Businessworld

TECH MAHINDRA-SATYAM

The Winner Takes All...

...both the potential upsides as well as the enormous risks

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VENKATESH G.

REACHING HIGH: The Satyam buy will help Anand Mahindra's Tech Mahindra leapfrog into the big league of Indian IT
(Pic by Subhabrata Das)

By sheer coincidence, the resurrection of Satyam Computer Services, battered after the confession of its erstwhile founder and Chairman B. Ramalinga Raju in early January, almost fell on Easter Sunday, on which day Jesus Christ was resurrected too. On Monday, 13 April, Tech Mahindra was declared the highest bidder and winner to acquire the scandal-hit company. On Thursday, 16 April, that decision was upheld by the Company Law Board (CLB), paving the way for completing the most high-profile acquisition in recent times.

Tech Mahindra will acquire Satyam using a special purpose vehicle, Venturbay Consultants, which will buy a preferential equity issue of 31 per cent of Satyam's equity capital, followed by a further acquisition of 20 per cent through an open offer to existing shareholders. Tech Mahindra will have to pay roughly Rs 2,900 crore for the 51 per cent stake.

There was a palpable sense of relief as the drama surrounding the Satyam acquisition drew to a close. Infosys Technologies' Chief Mentor N.R. Narayana Murthy, who had called Satyam "tainted", expressed relief that employees of Satyam could now breathe easier; Tata Consultancy Services (TCS) CEO S. Ramadorai echoed the sentiment, saying that things could now move on.

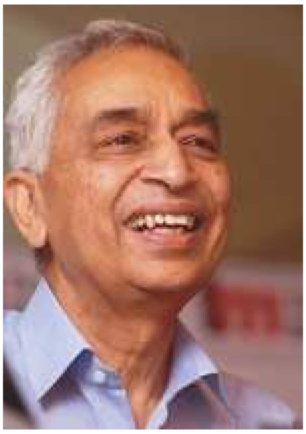
"It is a good thing that this issue is now behind us," says Kris Gopalakrishnan, CEO of Infosys Technologies. "It is commendable that Satyam's government-appointed board has been able to bring the uncertainty about its future to closure." The markets also cheered, sending Tech Mahindra's stock up 12 per cent.

While the acquisition will close the chapter on one part of the story, it will open several new chapters that will unfold over the next few months, and that will, in turn, open up fresh questions. What exactly has Tech Mahindra gotten for its money? What are the next steps for Tech Mahindra and what will it do with its new acquisition? What will Larsen & Toubro (L&T), the perceived front-runner that still holds about 12 per cent of Satyam, do now?

The past is often prologue, and some unanswered questions will resurface. Did the Big Three Indian IT companies — Infosys, TCS and Wipro — miss out on an opportunity and create competition for themselves in the form of a bigger Tech Mahindra? Can Tech Mahindra successfully navigate the minefield of lawsuits and creditor claims it will inherit with the acquisition? Will the government provide some form of protection?

Putting It Together

The CLB's approval of the deal on Thursday came with some key caveats, many of which were already in the public domain. Tech Mahindra cannot sell any of Satyam's assets for two years (this includes some of the real estate that Satyam owns, currently valued at around Rs 1,200-1,500 crore); the company cannot have more than four members on Satyam's board of directors, and the government nominees will stay.



TOUGH TASK AHEAD:
Tech Mahindra CEO Vineet Nayyar will have to handle Satyam's liabilities and put together a new management team

As part of the bidding terms for Satyam, Tech Mahindra is locked into the acquisition for three years, though it may be allowed to raise more equity if so required. Satyam needs cash for operations, and some of the money that pays for Tech Mahindra's stake will reduce the pressure on operational finances.

But the bill may not stop at the Rs 2,900 crore that will pay for the acquisition; there are still the lawsuits, including class action suits in the US courts that may require Tech Mahindra to have more money in its war chest. Even using a conservative estimate, that may be another $500 million or roughly Rs 2,500 crore.

To pay for the acquisition, Tech Mahindra officials have said that they have about Rs 700 crore in internal accruals; the company is reported to be in the process of raising another Rs 600 crore through a four- to five-year bond issue. Kotak Mahindra Bank is also said to be advising the company, and helping put together a consortium of lenders to enable financing of the acquisition.

