

Mahindra Satyam

Performance highlights

Y/E March (₹ cr)	1QFY13	4QFY12	% chg (qoq)	1QFY12	% chg (yoy)
Net revenue	1,880	1,666	12.8	1,434	31.1
EBITDA	408	292	39.7	213	91.6
EBITDA margin (%)	21.7	17.5	417bp	14.8	685bp
Adj. PAT*	352	425	(17.1)	225	56.4

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

Mahindra Satyam (Satyam) reported a strong set of 1QFY2013 numbers, beating our as well as the street's expectations across the board. The major highlight of the result was the considerable expansion in the operating margin (~420bp qoq). Satyam has successfully addressed its key concern areas in the past three years of client mining, employee retention, margin expansion, and dispute resolution. The company is back on its growth track after three years of metamorphosis undertaken by Tech Mahindra's management post its acquisition in June 2009.

We recommend a Buy rating on the stock.

Quarterly highlights: For 1QFY2013, Satyam reported revenue of US\$342mn, up 2.9% qoq. Satyam did a small acquisition of vCustomer during the quarter which contributed US\$2mn to the consolidated net revenue. On an organic basis, the USD revenue grew by 2.4% qoq. The company's EBITDA margin increased by 417bp qoq to 21.7%, on the back of INR depreciation and reduction in selling, general and administrative (SG&A) expenses. The PAT stood tall at ₹352cr, aided by forex gain of ₹66cr in 1QFY2013 vs. a loss of ₹59cr in 4QFY2012.

Outlook and valuation: The company's outlook remained cautious in the turbulent environment, as it does not expect to be insulated from turn of events on the macro front. However the deal pipeline for the company remains quite healthy across verticals such as manufacturing, retail and BFSI in the US. We expect the company's core competence in enterprise business solutions (EBS) to supplement growth and post a 9.1% and 12.3% CAGR in USD and INR revenue respectively over FY2012-14E. The company continued to deliver operational exuberance with a healthy volume growth. On the EBITDA front, the company is expected to post a 20.3% CAGR over FY2012-14E. At the current market price of ₹84, the stock is trading at 8.7x FY2014E EPS of ₹9.7. We value the stock at 10x FY2014E EPS, which gives a target price of ₹97. **We recommend Buy rating on the stock.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Net sales	5,481	5,145	6,396	7,574	8,062
% chg	(37.8)	(6.1)	24.3	18.4	6.4
Net profit*	292	494	1,197	1,113	1,136
% chg	(258.2)	68.9	142.4	(7.0)	2.1
EBITDA margin (%)	8.3	8.8	16.0	19.6	18.4
EPS (₹)*	2.5	4.2	10.2	9.5	9.7
P/E (x)	33.5	19.9	8.2	8.8	8.7
P/BV (x)	2.1	2.1	1.7	1.4	1.2
RoE (%)	6.3	10.7	20.6	16.1	14.1
RoCE (%)	4.1	4.6	12.2	15.7	13.7
EV/Sales (x)	1.4	1.4	1.1	0.9	0.7
EV/EBITDA (x)	16.8	15.6	6.8	4.6	4.1

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

BUY

CMP	₹84
Target Price	₹97

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	9,846
Net debt (₹ cr)	(2,830)
Beta	0.9
52 Week High / Low	92/62
Avg. Daily Volume	1,129,190
Face Value (₹)	2
BSE Sensex	17,224
Nifty	5,228
Reuters Code	SATY.BO
Bloomberg Code	SCS@IN

Shareholding Pattern (%)

Promoters	42.6
MF / Banks / Indian FIs	7.0
FII / NRIs / OCBs	22.3
Indian Public / Others	28.0

Abs. (%)	3m	1yr	3yr
Sensex	(0.4)	(4.9)	9.9
Mahindra Satyam	10.5	0.8	(20.0)

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Exhibit 1: 1QFY2013 performance (Consolidated, Indian GAAP)

