18.1	8.4
EBITDA Margin (%)	23.7	21.7	21.2	20.5
EPS (Rs)	20.5	24.7	29.1	31.6
P/E (x)	22.4	18.6	15.8	14.5
P/CEPS (x)	20.2	17.0	14.3	13.0
RoE (%)	27.9	26.0	25.1	23.0
RoACE (%)	26.7	26.0	26.3	25.8
P/BV (x)	5.5	4.3	3.6	3.1
EV/Sales (x)	4.1	3.1	2.4	1.9
EV/EBITDA (x)	17.5	14.4	11.4	9.4

Source: Company, Angel Research

Volumes aided by pricing power FY2008 Top-line

In FY2008, Satyam recorded impressive Topline growth of around 31% yoy. This was primarily driven by strong yoy volume growth of 42% including an outstanding 51% yoy growth in offshore volumes. Pricing also saw strong upside, with offshore billing rates clocking a 4.5% yoy increase, while onsite billing rates grew by 5.4% yoy. This led to Top-line, in Dollar terms, growing by over 46% yoy. However, on account of the significant appreciation of the Rupee, Top-line in Rupee terms grew by 31% yoy, which is still a very creditable performance. In FY2008, Satyam's realised Rupee rate stood at Rs40.06 per Dollar, as compared with Rs45.04 in FY2007, a fall of 11% yoy.

Exhibit 2: Volume growth – Continues to lead industry


Source: Company, Angel Research

CEBS continues to drive Service lines, Engineering Services also pulls its weight

During FY2008, in terms of service lines, it was Satyam's key business segment, Consulting and Enterprise Business Solutions (CEBS) that drove growth. This segment grew by an impressive 42% yoy, resulting in strong overall growth. It should be noted that every Dollar of consulting revenues typically generates three to four Dollars of downstream revenues for application development, implementation and maintenance. Thus, this has seemingly been the cornerstone of Satyam's industry-leading volume growth this fiscal.

The Extended Engineering Solutions (EES) business also clocked strong yoy growth of 35% in FY2008. Satyam is focussing on this segment for future growth, given its significant growth potential. A study by NASSCOM and Booz Allen Hamilton estimates that the market size for Engineering Services could touch US \$40bn by 2020. Thus, there exists strong scope for growth. Satyam's other segments viz., Infrastructure Management Services (IMS) and ADMS grew by 24% yoy and 21% yoy, respectively.

Exhibit 3: Service line break-up – CEBS continues good performance

(Rs cr)	FY2007	FY2008	% chg yoy
Application Devt. & Maintenance Services (ADMS)	2,956	3,582	21.2
Consulting and Enterprise Business Solns. (CEBS)	2,579	3,651	41.6
Extended Engineering Solutions (EES)	410	553	35.0
Infrastructure Management Services (IMS)	283	351	23.8
Total	6,228	8,137	30.6

Source: Company, Angel Research

Offshore revenues power ahead

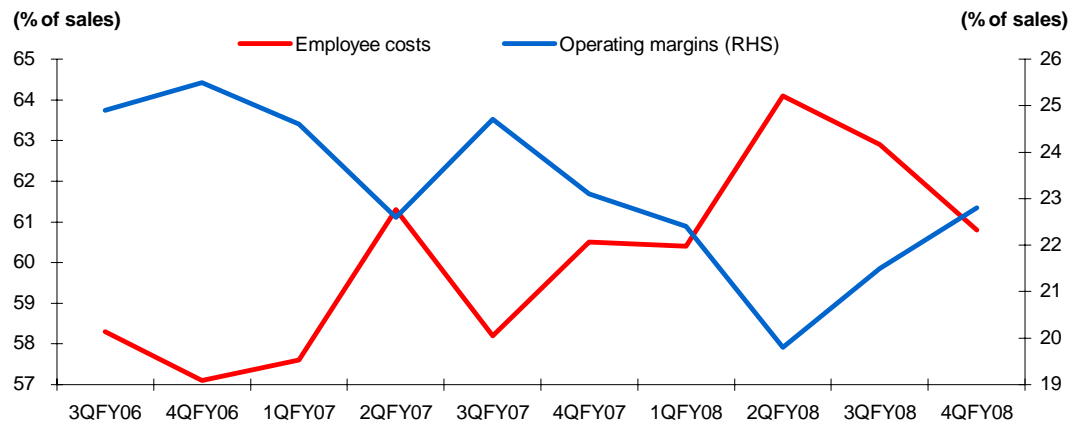
In FY2008, Satyam increased the proportion of offshore revenues significantly, with these powering ahead by 41% yoy. Offshore volumes clocked an outstanding 51% yoy growth during the fiscal, also aided by a positive trend in billing rates (offshore rates up 4.5% yoy). Onsite revenues, on the other hand, grew by 24% yoy. The total proportion of offshore revenues in FY2008 rose by 318bp yoy to 51.8% (48.7%), while onsite revenues fell to 48.2% (51.3%) of the total.