Advantage Tech Mahindra
Thus far, Tech Mahindra has been a niche player, with 60 per cent of its revenues coming from one client — British Telecom (BT). "Satyam becomes a breakout opportunity for Tech Mahindra," says Niosgant Verma, vice-president at Tholons Capital in Bangalore. "While the road ahead is tough and holds no guarantees, it gives Tech Mahindra a shot at becoming the fourth pillar of the Indian IT story."

BITTER SWEET DEAL?

Tech Mahindra will buy 31 per cent of Satyam's equity capital, followed by a further acquisition of 20 per cent through an open offer

The Winning Bid...
Tech Mahindra: Rs 58 per share, a 23 per cent premium over last Thursday's closing stock price.
...Others
L&T: Rs 45.90 per share
Wilbur Ross: Rs 20 per share

Revenue Avenues

	Satyam	Tech Mahindra
AMERICAS	5,088	730
EUROPE	1,778	2,773
REST OF THE WORLD	1,696	226

Figures are for FY08 in Rs crore

From servicing a single business — telecom — it acquires a wide base of clients across several industries and capabilities. "It will enable Tech Mahindra to move into several geographies using Satyam's spread," says C.S. Chandramouli, director, advisory services at Zinnov Consulting, a Bangalore-based firm. "They will have a comprehensive solution set for enterprises and be able to get into other verticals inorganically."

"During its last investor conference call, Tech Mahindra had indicated that revenue growth could be a challenge over the next quarters," says Manik Taneja, IT analyst at Emkay Global Financial Services in Mumbai. "There have been significant cuts in BT's core spending, and there could be more." In the third quarter of FY09, the company reported a 14 per cent drop in revenue from the previous quarter to $232 million.

"About 75 per cent of our revenues are in pounds sterling, and 70 per cent of Satyam's revenues come from the American market," said Anand Mahindra, chairman of Tech Mahindra, at the press conference that followed the announcement of the winning bid on Monday. "This is a marriage made in heaven." **Peter Schumacher, CEO of Value Consulting [Correction: Should read – Value Leadership Group], a US-based management consulting firm, echoed that thought, saying that the acquisition would give Tech Mahindra a 50/50 revenue split that most IT companies strive to achieve.**

It also benefits Tech Mahindra's subsidiaries such as Bristlecone — which provides supply chain management solutions using SAP — access to Satyam's clients such as Shell Oil, Adidas, Hitachi, Nike and Apple, among others. "We see a lot of synergies in this buy," said Vineet Nayyar, vice-chairman and CEO of Tech Mahindra, at the press conference.

Unwanted Legacies

The scam of Satyam's accounting misstatements and exaggerations apart, the acquisition will pose many challenges for Tech Mahindra. The first will be dealing with lawsuits that could potentially impose damages. Two US law firms — Izard Nobel LLP and Vianale & Vianale LLP — have filed class action lawsuits on the fraud perpetrated by Raju and his associates, leading to inflated stock prices and subsequent losses for Satyam's US shareholders.

Then there is the high-profile lawsuit filed by Upaid Systems against Satyam last year; the issue under contention dates back to 1997-98, when one of the subsidiaries of Satyam Computers was engaged by Intouch Technologies (currently Upaid Systems) for product development work.

A ROSE BY ANY OTHER NAME...
Infosys Technologies' Chief Mentor N.R. Narayana Murthy may have jumped the gun too early when he called Satyam "tainted", and deprived his company an acquisition opportunity. But none of the larger companies seem to rue the "loss". However, the question is being asked nevertheless: would it have been better for any of the Big Three — Infosys, Tata Consultancy Services (TCS) or Wipro — to have acquired Satyam? Would they have benefited? Despite the scam, Satyam's basic business was still in reasonably good shape, and some people are surprised that none of the larger firms evinced any interest in the company. "We do not look merely at valuation, but synergies and an entry into areas where we have no presence," says T.V. Mohandas Pai, human resources director at Infosys. Large clients prefer using multiple vendors. And while more than half of GE's business, for example, was accounted for by Satyam, over the past few months, an increasing amount was moving to others such as TCS. Three years ago, the market share of the Big Five (including HCL and Satyam) was 40 per cent of industry revenues, which has since gone up to 58 per cent; the acquisition of Satyam could have consolidated this growth to within the Big Three. Even on pricing, larger service providers are more expensive and would have to charge more for any clients acquired from Satyam; clients may not have been very willing. **"As we know, Satyam's contracts were priced lower than those of the Big Three," says Peter Schumacher, CEO of US-based Value Consulting [Correction: Should read – Value Leadership Group] . "A takeover of Satyam would mean price increases, and clients could have walked away and diluted the value of the acquisition." Some clients of Satyam may not have been receptive to a takeover by a larger firm.** **The Big Three also have other strategic imperatives. "They need to expand their onshore capabilities to compete against the likes of Accenture, IBM and Capgemini," says Peter Schumacher [see Businessworld correction] . Acquiring Satyam would have done nothing to further these strategic needs.**

