

Mahindra Satyam

Performance highlights

Y/E March (₹ cr)	1QFY12	4QFY11	% chg (qoq)	1QFY11	% chg (yoy)
Net revenue	1,434	1,375	4.3	1,248	14.9
EBITDA	210	178	17.8	121	73.0
EBITDA margin (%)	14.6	13.0	168bp	9.7	492bp
Adj. PAT*	225	245	(7.9)	105	113.7

Source: Company, Angel Research; Note: * excluding exceptional items

Mahindra Satyam (Satyam) reported its 1QFY2012 results, which were better than our as well as street estimations. The company is back on the growth track after two years of metamorphosis undertaken by TechMahindra's management post its acquisition in June 2009. The company's new management took over the reins and has again put the company on the map of the Indian IT industry.

We recommend a Buy rating on the stock.

Quarterly highlights: For 1QFY2012, Satyam reported strong dollar revenue growth of 5.2% qoq to US\$320mn on the back of 3.9% qoq volume growth. In rupee terms, revenue came in at ₹1,434cr, up 4.3% qoq. The company's EBITDA and EBIT margin increased by 168bp and 225bp qoq to 14.6% and 12.0%, respectively, aided by almost flat SG&A expenses qoq in terms of absolute number despite higher growth.

Outlook and valuation: The new management proved its ability of turning around the company in two years' time by putting it back to comparable industry level growth and improving margins from 3% in FY2010 to 14.6% in 1QFY2012. We expect the company to maintain its growth momentum as recorded over the past few quarters and grow at rates comparable to its peers at a 19.4% CAGR in USD revenue and 32.5% CAGR in earnings over FY2011–13E. At the CMP of ₹71, the stock is trading at a 9.6x FY2013 EPS of ₹7.4 i.e. at a PEG of 0.29x. **We value the stock at 40% discount to Infosys' target FY2013 PE i.e., 12.0x and recommend a Buy rating on the stock with a target price of ₹89.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E
Net sales	5,481	5,145	6,115	7,120
% chg	(37.8)	(6.1)	18.8	16.4
Net profit*	292	494	803	871
% chg	(258.2)	68.9	62.6	8.4
EBITDA margin (%)	8.3	8.8	14.3	15.0
EPS (₹)*	2.5	4.2	6.8	7.4
P/E (x)	28.4	16.9	10.4	9.6
P/BV (x)	1.8	1.8	1.5	1.3
RoE (%)	6.3	10.7	14.8	13.8
RoCE (%)	4.1	4.6	10.5	11.6
EV/Sales (x)	1.1	1.1	1.0	0.8
EV/EBITDA (x)	13.6	12.4	7.3	5.4

Source: Company, Angel Research; Note: *Excluding exceptional items

BUY

CMP	₹71
Target Price	₹89

Investment Period 12 Months

Stock Info

Sector	IT
Market Cap (₹ cr)	8,368
Beta	0.8
52 Week High / Low	114/54
Avg. Daily Volume	3,001,392
Face Value (₹)	2
BSE Sensex	16,858
Nifty	5,073
Reuters Code	SATY.BO
Bloomberg Code	SCS@IN

Shareholding Pattern (%)

Promoters	42.7
MF / Banks / Indian Fls	3.8
FII / NRIs / OCBs	13.0
Indian Public / Others	40.6

Abs. (%)	3m	1yr	3yr
Sensex	(9.0)	(7.8)	11.1
Mahindra Satyam	(1.0)	(17.6)	(82.6)