Y/E March (₹ cr)	1QFY13	4QFY12	% chg (qoq)	1QFY12	% chg (yoy)	FY2012	FY2011	% chg (yoy)
Net revenue	1,880	1,666	12.8	1,434	31.1	6,396	5,145	24.3
Direct costs	1,108	1,020	8.6	930	19.1	3,959	3,594	10.1
Gross profit	772	645	19.6	504	53.2	2,437	1,551	57.1
SG&A expenses	365	354	3.0	291	25.2	1,413	1,096	28.9
EBITDA	408	292	39.7	213	91.6	1,024	455	125.0
Dep. and amortization	49	42	18.9	38	29.8	158	185	(14.6)
EBIT	358	250	43.2	175	105.1	866	270	220.4
Interest charges	3	3	23.3	5	(31.1)	12	10	21.6
Other income	134	73		98		419	294	
PBT	489	320	52.7	268	82.2	1,273	555	129.5
Tax	133	(94)	(240.7)	43	211.7	85	58	47.3
PAT	356	414	(14.0)	226	57.8	1,188	497	139.1
Exceptional item	-	(109)		-		(109)	641	
Minority interest	4	(10)	(138.6)	1	629.1	(8)	3	(355.8)
Final PAT	352	534	(34.1)	225	56.4	1,306	(147)	(986.7)
Adj. PAT*	352	425	(17.1)	225	56.4	1,197	494	142.4
EPS* (₹)	3.0	3.6	(17.1)	1.9	56.2	10.2	4.2	142.3
Gross margin (%)	41.1	38.7	233bp	35.1	593bp	38.1	30.1	796bp
EBITDA margin (%)	21.7	17.5	417bp	14.8	685bp	16.0	8.8	717bp
EBIT margin (%)	19.1	15.0	404bp	12.2	687bp	13.5	5.3	829bp
PAT margin (%)	17.5	24.4	(695)bp	14.7	279bp	17.6	9.1	848bp

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

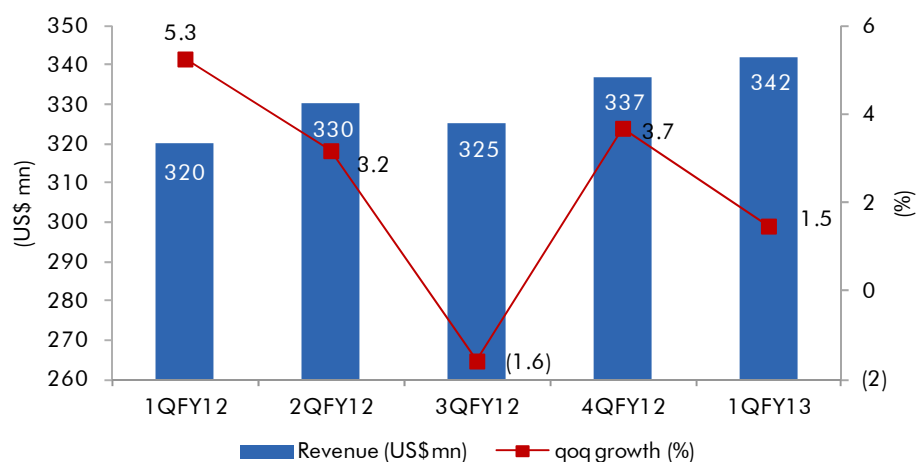
Exhibit 2: Actual vs. Angel estimates

(₹ cr)	Actual	Estimate	% Var.
Net revenue	1,880	1,848	1.7
EBITDA margin (%)	21.7	18.8	291bp
PAT	352	256	37.8

Source: Company, Angel Research

Operational exuberance continues

For 1QFY2013, Satyam reported a revenue of US\$342mn, up 2.9% qoq, majorly led by volume growth. In constant currency (CC) terms, the USD revenue growth was healthy at 4.6% qoq – better than many large cap players. Satyam did a small acquisition of vCustomer during the quarter which contributed US\$2mn to the consolidated net revenue. On an organic basis the USD revenue grew by 2.4% qoq. In INR terms, the revenue came in at ₹1,880cr, up 12.8% qoq, aided by qoq INR depreciation against the USD during the quarter.