A group of Satyam staff had used Upaid-developed software that they had access to during the course of their assignment with Intouch. They modified this software, and then tried to sell it as their own intellectual property. Satyam claimed that these staffers were no longer with the company when they tried to sell this seemingly illegally acquired product.

Apart from the existing ones, there could be more lawsuits arising in the future, says B. Sai Chandravadhan, vice-president of Chess Management, a legal audit and compliance company. "Typically, investors look to see if there's clarity on who would run the company in a case like this and then press for lawsuits when it becomes clear."

When Tech Mahindra officials were asked about the extent of liabilities arising out of these lawsuits, they declined to divulge details, citing CLB regulations that prevent a company from giving out information till the deal is sealed. Analysts point out that the risk from potential lawsuits, including class actions, could be high and cost around Rs 2,000 crore. **"Tech Mahindra must have factored in some significant legal expenses and settlements," says Schumacher of Value Consulting [Correction: Should read – Value Leadership Group].**

The People Problem: Excess Baggage?

Managing Satyam's 45,000 employees poses a challenge on a scale that may be outside the realm of Tech Mahindra's experience. True, there are not many overlaps when it comes to business verticals, so there are unlikely to be layoffs on that count. But there is a considerable amount of uncertainty whether key people in Satyam would be given the kind of free hand that they have been used to.

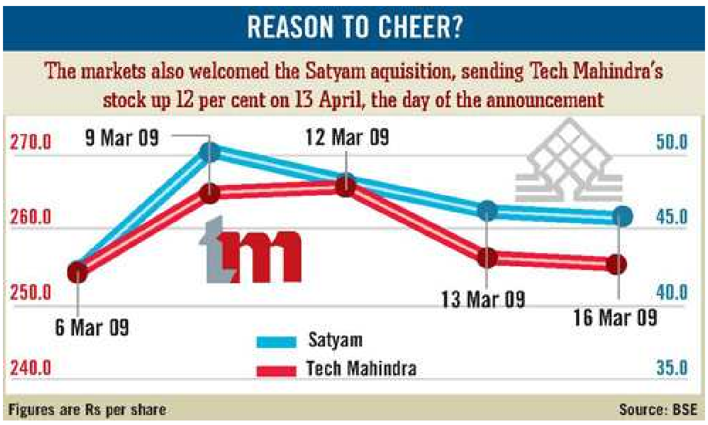
SIGH OF RELIEF: (From left) Satyam Board Chairman Kiran Karnik and members Deepak Parekh and T.N. Manoharan

"We have been informed that Tech Mahindra will retain key people with client-facing roles for a year," said a Satyam official, who requested anonymity. This is in line with the idea that clients would like continuity in the IT services business. There have been reports that 100 key people are definitely likely to be retained (apparently, this list does not include the name of Ram Mynampati, who had originally succeeded Raju as CEO).

On being questioned about a change in management if this deal came through, both the existing Satyam management and Tech Mahindra's leadership did not rule out changes in management. The CLB has already spelt out its position on the composition of the board of directors when it approved the deal — Tech Mahindra could appoint no more than four directors, and the three government-appointed nominees would stay on.

The new organisational structure will likely include Tech Mahindra officials at the top; at the press conference, Tech Mahindra CEO Nayyar introduced key management personnel: C.P. Gurnani, president of the company's international operations who has earlier had stints with Perot Systems India and HCL Technologies, and Sanjay Kalra, president of Tech Mahindra who has had stints with HCL Technologies and Tata Unisys. It was a demonstration of management capability and bandwidth to make this acquisition work.

But industry analysts and observers say that there is a strong possibility of shutting down units that have no synergies with Tech Mahindra. This could mean that Satyam BPO — which employs about 5,000 people — may not be perceived as having any strategic interest for Tech Mahindra; revenues from its BPO operations is negligible.



Clearing Some Hurdles

Tech Mahindra can take a short breather while it gets together the money required to put into the escrow account; company officials declined to comment, citing CLB rules. But the competition is gearing up for action.