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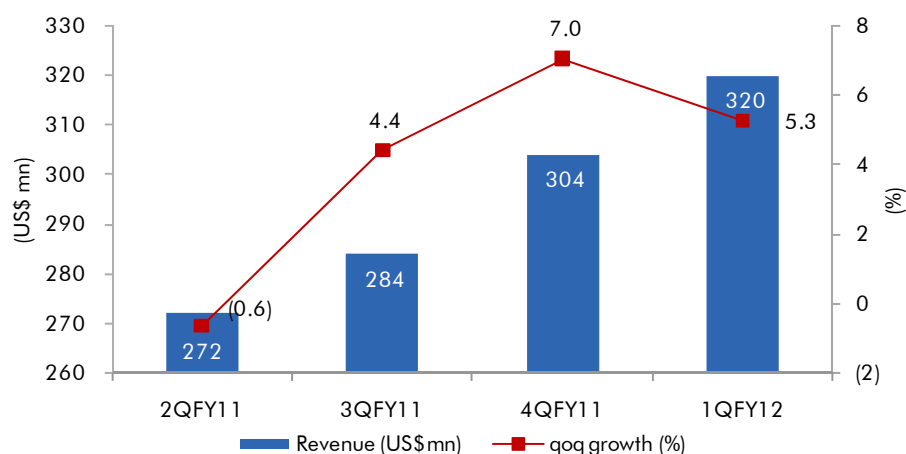
Exhibit 1: 1QFY2012 performance (Consolidated, Indian GAAP)

Y/E March (₹ cr)	1QFY12	4QFY11	% chg (qoq)	1QFY11	% chg (yoy)	FY2011	FY2010	% chg (yoy)
Net revenue	1,434	1,375	4.3	1,248	14.9	5,145	5,481	(6.1)
Direct costs	930	904	2.9	868	7.2	3,594	3,981	(9.7)
Gross profit	504	471	6.9	380	32.5	1,551	1,500	3.4
SG&A expenses	294	293	0.3	259	13.5	1,096	1,043	5.0
EBITDA	210	178	17.8	121	73.0	455	457	(0.4)
Dep. and amortisation	38	44	(14.2)	59	(36.0)	185	214	(13.9)
EBIT	172	134	28.4	62	177.4	270	243	11.5
Interest charges	5	2	88.8	3	81.2	10	33	(70.5)
Other income	101	102		73		294	106	
PBT	268	234	14.7	133	102.2	555	315	76.0
Tax	43	(12)	(470.0)	26	61.2	58	22	160.4
PAT	226	246	(8.0)	106	112.4	497	293	69.7
Exceptional item	-	572		8		641	417	
Minority interest	1	1	(45.0)	1	(38.9)	3	1	371.4
Final PAT	225	(327)	(168.9)	98	131.0	(147)	(125)	18.2
Adj. PAT*	225	245	(7.9)	105	113.7	494	292	68.9
EPS* (₹)	1.9	2.1	(8.0)	0.9	113.4	4.2	2.5	68.1
Gross margin (%)	35.1	34.3	87bp	30.5	466bp	30.1	27.4	277bp
EBITDA margin (%)	14.6	13.0	168bp	9.7	492bp	8.8	8.3	51bp
EBIT margin (%)	12.0	9.7	225bp	5.0	703bp	5.3	4.4	83bp
PAT margin (%)	14.7	16.5	(187)bp	8.0	670bp	9.1	5.2	385bp

Source: Company, Angel Research; Note: *Excluding exceptional items

Revenue momentum continues

For 1QFY2012, Satyam reported strong dollar revenue growth of 5.2% qoq to US\$320mn on the back of 3.9% qoq volume growth. Dollar revenue was aided by 0.6% qoq growth because of favourable cross-currency movement derived due to USD depreciation of 1.8%, 5.2% and 5.7% qoq as against the GBP, Euro and AUD, respectively. In rupee terms, revenue came in at ₹1,434cr, up 4.3% qoq – lower growth as against dollar revenue was due to 1.0% qoq INR appreciation against USD in 1QFY2012.

Exhibit 2: Trend in revenue growth (qoq)


Source: Company, Angel Research

Industry wise, growth was led by retail and logistics and technology, media and entertainment (TME) segments, revenue of which grew by 14.8% and 10.8% qoq, respectively. In the TME segment, the company is witnessing robust traction from technology and hi-tech clients. Revenue from its anchor industry segment – manufacturing also posted decent 5.3% qoq growth. However, other industry segments such as BFSI and healthcare and lifesciences reported a decline in revenue by 0.6% and 7.9% qoq, respectively.

Exhibit 3: Growth in industry segments

Particulars	% to revenue	% growth (qoq)
Manufacturing	32.0	5.3
TME (includes telecom also)	20.0	10.8
BFSI	17.0	(0.6)
Retail and logistics	12.0	14.8
Healthcare and lifesciences	7.0	(7.9)
Others	11.0	(3.5)

Source: Company, Angel Research

Geography wise, growth was led by emerging markets (RoW), which reported 14.0% qoq revenue growth. America as well as Europe also reported decent revenue growth of 3.2% and 1.1% qoq, respectively.

