

August 10, 2011

Reco	Previous Reco
Hold	Hold
CMP	Target Price
Rs 71	Rs 80
EPS change FY12E/13E (%)	29/5
Target Price change (%)	5
Nifty	5,073
Sensex	16,858

Price Performance

(%)	1M	3M	6M	12M
Absolute	(21)	(1)	18	(18)
Rel. to Nifty	(11)	8	24	(11)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	IT Services
Bloomberg	SCS@IN
Equity Capital (Rs mn)	2353
Face Value(Rs)	2
No of shares o/s (mn)	1177
52 Week H/L	114/54
Market Cap (Rs bn/USD mn)	84/1,857
Daily Avg Volume (No of sh)	4347964
Daily Avg Turnover (US\$mn)	8.1

Shareholding Pattern (%)

	Jun-11	Mar-11	Dec-10
Promoters	42.7	42.7	42.7
FII/NRI	23.9	20.2	18.4
Institutions	3.5	3.4	3.1
Private Corp	6.0	7.1	9.1
Public	24.0	26.7	26.7

Source: Capitaline

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- MSat's performance continues to be strong with US\$ rev up 5.3% QoQ while mgns improved by ~160 bps QoQ to 14.6% (note that mgns have improved by ~820 bps over past 2 qtrs)
- Net Profits at Rs 2250 mn (-8% QoQ, +113.5% YoY) beat est driven by higher margin show and aided further by lower taxes and higher other income
- Growth within top clients impressive(top 5/10 client revenues up by 5% QoQ) while ROW/Manufacturing/TIME drive growth with a 14%/5%/11.6% sequential increase
- Raise FY12/13E EPS by 29/5.3% to Rs 6.4/6.7 driven largely by higher mgn assumptions (14/14.2% V/s 12.7/13.7% earlier) and lower taxes. HOLD, TP of Rs 80 (Rs 76 earlier)

Margins continue to surprise positively

While Mahindra Satyam's (Msat) revenues were in line with expectations at US\$ 320 mn (+5.3% QoQ, 3.9% sequential volume growth), margins improved by ~160 bps sequentially to 14.6% (expanded by ~800 bps over the past 2 quarters). Profits at Rs 2.3 bn (-8% QoQ, +114% YoY) beat estimates aided by better margin performance and higher other income/lower taxes. **Growth continued to be led by emerging geographies (up by ~14% QoQ post a strong 42% increase in March'11 qtr) while maintstay geographies like US and Europe continue to grow lower than co average for the 2nd quarter in a row.** Revenues from top 5/10 clients increased by ~5% sequentially as company continued to rationalize client base (no of active client base down to 220 V/s 230 at March'11 quarter) with no of US\$ 10 mn+/20 mn+ clients increasing to 36/14 (V/s 33/12 at March'11 qtr end). Co raised overall headcount by ~2,172 employees (+7.5% QoQ) as it added ~1,300 freshers during the quarter with attrition reducing by ~500 bps sequentially to 17%

Salary hikes to be effective from Q3FY12 onwards, further margin improvements hinge on improving pricing

MSat will implement wage increments (12% offshore hikes and ~2.5% onsite hikes starting Oct'11) which will impact margins by ~250-300 bps in Q3FY12. While **MSat's margins have continued to surprise us positively over the past 2 quarters, we see limited room for margin improvement for any further cost rationalizations given (1) MSat's per employee costs similar to Tier 1 peers like Infosys and TCS despite higher onsite business and a narrow employee bulge, (2) non manpower expenses for MSat also are in line with Tier 1 peers. Our calculations suggest that nearly all the EBITDA productivity differential is accounted for ~16% lower realization for the company despite higher onsite mix.**

Raise FY12/13E by ~29%/5% to Rs 6.4/6.7, HOLD with a TP of Rs 80

We raise our FY12/13E earnings by ~29%/5% to Rs 6.4/6.7 (V/s Rs 5/6.4 earlier) driven primarily by higher margin assumptions to 14%/14.2% (V/s 12.7%/13.7% earlier) and aided further by higher other income and lower taxes (we expect a 17% tax rate V/s 25% earlier). Retain HOLD with a revised TP of Rs 80(V/s Rs 76 earlier) and expect stock to trade firm in the near term post the sharp correction (~20% in the past 1 months).