Exhibit 3: Trend in revenue growth (qoq)


Source: Company, Angel Research

Industry-wise, the growth was led by manufacturing and healthcare & lifesciences industry segments, the revenue of which grew by 8.4% and 19.0% qoq, respectively. Unlike its peers, the company's revenue from the BFSI segment surprisingly grew by 2.0% qoq. Industry segments such as technology, media and entertainment (TME) and retail and logistics posted ~2.0% qoq growth each in revenue. The company is witnessing IT spending from retail and manufacturing clients to drive cost efficiency measures. In BFSI, IT spend is coming from areas such as risk, compliance management and regulatory issues.

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (qoq)
Manufacturing	34.0	8.4
TME (includes telecom also)	21.0	2.0
BFSI	19.0	2.0
Retail and logistics	11.0	2.0
Healthcare and lifesciences	7.0	19.0
Others	9.0	(16.5)

Source: Company, Angel Research

Geography-wise, growth was led by America, revenue from which grew by 8.0% qoq. However, the revenue from Europe declined by 6.5% qoq. The management indicated that the deal pipeline remains strong from emerging geographies with MNCs trying to expand their footprints in the same.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (qoq)
Americas	54.0	8.0
Europe	22.0	(6.5)
RoW	24.0	(2.1)

Source: Company, Angel Research

Hiring and client metrics

During the quarter, the company added merely 2,643 net employees (~1,400 due to vCustomer acquisition), taking its total employee base to 35,996. The attrition rate of the company declined to 13.5% in 1QFY2013 from 15.0% in 4QFY2012. The management indicated that most of the hiring done by the company in this quarter was of freshers but going ahead hiring will be done keeping in mind the demand scenario and signs from the macroeconomic environment.

Exhibit 6: Employee metrics

Particulars	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13
Net employee addition	2,172	654	188	1,073	2,643
Total employees	31,438	32,092	32,280	33,353	35,996
Attrition (%)	17.0	15.6	16.0	15.0	13.5

Source: Company, Angel Research

During the quarter, the revenue from the company's top 5/10 clients grew by 6/7% qoq. The active client base of the company jumped to 372 from 314 in 4QFY2012, as ~49 clients were added because of vCustomer acquisition.

Exhibit 7: Client metrics

Particulars	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13
Total active clients	220	228	245	314	372
US\$ 1mn–5mn	83	77	79	83	94
US\$ 5mn–10mn	11	12	14	13	21
US\$ 10mn–20mn	22	19	18	17	14
US\$ 20mn–50mn	11	13	12	13	12
US\$ 50mn+	3	3	3	3	4

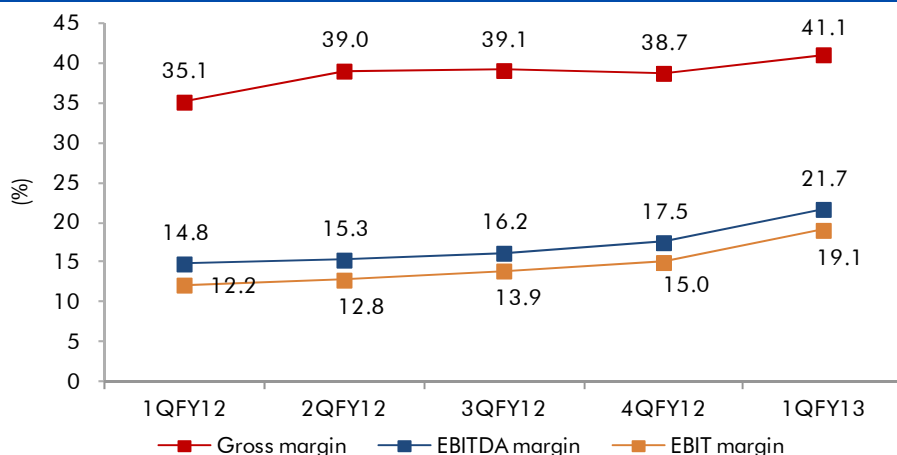
Source: Company, Angel Research

Margin enhances

During the quarter, the company's EBITDA and EBIT margin increased by 417bp and 404bp qoq to 21.7% and 19.1%, respectively. The key margin drivers were: 1) INR depreciation against USD: +300bp, 2) utilization improvement and employee pyramid rationalization: +85bp, 3) SG&A and other efficiencies: +65bp and 4) increased visa costs: -30bp. The SG&A expenses as a % to revenue stood at 19.4% as against 21.2% in 4QFY2012, aided by reduction in rental expenses and legal and professional charges.