Exhibit 4: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)
Americas	50.0	3.2
Europe	24.0	1.1
RoW	26.0	14.0

Source: Company, Angel Research

Hiring and utilisation

During the quarter, the company added 2,172 net employees, taking its total employee base to 31,438. Out of the total net employee additions, ~1,300 were freshers. Also, attrition rate of the company declined significantly to 17% from 22% in 4QFY2011.

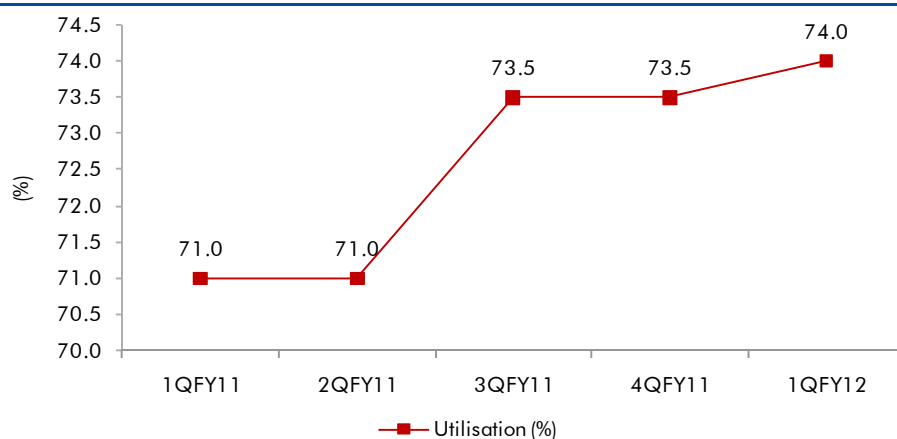
Exhibit 5: Employee metrics

Particulars	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Net employee addition	248	346	764	434	2,172
Total employees	27,722	28,068	28,832	29,266	31,438
Attrition (%)	30	25	25	22	17

Source: Company, Angel Research

Despite hiring of freshers, Satyam managed to increase its utilisation rate (incl. trainees) by 50bp qoq to 74.0% from 73.5% in 4QFY2011.

Exhibit 6: Utilisation trend



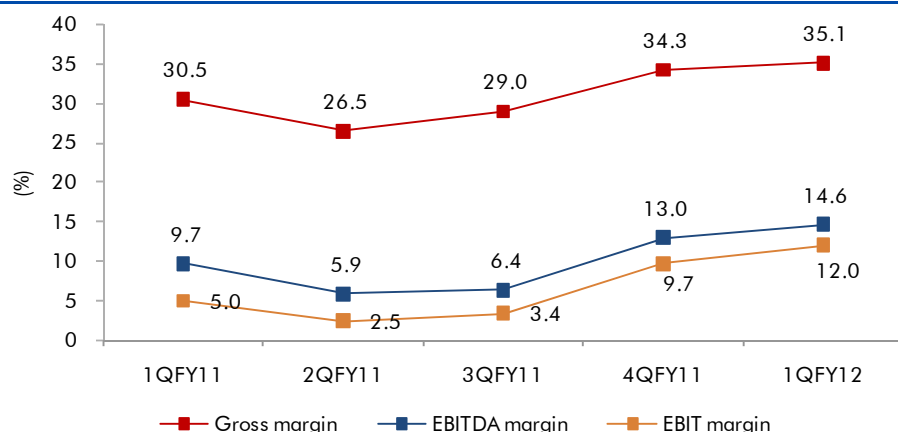
Source: Company, Angel Research

Margin profile

During the quarter, the company's EBITDA and EBIT margin increased by 168bp and 225bp qoq to 14.6% and 12.0%, respectively, aided by qoq almost flat SG&A expenses in terms of absolute number despite higher growth.

The company has announced wage hike of 12.5% for offshore employees and 2.5% for onsite employees effective from October 2011 (wage hikes are postponed by one quarter for FY2012). This will negatively affect the company's EBITDA margin by 250–300bp in 3QFY2012.