Financials

Y/E March (in Rs mn)	Net Sales	EBITDA	EBITDA %	PAT	EPS (Rs)	ROE %	P/E (x)	EV/ EBITDA	P/B (x)
FY10	54,810	4,569	8.3	3,917	2.5	58.4	28.7	13.7	4.5
FY11	51,450	4,551	8.8	4,318	4.2	27.4	17.0	12.5	4.9
FY12E	61,795	8,630	14.0	7,197	6.4	36.1	11.0	6.5	3.4
FY13E	73,901	10,508	14.2	7,799	6.7	27.6	10.6	4.7	2.6

Quarterly performance

Rs mn	Q1 FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	QoQ (%)	YoY %	YTD '12	YTD '11	YoY %
Revenue	12,480	12,424	12,793	13,753	14,339	4.3	14.9	14,339	12,480	14.9
Operating Expenditure	11,266	11,689	11,974	11,970	12,240	2.3	8.6	12,240	11,266	8.6
Cost of revenues	8,677	9,136	9,089	9,041	9,301	2.9	7.2	9,301	8,677	7.2
as % of sales	69.5	73.5	71.0	65.7	64.9			64.9	69.5	
SG&A expenses	2,589.0	2,553.0	2,885.0	2,929.0	2,938.1	0.3	13.5	2,938	2,589	13.5
as % of sales	20.7	20.5	22.6	21.3	20.5			20.5	20.7	
EBITDA	1,214	735	819	1,783	2,100	17.8	73.0	2,100	1,214	73.0
Depreciation	594	429	381	443	380	(14.2)	(36.0)	380	594	(36.0)
EBIT	620	306	438	1,340	1,720	28.3	177.3	1,720	620	177.3
Other Income	707	909	850	1,000	963	(3.7)	36.3	963	707	36.3
PBT	1,327	1,215	1,288	2,340	2,683	14.6	102.2	2,683	1,327	102.2
Total Tax	264	270	159	(115)	426	(470.0)	61.2	426	264	61.2
Adjusted PAT	1,063	945	1,129	2,455	2,257	(8.1)	112.4	2,257	1,063	112.4
(Profit)/loss from JV's/Ass/MI	9.0	7.0	7.0	10.0	5.5			5.5	9.0	
APAT after MI	1,054	938	1,122	2,445	2,252	(7.9)	113.6	2,252	1,054	113.6
Extra ordinary items	-79	-84	-533	-5715	0			0	-79	
Reported PAT	975	854	589	(3,270)	2,252	(168.9)	131.0	2,252	975	131.0
Reported EPS	0.8	0.7	0.5	(2.8)	1.9	(168.9)	131.0	1.9	0.8	131.0

Margins (%)						(bps)	(bps)				(bps)
EBIDTA	9.7	5.9	6.4	13.0	14.6	168	492	14.6	9.7	492	
EBIT	5.0	2.5	3.4	9.7	12.0	225	702	12.0	5.0	702	
EBT	10.6	9.8	10.1	17.0	18.7	169	808	18.7	10.6	808	
PAT	7.8	6.9	4.6	(23.8)	15.7	3,948	789	15.7	8.4	726	
Effective Tax rate	19.9	22.2	12.3	(4.9)	15.9	2,077.5	(403.4)	15.9	19.9	(403.4)	