Going ahead, the management indicated that the company will give a wage hike to offshore employees from 2QFY2013 onwards with the quantum of hikes to be decided shortly. We expect this to impact the operating margin of the company by 250-300bp.

Exhibit 8: Margin profile



Source: Company, Angel Research

Outlook and valuation

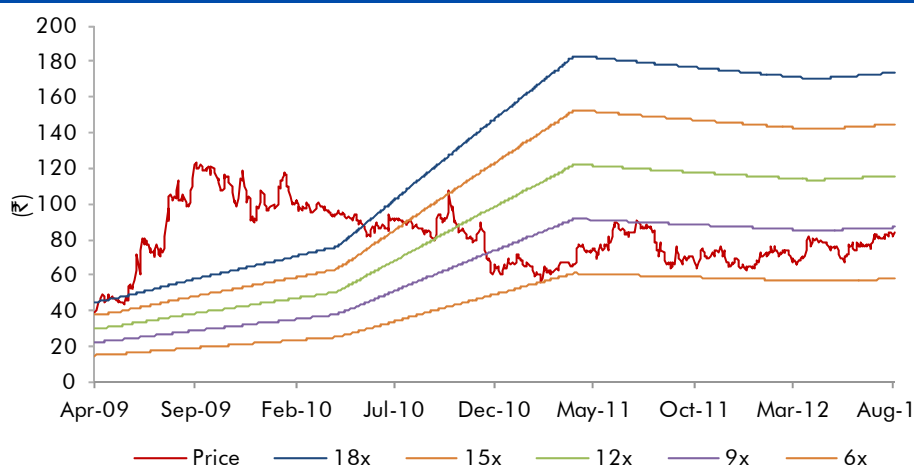
The new management has proved its ability of turning around the company in two years' time by putting it back to comparable industry level growth and improving margins from 3% in FY2010 to 16.0% in FY2012 and 21.7% in 1QFY2013. The company's outlook remained cautious in the turbulent environment, as it does not expect to be insulated from turn of events on the macro front. However the deal pipeline for the company remains quite healthy across verticals such as manufacturing, retail and BFSI in the US. Keeping in view the uncertain demand environment, the management indicated that they will go slow on fresh hiring with dependence on off campus fresher recruitment and just-in-time lateral hiring. Satyam has successfully addressed its key concern areas in the past three years of client mining, employee retention, margin expansion, and dispute resolution. Satyam has enterprise business solutions (EBS) (~40% of its revenue) and manufacturing (~34% of its revenue) showing modest 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 color given by the managements of most other tier-I companies as well. We expect the company's core competence in EBS to supplement growth and post a 9.1% and 12.3% CAGR in USD and INR revenue, respectively, over FY2012-14E.

On the operating front, Satyam scaled up its margins from 8.8% in FY2011 to 16.0% in FY2012 on the back of factors such as INR depreciation and rationalization of employee pyramid (number of employees < 3 years are now at ~32% vs. 24% in FY2011). The management indicated that the company will resort to just-in-time hiring in the near term, which will help the company improve its utilization level from the current level, thereby providing a cushion to its operating margin in FY2013, which will be negatively impacted in 2QFY2013 due to wage hikes. On the EBITDA front, the company is expected to post a 20.3% CAGR over FY2012-14E. At the current market price of ₹84, the stock is trading at 8.7x FY2014E EPS of ₹9.7. **We value the stock at 10x FY2014E EPS, which gives a target price of ₹97. We maintain our Buy rating on the stock.**

Exhibit 9: Key assumptions

Particulars	FY2013	FY2014
Revenue growth - USD terms (%)	8.7	9.4
Revenue growth - INR terms (%)	18.4	6.4
EBITDA margin (%)	19.6	18.4
EBIT margin (%)	17.0	15.9
Tax rate (%)	27.0	25.5
EPS growth (%)	(7.1)	2.1