Exhibit 7: Margin profile



Source: Company, Angel Research

Client pyramid

The client pyramid of the company saw qualitative improvement, with clients being added to higher revenue brackets. Two clients were added in the US\$20mn–50mn bracket and one in the US\$10mn–20mn revenue bracket. However, active client base of the company declined to 220 in 1QFY2012 from 230 in 4QFY2011. Overall, the company added 32 new clients during this quarter.

Exhibit 8: Client metrics

Particulars	3QFY11	4QFY11	1QFY12
Total active clients	217	230	220
US\$1mn–5mn	76	96	83
US\$5mn–10mn	14	15	11
US\$10mn–20mn	21	21	22
US\$20mn–50mn	7	9	11
US\$50mn+	3	3	3

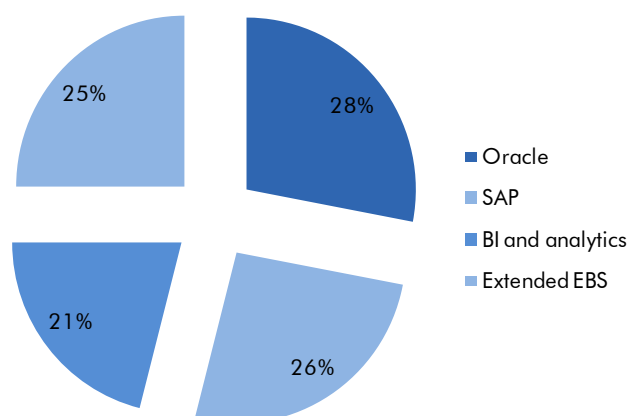
Source: Company, Angel Research

Investment rationale

Anchor verticals firing up cylinders to grow

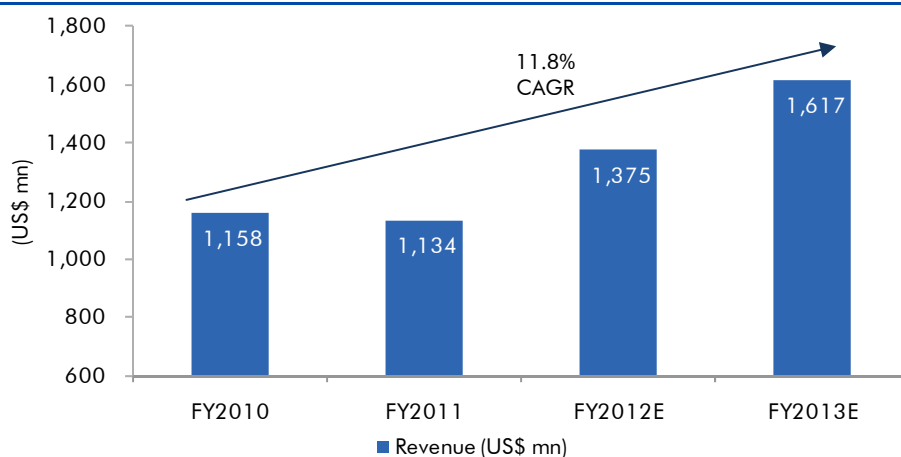
Satyam has enterprise business solutions (EBS) (~40% of its revenue) and manufacturing (~32% of its revenue) showing strong traction. The company expects this service and vertical, respectively, to bolster growth and help it to track the industry’s growth rate. This is coherent with the demand colour given by the managements of most other tier-I companies as well. We expect the company’s core competence in EBS to supplement growth of 19.4% CAGR in revenue. This is indicated by the hiring plan highlighted by the company of 5,000 freshers, which is ~40% to total hiring plan for FY2012.