Source: Company, Emkay Research

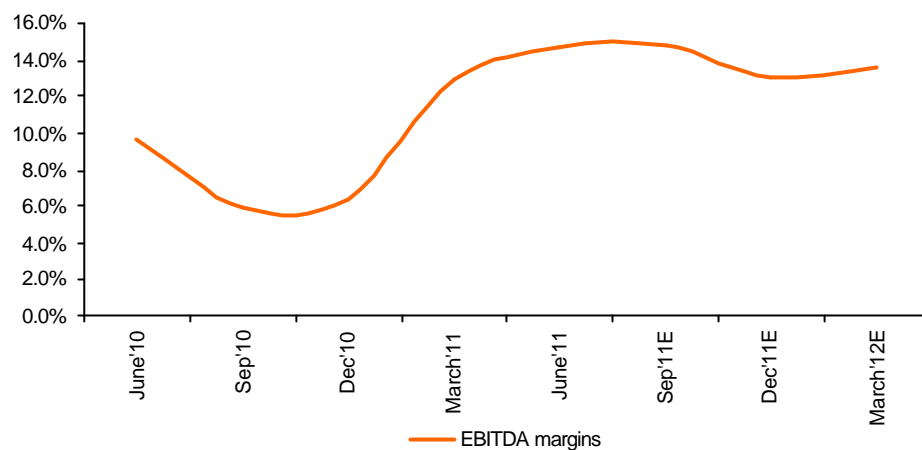
	June'10	Sep'10	Dec'10	March'11	June'11
Infosys	1.18	1.24	1.23	1.22	1.29
TCS	1.12	1.21	1.16	1.15	1.21
Mahindra Satyam	1.28	1.34	1.29	1.27	1.21
Non manpower expenses, % of revenues					
Infosys	9.4	14.4	13.0	13.7	14.2
TCS	15.4	15.0	15.6	14.8	15.8
Mahindra Satyam	18.0	16.7	18.0	14.9	14.7

Source: Companies, Emkay Research

Mahindra Satyam has leveraged non manpower expenses meaningfully through the past few quarters

Further expansion in margins to depend on improvement in revenue productivity

Our calculations suggests that nearly all the differential in EBITDA productivity between Infy and MSat is now on account of revenue productivity differential



Source: Company, Emkay Research

Raise FY12/13E earnings by ~29%/5.3% to Rs 6.4/6.7 driven primarily by higher op margin assumptions and lower tax rate assumptions to 17.4% (V/s 25% earlier)

(All fig in Rs mn except EPS)	FY12E			FY13E		
	Old	New	% change	Old	New	% change
Revenues(US\$ mn)	1,375	1,375	0.0%	1,623	1,642	1.2%
Revenues	61,854	61,795	-0.1%	73,022	73,901	1.2%
EBITDA	7,868	8,630	9.7%	9,994	10,508	5.1%
Net profits	5,893	7,604	29.0%	7,506	7,951	5.9%
EPS	5	6.4	28.9%	6.4	6.7	5.3%

Source: Emkay Research

Financials

Income Statement

Y/E, Mar (Rs. m)	FY10	FY11	FY12E	FY13E
Net Sales	54,810	51,450	61,795	73,901
Growth (%)		(6)	20	20
Total Expenditure	(50,241)	(46,899)	(53,165)	(63,392)
Growth (%)		(7)	13	19
EBIDTA	4,569	4,551	8,630	10,508
Growth (%)		(0)	90	22
EBIDTA %	8.3	8.8	14.0	14.2
Other Income	2,043	2,289	2,027	2,030
Depreciation	(2,144)	(1,847)	(1,674)	(1,900)
EBIT	4,468	4,993	8,983	10,639
Interest	(329)	(97)	(180)	(180)
EBT	4,139	4,896	8,802	10,459
Tax	(222)	(578)	(1,605)	(2,660)
EAT	3,917	4,318	7,197	7,799
Growth (%)		10	67	8
EAT (%)	7.1	8.4	11.6	10.6