Source: Company, Angel Research

Exhibit 10: One-year forward PE(x) chart


Source: Company, Angel Research

Exhibit 11: Recommendation summary

Company	Reco.	CMP (₹)	Tgt. price (₹)	Upside (%)	FY2014E EBITDA (%)	FY2014E P/E (x)	FY2011-14E EPS CAGR (%)	FY2014E EV/Sales (x)	FY2014E RoE (%)
HCL Tech	Accumulate	525	585	11.5	17.5	11.7	7.7	1.2	21.1
Hexaware	Buy	115	133	15.3	21.4	9.5	10.8	1.2	24.0
Infosys	Accumulate	2,206	2,530	14.7	31.9	12.6	6.2	2.3	22.1
Infotech Enterprises	Accumulate	173	187	8.1	17.5	8.8	10.7	0.5	13.7
KPIT Cummins	Neutral	120	-	-	14.8	10.7	11.9	0.8	17.8
Mahindra Satyam	Buy	84	97	16.0	18.4	8.7	(1.8)	0.7	14.1
MindTree	Accumulate	642	708	10.4	17.1	9.1	9.6	0.8	19.3
Mphasis	Neutral	407	-	-	17.7	11.0	0.5	0.9	12.6
NIIT ^	Accumulate	36	40	10.5	15.1	4.1	9.5	0.2	18.4
Persistent	Accumulate	378	398	5.3	24.3	8.5	7.7	0.8	15.5
TCS	Accumulate	1,233	1,304	5.8	29.1	17.0	10.1	3.3	28.3
Tech Mahindra	Neutral	720	-	-	16.5	8.5	(1.2)	1.3	18.4
Wipro	Buy	340	420	23.5	19.3	12.1	7.3	1.3	18.0

Source: Company, Angel Research; Note: ^ Valued on SOTP basis

Company Background

Mahindra Satyam (erstwhile Satyam Computers) was incorporated by Raju brothers in 1987, with a strong focus on the manufacturing industry and the enterprise business solutions (EBS) vertical. The Mahindra Group acquired Satyam in April 2009 after the erstwhile founders reported financial irregularities in January 2009 and it is now back on its growth track after two years of metamorphosis undertaken by Tech Mahindra's management. The company's new management took over its reins and has again put the company on the map of the Indian IT industry (sixth largest Indian IT services provider) with improved business flow, strong client mining and better margins.

Profit and loss statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012	FY2013E	FY2014E
Net revenues	5,481	5,145	6,396	7,574	8,062
Employee costs	3,981	3,594	3,959	4,588	4,966
Gross profit	1,500	1,551	2,437	2,986	3,096
% to net sales	27.4	30.1	38.1	39.4	38.4
SG&A expenses	1,043	1,096	1,413	1,503	1,612
% to net sales	19.0	21.3	22.1	19.8	20.0
EBITDA	457	455	1,024	1,482	1,483
% to net sales	8.3	8.8	16.0	19.6	18.4
Dep. and amortization	214	185	158	192	202
% to net sales	3.9	3.6	2.5	2.5	2.5
EBIT	243	270	866	1,291	1,282
% to net sales	4.4	5.3	13.5	17.0	15.9
Interest charges	33	10	12	12	10
Other income	106	294	419	261	258
PBT	315	555	1,273	1,539	1,530
Tax	22	58	85	416	390
% of PBT	7.0	10.4	6.7	27.0	25.5
PAT	293	497	1,188	1,123	1,140
Exceptional item	417	641	(109)	-	-
Minority interest	1	3	(8)	10	4
Final PAT	(125)	(147)	1,306	1,113	1,136
Adj. PAT*	292	494	1,197	1,113	1,136
EPS (₹)*	2.5	4.2	10.2	9.5	9.7

