A New Mahindra Satyam?

Executive Summary

A Financial, Operational, and Strategic Review

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Executive Summary

On January 7, 2009, Mr. Ramalinga Raju's confession to accounting fraud and subsequent resignation as Chairman of Satyam Computer Services left the company's clients, employees, and investors in significant turmoil and caused what is considered the biggest crisis in the Indian IT services industry. The period post the crisis witnessed notable attrition of clients, leadership, and employees from the company.

As additional details of the fraud emerged, it became evident that the fraud was perpetrated by a select group of individuals by overstating financial performance and did not reflect a failure of Satyam's business and operating model or the erosion of core capability and competency sets. While the law took its course with the fraud perpetrators, efforts were required to protect the interests of Satyam's employees and clients and to uphold the image of the Indian IT services industry.

The Indian Government stepped in and provided the required handholding and support to shepherd the company out of the crisis. Three months later, a sense of stability was restored when Tech Mahindra (the telecom-centric IT services company owned jointly by Indian conglomerate Mahindra Group and British Telecom) won the bid to acquire a majority stake in Satyam on April 13, 2009.

The acquisition provided Satyam with the corporate identity and resources to survive as a company and continue competing in the offshore IT services market. At the same time, a lot of unanswered questions remained in the marketplace regarding the impact of the fraud on the company's stature, implications on financial health and operating model, and future strategy post the Tech Mahindra acquisition.

On September 29, 2010, Mahindra Satyam (the new branding of legacy Satyam) provided restated financials of the company for the two financial years ending March 2009 (FY09) and March 2010 (FY10), bringing to rest months of uncertainty and speculation on the actual financial and operational health of the company.

This Breaking Viewpoint provides Everest's assessment of Mahindra Satyam's financial health, foundations for growth, and strategic direction based on an analysis of the restated financials, interactions with senior leadership of the company and key clients, and insights from our buyer advisory experience. The report examines[1]:

- The restated financials and their implications on Mahindra Satyam's relative standing and positioning among the top Indian IT majors
- Market success indicators reflected by new logos and client retention and expansion activity
- Differentiated foundations for growth of Mahindra Satyam
- The vision for the new company and future strategic direction
- Implications for the global sourcing marketplace

Satyam crisis – Timeline of key events

07 Jan '09: Irregularities in Satyam's accounts revealed

11 Jan '09: Indian Government reconstitutes Satyam's board

13 Apr '09: Tech Mahindra selected as strategic investor in Satyam

21 Jun '09: Satyam unveils new brand identity – "Mahindra Satyam"

23 Jun '09: New leadership team announced for Mahindra Satyam

29 Sep '10: Mahindra Satyam restates financials for FY09 and FY10

1 Uncertainty still remains over the outcome of the legal liabilities and all the details of what happened to the money. Our analysis does not try to explain the history of the fraud or the personalities involved in the scandal but, rather, articulates the current state and what we see happening moving forward with the business entity beyond just the financials

Key facts:

- US$1.15 billion revenues in FY10
- 8.3% EBITDA margin for FY10
- 44 new logos in FY10 including two Fortune 500 clients
- 340 active clients at the end of FY10
- Integration with Tech Mahindra expected to conclude in 2011
- US$2.1 billion revenues for combined entity

Key messages

While reported stand-alone financials are expectedly weak, the combined Mahindra Satyam-Tech Mahindra entity justifies positioning among Tier-1 Indian IT companies

- Significant client churn immediately after the crisis and the base line over-stated results dragged the stand-alone revenues for FY10 down to US$1.15 billion (40 percent decline from FY09). EBITDA margin excluding extraordinary expenses stood at 8.3 percent for FY10.
- Steadily improving financials in recent quarters and the backing of the Mahindra Group (a US$7.1 billion Indian conglomerate) should alleviate client and industry concerns about the overall financial stability of the company.
- The pending integration of Mahindra Satyam and Tech Mahindra will create an entity with approximately US$2.1 billion in revenues, placing it behind HCL Technologies (US$2.7 billion for 12 months ended June 2010). However, the combined scale re-validates the company's standing among Tier-1 Indian IT suppliers (Wipro, Infosys, TCS, Cognizant, and HCL).