Balance Sheet

Y/E, Mar (Rs. m)	FY10	FY11	FY12E	FY13E
Equity share capital	2,352	2,353	2,353	2,353
Reserves & surplus	43,947	43,860	51,464	59,414
Networth	46,299	46,213	53,817	61,767
Minority Interest	201	234	234	234
Secured Loans	422	315	315	-
Unsecured Loans	-	-	-	-
Loan Funds	422	315	315	-
Total Liabilities	46,923	46,762	54,366	62,001
Goodwill				
Gross Block	25,635	30,847	33,847	37,847
Less: Depreciation	(19,501)	(21,348)	(23,022)	(24,922)
Net block	6,134	9,499	10,825	12,925
Capital WIP	3,731	-	-	-
Investment	6,268	4,348	4,348	4,348
Current Assets	39,799	47,286	51,301	62,475
Inventories	-	592	-	-
Sundry debtors	9,230	11,588	13,544	16,197
Cash & bank balance	21,768	27,538	27,599	34,130
Loans & advances	3,845	3,782	5,079	6,074
Other current assets	4,956	3,786	5,079	6,074
Current Liab & Prov	24,222	31,044	28,781	34,420
Current liabilities	8,818	15,463	13,544	16,197
Provisions	15,404	15,581	15,237	18,222
Net current assets	15,577	16,242	22,520	28,056
Misc exps	15,187	16,660	16,660	16,660
Deferred Tax	26	13	13	13
Total Assets	46,923	46,762	54,366	62,002

Cash Flow

Y/E, Mar (Rs. m)	FY10	FY11	FY12E	FY13E
Net Profit after Tax	(1,246)	(1,473)	7,604	7,951
Add : Depreciation	2,144	1,847	1,674	1,900
Add : Misc exp w/off				
Net changes in WC	(990)	5,484	(5,621)	(1,990)
Operational Cash Flows	914	5,525	3,087	10,874
Capital expenditure	379	(1,481)	(3,000)	(4,000)
Investments	(5,994)	-	-	-
Investing Cash Flows	(5,615)	(1,481)	(3,000)	(4,000)
Borrowings	(7,720)	(107)	-	(315)
dividend paid	-	-	-	-
Issue of shares	29,180	-	(92)	(92)
Share Premium				
Financing Cash Flows	21,460	(107)	(92)	(407)
changes in cash	16,759	3,937	(5)	6,467
Opening balance	5,009	21,768	27,538	27,599
Closing balance	21,768	27,538	27,599	34,130

Key Ratios

Y/E, Mar	FY10	FY11	FY12E	FY13E
EPS (Rs)	2.5	4.2	6.4	6.7
CEPS (Rs)	4.3	5.8	7.9	8.3
Book Value Per Share (Rs)	15.9	14.6	21.1	27.8
Dividend Per Share (Rs)	-	-	-	-
Valuations Ratios (x)				
PER	28.7	17.0	11.0	10.6
P/CEPS	17.2	12.9	9.4	8.9
P/BV	4.5	4.9	3.4	2.6
EV/EBIDTA	13.7	12.5	6.5	4.7
EV/Sales	1.1	1.1	0.9	0.7
M-Cap/sales	1.8	2.0	1.6	1.4
Profitability Ratios (%)				
RoCE	25.5	14.5	32.3	29.6
RoNW	58.4	27.4	36.1	27.6
EBITDA Margin	8.3	8.8	14.0	14.2
EBIT Margins	4.4	5.3	11.3	11.6
Net Profit Margin	7.1	8.4	11.6	10.6

Recommendation History: Mahindra Satyam – SCS IN

Date	Reports	Reco	CMP	Target
23/05/2011	Mahindra Satyam Q4FY11 Result Update	Hold	74	76
14/02/2011	Mahindra Satyam Q3FY11 Result Update	Reduce	65	65
16/11/2010	Mahindra Satyam Q2FY11 Result Update	Reduce	85	70
11/10/2010	Mahindra Satyam Re-initiating Coverage	Reduce	86	81

Recent Research Reports

Date	Reports	Reco	CMP	Target
08/08/2011	Infinite Computer Q1FY12 Result Update	Buy	104	160
28/07/2011	eClerx Services Q1FY12 Result Update	Accumulate	819	885
28/07/2011	HCL Tech Q4FY11 Result Update	Hold	503	540
27/07/2011	Hexaware Tech. Q2CY11 Result Update	Accumulate	82	95

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