Note: * excluding exceptional item

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Liabilities					
Share capital	235	235	235	235	235
Share app. money pending allotment	0	-	0	-	-
Reserves and surplus	4,395	4,386	5,583	6,696	7,831
Total shareholders' funds	4,630	4,621	5,818	6,931	8,067
Minority interest	20	23	15	15	15
Loan funds	42	32	23	23	23
Deferred tax liability	4	7	2	2	2
Sub-total	4,696	4,683	5,858	6,971	8,106
Amt pending investigation suspense	1,230	1,230	1,230	1,230	1,230
Total capital employed	5,927	5,913	7,088	8,201	9,337
Assets					
Fixed assets	987	950	974	942	961
Investments	627	435	35	441	628
Deferred tax asset	7	8	170	8	8
Current assets, loans and advances					
Inventories	-	59	15	20	20
Sundry debtors	923	1,159	1,402	1,681	1,789
Cash and bank balances	2,177	2,754	2,852	3,100	3,837
Other current assets	496	379	381	386	347
Loans and advances	385	378	692	750	798
Less: Current liab. and provisions					
Liabilities	882	1,546	1,396	1,508	1,633
Provisions	1,540	1,558	1,014	1,212	1,290
Net current assets	1,558	1,624	2,932	3,216	3,869
Profit and loss account	2,749	2,896	2,978	3,594	3,871
Sub-total	5,927	5,913	7,088	8,201	9,337
Unexplained diff. suspense acc. (net)	-	-	-	-	-
Total capital deployed	5,927	5,913	7,088	8,201	9,337

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Pre tax profit from operations	210	261	855	1,278	1,272
Depreciation	214	185	158	192	202
Pre tax cash from operations	424	445	1,012	1,470	1,473
Other income/prior period ad	106	294	419	261	258
Net cash from operations	530	740	1,440	1,721	1,727
Tax	22	58	85	416	390
Cash profits	507	679	1,354	1,304	1,337
(Inc)/dec in current assets	507	(172)	(515)	(347)	(118)
Inc/(dec) in current liabilities	(445)	682	(695)	311	202
Net trade working capital	62	510	(1,210)	(36)	85
Cash flow from operating activities	569	1,189	145	1,268	1,422
(Inc)/dec in fixed assets	38	(148)	(182)	(160)	(220)
(Inc)/dec in investments	(627)	192	400	(406)	(188)
(Inc)/dec in deferred tax	(1)	1	(167)	162	-
(Inc)/dec in other non-current assets	(125)	(147)	(81)	(616)	(277)
Inc/(dec) in minority interest	1	3	(8)	-	-
Cash flow from investing activities	(714)	(99)	(39)	(1,020)	(685)
Inc/(dec) in debt	(772)	(11)	(8)	-	-
Inc/(dec) in equity/premium	2,593	(503)	0	(0)	-
Dividends	-	-	-	-	-
Cash flow from financing activities	1,821	(513)	(8)	(0)	-
Cash generated/(utilized)	1,676	577	98	248	737
Cash at start of the year	501	2,177	2,754	2,852	3,100
Cash at end of the year	2,177	2,754	2,852	3,100	3,837

Key ratios

Y/E March	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Valuation ratio (x)					
P/E (on FDEPS)	33.5	19.9	8.2	8.8	8.7
P/CEPS	-	-	6.7	7.5	7.3
P/BVPS	2.1	2.1	1.7	1.4	1.2
Dividend yield (%)	-	-	-	-	-
EV/Sales	1.4	1.4	1.1	0.9	0.7
EV/EBITDA	16.8	15.6	6.8	4.6	4.1
EV/Total assets	1.3	1.2	1.0	0.8	0.6
Per share data (₹)					
EPS	2.5	4.2	10.2	9.5	9.7
Cash EPS	0.8	0.3	12.5	11.1	11.4
Dividend	-	-	-	-	-
Book value	39.4	39.3	49.5	59.0	68.7
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.9	0.9	0.9	0.7	0.7
Cost of debt (PBT/EBIT)	1.3	2.1	1.5	1.2	1.2
EBIT margin (EBIT/Sales)	0.0	0.1	0.1	0.2	0.2
Asset turnover ratio (Sales/Assets)	0.9	0.9	0.9	0.9	0.9
Leverage ratio (Assets/Equity)	1.3	1.3	1.2	1.2	1.2
Operating ROE	6.3	10.8	20.4	16.2	14.1
Return ratios (%)					
RoCE (pre-tax)	4.1	4.6	12.2	15.7	13.7
Angel RoIC	6.5	8.6	20.5	25.3	23.3
RoE	6.3	10.7	20.6	16.1	14.1
Turnover ratios (x)					
Asset turnover (fixed assets)	5.6	5.4	6.6	8.0	8.4
Receivables days	61	82	80	81	81
Payable days	81	157	129	120	120

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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%)	