Rupee appreciation, higher Employee costs lead to Margin fall

Satyam's EBITDA Margins witnessed a 206bp yoy fall in FY2008. This was due mainly to two key headwinds – Rupee appreciation during the year and higher Employee costs. As is well-known, the Rupee appreciated by a significant 11% against the Dollar in FY2008. Higher Employee costs also impacted Margins. In FY2008, Employee cost, as a percentage of Sales, stood at 62.1% (59.5%) and thus had a yoy negative impact of 258bp on Margins. The combined impact of these two headwinds over the fiscal stood at around 800bp. Thus, Rupee appreciation would have had a negative impact of around 540bp, which implies that a 1% movement in the Rupee will have an impact of around 50bp on Satyam's Margins.

Nonetheless, the impact of these two headwinds to a significant extent was mitigated by higher pricing (up 6% yoy), higher offshore (up 318bp yoy) higher utilisation rates (78.4% offshore with trainees v/s 70.5% in FY2007) and better subsidiary profitability. Thus, Satyam has managed to offset the adverse impact of the above-mentioned headwinds to the extent of nearly 600bp, having utilised most of its available levers for Margin defence.

Exhibit 4: EBITDA Margins and Employee costs



Source: Company, Angel Research

Higher Other Income aids Bottomline growth

Despite the lower Margins and higher Taxes paid, higher Other Income (up 46% yoy) enabled Satyam to record a decent 20% yoy growth in Bottomline in FY2008.

Acquires S&V Management Consultants and Caterpillar's MR&CA operations

Satyam acquired two companies viz., S&V Management Consultants, and construction and mining equipment major, Caterpillar's Market Research and Customer Analytics (MR&CA) operations. S&V Management Consultants is a Belgium-based supply chain management (SCM) consulting firm, having 60 consultants on its rolls. S&V owns a business decision support software, Equazion®, a supply chain performance management suite. The company will operate as a fully owned subsidiary of Satyam. This deal is an all-cash, US \$35mn buy-out, including upfront payments and earn-outs.

Satyam also acquired Caterpillar's MR&CA intellectual property and assets for a consideration of US \$60mn. The company is launching a business unit to provide MR&CA solutions to service Caterpillar and other clients in diverse verticals. This acquisition will enable Satyam to expand its knowledge process outsourcing (KPO) capabilities.

Forex hedging increased to US \$1bn

At the end of FY2008, Satyam's forex hedges crossed US \$1bn, of which around 40% were forward contracts and the balance, option contracts.

Client data

Satyam added a gross of 32 clients in 4QFY2008 (excluding subsidiaries). The company's active client base now stands at 617 (standalone). Including subsidiaries, Satyam's client base stands at 654. The number of clients in different revenue buckets continues to grow, with 230 clients now giving the company annualised revenues in excess of US \$1mn (220

at the end of 3QFY2008, 180 at the end of FY2007). 50 clients give Satyam annualised revenues in excess of US \$10mn compared with 49 at the end of 3QFY2008 and 35 at the end of FY2007.

Guides for 24-26% Top-line growth, 17-19% EPS growth in FY2009

Satyam has guided to a Topline growth of 24-26% yoy in FY2009, which is expected to hit Rs10,500-10,670cr. EPS is expected to grow by 17-19% yoy to hit a range of Rs29.5-30.0. This signifies a reasonably strong growth outlook for FY2009. However, it should be noted that a key risk here is that the company has assumed a Rupee-Dollar rate of Rs40 in its guidance, as has been the case with Infosys. This, we believe, is fairly optimistic and if the Rupee does appreciate, the company could have a difficult time meeting its guidance. On the Margins front, Satyam expects these to fall by 50bp yoy in FY2009. The basic assumptions underlying this expectation are stable pricing and a similar offshore ratio as in 4QFY2008. Thus, any billing rate increases and higher offshore, apart from some leverage on the SG&A front, could lead to Margins being stable.