Exhibit 9: Service-wise resource distribution in EBS



Source: Company, Angel Research

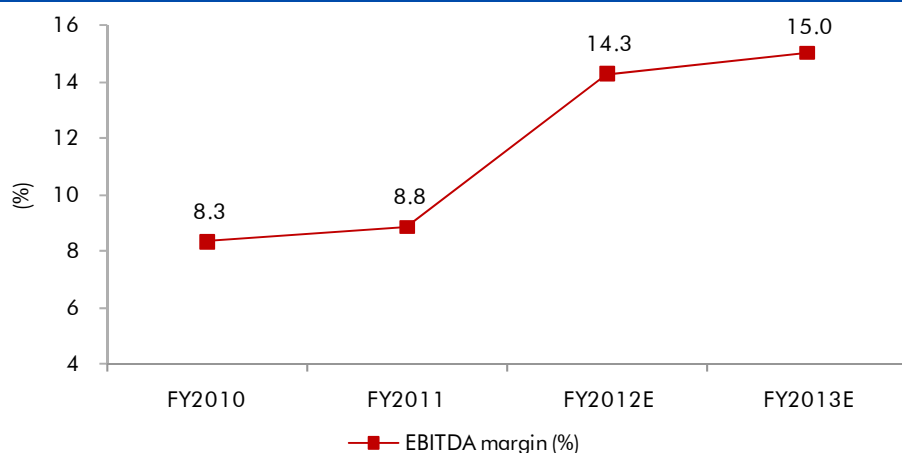
Exhibit 10: Revenue expectations



Source: Company, Angel Research

Adequate margin levers to bolster earnings growth

Satyam has adequate margin levers such as 1) employee pyramid rationalisation (no. of employees < 3 years are very less at ~20% vis-à-vis industry at ~40 to 45%), 2) strong volume growth expected on the back of strengthening deal pipeline improving utilisations to 75% by FY2013 from the current 74%, 3) better pricing on the back of improvement in business mix, 4) current SGA at 20.5% to sales, which is on the higher side and can be brought down to 19.0% by FY2013. Strong margin improvement along with 1) ITM hedges of US\$340mn covering the next six quarters with rate of 46.9 INR/USD and 2) lower tax rates ~MAT rate due to the tax shield related to losses booked in FY2010 and prior are expected to bolster earnings by a 32.5% CAGR over FY2011–13.

Exhibit 11: Margin expectations


Source: Company, Angel Research

Overhang of impending liabilities are behind

In 4QFY2011, the company settled most of its legal disputes such as 1) Upaid settlement of US\$70mn, 2) SEC settlement of US\$125mn and 3) SEZ settlement of US\$10mn. The only impending liability remains is the US\$70mn Arbedden case, which is confronting the company. Post the settlement of the above-stated liabilities, the company has adequate cash of ₹1,800cr

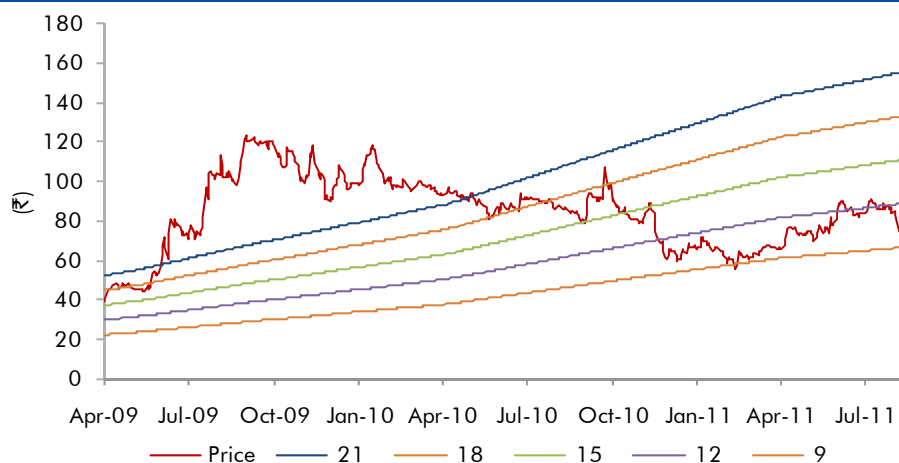
Outlook and valuations

The new management proved its ability of turning around the company in two years' time by putting it back to comparable industry level growth and improving margins from 3% in FY2010 to 14.6% in 1QFY2012. We expect the company to maintain its growth momentum as recorded over the past few quarters and grow at rates comparable to its peers at a 19.4% CAGR in USD revenue and 32.5% CAGR in earnings over FY2011–13E. At the CMP of ₹71, the stock is trading at a 9.6x FY2013 EPS of ₹7.4 i.e. at a PEG of 0.29x. **We value the stock at 40% discount to Infosys' target FY2013 PE i.e., 12.0x and recommend a Buy rating on the stock with a target price of ₹89.**