Satyam's advantage over its larger rivals has been its pricing strategy; market analysts point out that Satyam has kept its prices between 3 and 6 per cent lower. But as the downturn has progressed, other IT companies have felt the pressure on their margins and business volumes; Infosys Technologies, in its results conference on Wednesday, said the outlook for FY10 would be bad. That outlook does not seem to look much better for the others too.

So the likelihood of Tech Mahindra's competitors poaching on Satyam's client list is becoming a reality. "It's not as if it has not happened before," says an investment banker, whose company specialises in advising technology companies. "It's in the nature of the competition, and it's just going to get sharper now."

The other risk that Tech Mahindra faces is that of losing not just client projects, but the personnel associated with them, since clients like continuity. That is a real threat for Tech Mahindra; the vast experience of Satyam's employees is a very tangible asset in the IT services business, and losing key project personnel could be a problem.

OPPORTUNITIES AND THREATS

Tech Mahindra, which has so far serviced only telecom, will now be able to move into several verticals using Satyam's spread

VERTICALS	INFOSYS	TCS	TECH MAHINDRA
Financial services	5,706	7,554	No presence
Manufacturing	2,291	1,838	No presence
Telecom	3,215	3,561	2,849
Retail	1,945	1,326	No presence

Figures are FY08 revenues in Rs crore Source: Company Reports

The restatement of accounts is still a work in progress, but the combined client base of Tech Mahindra and Satyam could be in excess of 500, including the likes of General Electric, General Motors, Nestle, Citibank and BT. Managing that base will pose significant challenges for Tech Mahindra. "It's imperative for the new owners to restore confidence in clients, employees and investors — in that order," says Partha Iyengar, head of research at Gartner India.

The biggest challenge — though one that is some way in the future — is the integration of the two companies. Sooner or later, the two will have to be merged into one to leverage that scale advantage. Tech Mahindra has acquired a company almost twice its size and capability; and, in a deteriorating environment, integration with incurring huge costs in terms of people lost, compromising on margins will occupy significant management bandwidth. "Tech Mahindra's management will be put to the test over the next two-three years in gaining visibility and customer confidence," says Chandramouli.

The Test Of The Rest

On its part, L&T will have to deal with life after having lost the bid; it remains a significant shareholder, even after its current 12 per cent stake in Satyam will go down to a little over 9 per cent on the expanded capital base, after the preferential issue of shares to Tech Mahindra. L&T cannot sell its stake for at least six months; that Satyam stake is still considered a strategic investment and the company will not have to mark it to market immediately. But company officials say that L&T will sell its holding "at an appropriate time". Their IT business may not be spectacular, but it remains a good one, they say.

But even after the CLB approved the deal, people such as B.K. Modi of the Spice Group, one of the original contenders for Satyam, continue to criticise and question the bidding process, saying he will approach the CLB questioning the propriety of having Deepak Parekh, who is a member of Tech Mahindra parent Mahindra & Mahindra's board of directors, in addition to being on Satyam's, evaluate the bids for Satyam.

Modi says he is writing to Justice S.P. Bharucha, who oversaw the bidding and evaluation process about the apparent conflict of interest that should at least have been recognised and noted for the record. Sour grapes, say some analysts, dismissing his concerns while pointing out that this question should have been raised much earlier. Most believe that his protest is unlikely to derail the acquisition at this juncture.

In another more surprising development, the Institute of Chartered Accountants of India (ICAI), the accounting standards quasi-regulatory body, expressed its opposition to the acquisition. Uttam Prakash Agarwal, ICAI president, said on Thursday that the deal should not have gone through till a clearer picture of the accounts emerged.

“Why is it taking so long to restate the accounts? Considering the complexity, ICAI should have got its act together faster,” says a partner from an accounting firm in Mumbai, who requested anonymity. As part of its consent, the CLB gave Satyam’s new auditors KPMG and Deloitte until the end of December 2009 to submit the restated accounts.

But none of this is likely to deter the process. The ICAI has no regulatory power to stop the acquisition, though a court could. But from all indications, none of the ‘aggrieved’ parties seems inclined to go that far. So Tech Mahindra will go ahead and finish what it started. Hopefully, it will be able to complete its acquisition without more hiccups. And the world will be watching to see if Tech Mahindra removes the Satyam stain on corporate India’s reputation.

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