However, we believe the company's Margin assumptions discount two key risks – Rupee appreciation and a likely fall in FY2009 utilisation rates. If the Rupee does appreciate, there will be further Margin pressure, as we have already witnessed in FY2008. The Rs40 per Dollar assumption, we believe, is optimistic and clearly puts at risk the company's ability to meet its guidance in case the domestic currency was to appreciate against the greenback. Also, utilisation rates are ruling at extremely high levels. In FY2008, Satyam's offshore utilisation rate (including trainees) stood at 78.4% (70.5% in FY2007), which we believe is unsustainably high. The company has utilised this lever to the fullest this fiscal to mitigate the adverse impact of the appreciating Rupee and wage hikes, and going into FY2009 we believe it will most likely fall. A peer comparison suggests that Infosys' utilisation rate in FY2008 stood at 70%, a good 840bp lower than Satyam, while Wipro's utilisation rate stood at around 74%. Therefore, this metric is unlikely to remain a lever for Margin defence in FY2009.

Offshore salary hike of 12-14%, 3-4% onsite hike in FY2009

Satyam's offshore staff would receive a salary hike of 12-14% in FY2009, while its onsite staff will receive an increment of 3-4%, both effective from July 1, 2008. These salary hikes would impact Margins by 300-350bp. As mentioned earlier, the company will utilise key levers of Margin defence such as pricing and a higher offshore proportion of revenues to offset this impact. However, as mentioned earlier, utilisation is unlikely to be a lever for Margin defence in FY2009 for Satyam, given its unsustainably high levels in FY2008. The Rupee assumption at Rs40 per Dollar is also optimistic. In the current environment, getting price hikes is a difficult task. The offshore ratio, at nearly 52%, also seems to have relatively limited scope for further increase. Thus, Margin management seems to be shaping up as a significant challenge for Satyam in FY2009.

To recruit 14-15,000 gross employees in FY2009

Satyam expects to recruit a gross of 14-15,000 employees in FY2009 for its standalone entity. On a consolidated basis, the figure is likely to be around 18,000. At the end of FY2008, Satyam had a total of 51,127 employees on its rolls (consolidated). The company's trailing 12-month (TTM) attrition rate fell for the seventh consecutive quarter to 13.1%, which is a significant positive.

Announces final dividend of Rs2.50 per share

The Board of Directors have proposed a final dividend of Rs2.50 per share, taking the total dividend for FY2008 to Rs3.50 per share, translating into a dividend yield of 0.8%.

Outlook and Valuation

Going ahead, we expect Satyam to maintain a CAGR growth of 22.7% in Top-line and 13.2% in Bottom-line over FY2008-10E. We expect EBITDA Margins to remain under pressure and decline by 50-60bp annually over the mentioned period. At the CMP, the stock is trading at 14.5x FY2010E EPS. We have assumed a 'best-case scenario' for Satyam in terms of volume growth, pricing and Margin performance. Even so, the stock is still trading at slightly high valuations and given the risks inherent in Satyam's assumptions for FY2009, **we downgrade the stock to Neutral.**

Exhibit 5: Financial Performance (Consolidated)

Y/E March (Rs cr)	FY2008 4Q	FY2008 3Q	% chg (qoq)	FY2007 4Q	% chg (yoy)	FY2008	FY2007	% chg
Sales	2,416	2,196	10.0	1,779	35.8	8,473	6,485	30.7
Personnel and Other Direct Costs	1,471	1,381	6.5	1,077	36.6	5,262	3,860	36.3
Gross Profit	945	814	16.1	702	34.6	3,212	2,625	22.4
Operating & Administrative Expenses	395	343	15.1	292	35.1	1,377	1,087	26.6
EBITDA	551	471	16.9	410	34.2	1,835	1,538	19.3
Other Income	23	70	(67.4)	70	(67.4)	267	183	45.8
Interest	5	8	(43.7)	7	(38.4)	20	16	26.8
Depreciation	44	42	2.9	35	23.0	164	148	10.2
Income before Income Taxes	526	491	7.0	438	20.0	1,918	1,557	23.2
Tax	59	58	1.8	44	32.6	230	152	51.5
Minority Interest	-	-	-	-	-	-	0	-
Profit after Tax / (Loss)	467	434	7.7	394	18.6	1,688	1,405	20.2
Diluted EPS (Rs)	6.8	6.3	7.7	5.8	17.0	24.7	21.0	17.8
Gross Profit Margin (%)	39.7	37.1		39.5		37.9	40.5	
EBITDA Margin (%)	22.8	21.5		23.1		21.7	23.7	
Net Profit Margin (%)	19.3	19.8		22.1		19.9	21.7	

Source: Company, Angel Research


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