Exhibit 12: Key assumptions

Particulars	FY2012	FY2013
Revenue growth - USD terms (%)	21.2	17.6
Revenue growth - INR terms (%)	18.8	16.4
EBITDA margin (%)	14.3	15.0
EBIT margin (%)	11.6	12.3
Tax rate (%)	17.4	21.8
EPS growth (%)	62.4	8.4

Source: Company, Angel Research

Exhibit 13: One-year forward PE(x) chart


Source: Company, Angel Research

Exhibit 14: Recommendation summary

Company	Reco.	CMP (₹)	Tgt. price (₹)	Upside (%)	Target P/E (x)	FY2013 EBITDA (%)	FY2013E P/E (x)	FY2011-13E EPS CAGR (%)	FY2013E RoCE (%)	FY2013E RoE (%)
3iInfotech	Neutral	31	-	-	-	21.5	2.6	(4.3)	12.0	15.1
Educomp	Buy	275	332	20.7	7.0	45.6	5.8	18.8	11.1	15.3
Everonn	Neutral	528	-	-	-	38.5	8.8	32.5	13.9	17.1
HCL Tech	Buy	411	578	40.6	14.0	17.9	10.0	29.8	18.1	23.8
Hexaware	Accumulate	81	88	8.4	11.5	15.1	10.6	63.4	16.8	17.8
Infosys	Buy	2,377	3,200	34.6	20.0	30.6	14.9	15.7	24.7	22.7
Infotech Enterprises	Buy	123	145	18.2	9.0	16.1	7.5	13.9	15.2	13.4
KPIT Cummins	Buy	165	206	24.9	12.0	16.1	9.8	21.8	20.6	17.7
Mahindra Satyam	Buy	71	89	25.2	12.0	15.0	9.6	32.7	11.6	13.8
MindTree	Accumulate	403	445	10.4	11.0	13.3	10.0	27.5	16.9	15.4
Mphasis	Buy	400	482	20.6	11.0	17.6	8.8	10.3	17.7	17.0
NIIT ^	Buy	47	69	47.6	10.0	13.8	6.8	11.2	12.4	16.6
Persistent	Buy	318	424	33.2	11.0	19.5	8.3	5.1	16.6	15.4
TCS	Buy	967	1,368	41.4	22.0	28.9	15.6	18.4	30.2	31.3
Tech Mahindra	Accumulate	729	790	8.4	9.0*	18.3	12.9	6.8	14.9	15.6
Wipro	Buy	347	419	20.7	16.0	18.7	13.3	9.9	13.8	19.8

Source: Company, Angel Research; Note: *on a standalone basis (excluding value from Mahindra Satyam), ^ Valued on SOTP basis

Profit and loss statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E
Net revenues	5,481	5,145	6,115	7,120
Employee costs	3,981	3,594	4,012	4,689
Gross profit	1,500	1,551	2,103	2,431
% to net sales	27.4	30.1	34.4	34.1
SG&A expenses	1,043	1,096	1,230	1,361
% to net sales	19.0	21.3	20.1	19.1
EBITDA	457	455	873	1,070
% to net sales	8.3	8.8	14.3	15.0
Dep. and amortisation	214	185	164	192
% to net sales	3.9	3.6	2.7	2.7
EBIT	243	270	709	878
% to net sales	4.4	5.3	11.6	12.3
Interest charges	33	10	18	18
Other income	106	294	284	256
PBT	315	555	975	1,116
Tax	22	58	170	243
% of PBT	7.0	10.4	17.4	21.8
PAT	293	497	805	873
Exceptional item	417	641	-	-
Minority interest	1	3	2	2
Final PAT	(125)	(147)	803	871
Adj. PAT*	292	494	803	871
EPS (₹)*	2.5	4.2	6.8	7.4