Though engagement renewals and new client wins are encouraging, buyers remain hesitant in inviting Mahindra Satyam to new sourcing initiatives

- After the wave of client attrition in the first few months of 2009, Mahindra Satyam was successful in winning new logos and retaining and expanding existing client engagements.
- Despite winning new logos, the uncertainty regarding the company's financial health and future outlook did deter many companies from inviting Mahindra Satyam to a new sourcing mandate. We expect that the restatement of financials and a better understanding of the company's capabilities will improve Mahindra Satyam's participation in RFPs, especially in the areas that are foundations for growth.

To recapture a growth trajectory, Mahindra Satyam will best be able to differentiate itself using four foundations for growth, derived from strong capabilities carried forward from legacy Satyam and synergies with the Mahindra Group's manufacturing heritage and Tech Mahindra's telecom expertise

- **Manufacturing:** Mahindra Group's core businesses across the automotive, aerospace, engineering and defense, and component manufacturing segments strengthen the capabilities and experience of the largest vertical for legacy Satyam, enabling an end-to-end proposition from services to manufacturing.
- **Telecommunications:** Distinctive expertise of Tech Mahindra working with global telecom service providers and equipment manufacturers is being leveraged in other enterprise verticals through digital convergence solutions such as enterprise mobility
- **Enterprise IT services:** A legacy strength for Satyam, enterprise services remain strong especially in the areas of enterprise integration (through SAP, Oracle and Business Intelligence).
- **Vertical-led BPO:** Manufacturing, telecom, pharmaceutical, and financial services are key growth engines for this emerging area within Mahindra Satyam, providing an opportunity to position integrated IT-BPO solutions to existing and new clients.

The impending integration of Mahindra Satyam and Tech Mahindra is being actively architected with the aspiration of creating a leader in the Information Communications Technology (ICT) market

- Our interactions with the leadership indicate that, while the synergies between Mahindra Satyam and Tech Mahindra are already realized in several operational and go-to-market areas, the overall integration is likely to be completed in 2011.
- Post integration, the companies will pursue a vision of combining their individual strengths in Information Technology and Communications to "be the world's most valued ICT company."

Mahindra Satyam's recovery and integration with Tech Mahindra highlights important implications for the global sourcing marketplace

- The Satyam crisis underscored the need for robust risk management in global sourcing. With global sourcing programs becoming increasingly complex and critical, buyers need to embrace holistic risk management practices that impact not only specific engagements but also the portfolio of suppliers and delivery locations.
- Buyers of global sourcing services are likely to benefit through the "re-introduction" of a major offshore IT services supplier, especially in the identified areas that are expected to support growth for Mahindra Satyam.
- The supplier landscape is likely to see increased competitive intensity, especially in light of the fierce aggression with which the combined entity is expected to pursue growth and increase market share.
- Mahindra Satyam itself will need to reinforce industry confidence by backing promises with strong performance, bridging the gap in financial performance with peers, ensuring a smooth integration with Tech Mahindra, maintaining strategic differentiation, and aggressively continuing investments to drive growth and market share.

About Everest

Everest Group is a global consulting and research firm that comprehensively serves the sourcing market. An industry leader since creating the sourcing consultancy practice in 1991, Everest has earned a worldwide reputation for ongoing innovation by helping clients capture optimum value through the development and implementation of sourcing strategies and implementations, including captive, outsourced and shared services approaches. We help companies create strategies and sourcing relationships that deliver total value – improving performance and results while effectively managing risks.

Since its inception, Everest has forged over 600 major outsourcing relationships, advising clients on complex sourcing issues in more than 30 key business processes worldwide. Our experience spans numerous Fortune 500 clients in industries including banking, energy & utilities, healthcare, hospitality, insurance, manufacturing, media & entertainment, retail, and telecom.

The Everest Research Institute serves as a central source of independent and objective strategic intelligence, analysis, and actionable insight for leading corporations, suppliers, technology providers, and investors in the global outsourcing and offshoring marketplace. Our research analysts address both business process and information technology sourcing topics, providing the global sourcing community with information that empowers highly productive, sustainable sourcing strategies and relationships.

Through a uniquely integrated consulting and research delivery model, Everest offers its clients the flexibility and scalability to support a broad scope of business situations, client needs, and project requirements. Service offerings range from comprehensive support for critical initiatives to modular support for ad hoc inquiries.

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