Note: * excluding exceptional item

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E
Liabilities				
Share capital	235	235	235	235
Share app. money pending allotment	0	-	-	-
Reserves and surplus	4,395	4,386	5,189	6,060
Total shareholders' funds	4,630	4,621	5,424	6,295
Minority interest	20	23	20	20
Loan funds	42	32	50	50
Deferred tax liability	4	7	-	-
Sub-total	4,696	4,683	5,494	6,365
Amount pending investigation suspense acc.	1,230	1,230	1,230	1,230
Total capital employed	5,927	5,913	6,725	7,595
Assets				
Fixed assets	987	950	1,110	1,168
Investments	627	435	350	350
Deferred tax asset	7	8	8	8
Current assets, loans and advances				
Inventories	-	59	60	60
Sundry debtors	923	1,159	1,357	1,561
Cash and bank balances	2,177	2,754	2,067	2,582
Other current assets	496	379	499	496
Loans and advances	385	378	611	712
Less: Current liabilities and provisions				
Liabilities	882	1,546	1,154	1,285
Provisions	1,540	1,558	1,529	1,709
Net current assets	1,558	1,624	1,911	2,417
Profit and loss account	2,749	2,896	3,345	3,652
Sub-total	5,927	5,913	6,725	7,595
Unexplained differences suspense account (net)	-	-	-	-
Total capital deployed	5,927	5,913	6,725	7,595

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E
Pre tax profit from operations	210	261	691	860
Depreciation	214	185	164	192
Pre tax cash from operations	424	445	855	1,052
Other income/prior period ad	106	294	284	256
Net cash from operations	530	740	1,139	1,308
Tax	22	58	170	243
Cash profits	507	679	967	1,063
(Inc)/dec in current assets	507	(172)	(553)	(301)
Inc/(dec) in current liabilities	(445)	682	(422)	311
Net trade working capital	62	510	(974)	10
Cash flow from operating activities	569	1,189	(7)	1,073
(Inc)/dec in fixed assets	38	(148)	(325)	(250)
(Inc)/dec in investments	(627)	192	85	-
(Inc)/dec in deferred tax	(1)	1	(7)	-
(Inc)/dec in other non current assets	(125)	(147)	(448)	(308)
Inc/(dec) in minority interest	1	3	(3)	-
Cash flow from investing activities	(714)	(99)	(699)	(558)
Inc/(dec) in debt	(772)	(11)	19	-
Inc/(dec) in equity/premium	2,593	(503)	-	-
Dividends	-	-	-	-
Cash flow from financing activities	1,821	(513)	19	-
Cash generated/(utilised)	1,676	577	(687)	515
Cash at start of the year	501	2,177	2,754	2,067
Cash at end of the year	2,177	2,754	2,067	2,582

Key ratios

Y/E March	FY2010	FY2011	FY2012E	FY2013E
Valuation ratio (x)				
P/E (on FDEPS)	28.4	16.9	10.4	9.6
P/CEPS	93.0	223.4	8.6	7.9
P/BVPS	1.8	1.8	1.5	1.3
Dividend yield (%)	-	-	-	-
EV/Sales	1.1	1.1	1.0	0.8
EV/EBITDA	13.6	12.4	7.3	5.4
EV/Total assets	1.0	1.0	0.9	0.8
Per share data (₹)				
EPS	2.5	4.2	6.8	7.4
Cash EPS	0.8	0.3	8.2	9.0
Dividend	-	-	-	-
Book value	39.4	39.3	46.2	53.6
Dupont analysis				
Tax retention ratio (PAT/PBT)	0.9	0.9	0.8	0.8
Cost of debt (PBT/EBIT)	1.3	2.1	1.4	1.3
EBIT margin (EBIT/Sales)	0.0	0.1	0.1	0.1
Asset turnover ratio (Sales/Assets)	0.9	0.9	0.9	0.9
Leverage ratio (Assets/Equity)	1.3	1.3	1.2	1.2
Operating ROE	6.3	10.8	14.8	13.9
Return ratios (%)				
RoCE (pre-tax)	4.1	4.6	10.5	11.6
Angel RoIC	6.5	8.6	15.2	17.5
RoE	6.3	10.8	14.8	13.9
Turnover ratios (x)				
Asset turnover (fixed assets)	5.6	5.4	5.5	6.1
Receivables days	61	82	81	80
Payable days	81	157	105	100

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

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

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