Strategy Update - Satyam's moment of truth

January 9, 2009

Wednesday morning turned out to be a big shock for the Indian as well as foreign investors. The promoter and Chairman of Satyam Computer Services (Satyam), a company with over 2 Lakh shareholders, publicly admitted the biggest fraud in the history of corporate India. He confessed to the overstatement of the Balance Sheets by over Rs72.31bn. This development follows the failed attempt by Satyam's promoters to merge the former with Maytas Infra Ltd. last month.

The promoter's admission of a fraud in Satyam brought the markets crashing down on Wednesday. The stock ended down 77% and the Sensex by over 7%. Real estate, oil and gas and IT sectors witnessed sharp selling. The Sensex reported the fifth steepest fall in percentage terms.

We believe the ongoing Satyam saga will not only affect the confidence of Indian investors in the stock markets, but will also change the perspective of foreign investors on Indian equities.

Promoter led scams may not be new in the western world, or even in India. However, it is certainly for the first time that it has happened in a company Satyam's size.

The Crisis of Confidence in Corporate Governance and Promoter Integrity, which reared its ugly head in the US at the beginning of this decade (via Enron, WorldCom, Tyco etc.) has, as the decade nears its end, finally landed, that too with a bang, on the Indian shores, via Satyam Computer Services, one of the top Indian IT companies.

Where does an investor go from here? Clearly Satyam was a highly reputed brand, with listings on the Nasdaq and offices practically around the world. While there is enough media coverage on Satyam, we believe the crucial question for investors, both domestic and off-shore is: How will the Satyam crisis impact the overall rating of India's equity markets? The crisis of confidence was apparent the way a number of non-Satyam group stocks were hammered Wednesday.

We are prima facie of the view that **the Satyam crisis will have far reaching implications, going way beyond the IT sector or issues of corporate governance.**

Our prima facie opinions are as follows:

- **FIIs to remain cautious; may pare investments in several leading Indian companies**
- **Other emerging markets to benefit, as capital outflows from Indian equities are just a matter of time** (the Indian rupee INR weakened from Tuesday's close of 48.66/69 per USD to 48.80/81 at close on Wednesday; FII sold equities worth Rs11.11bn ($227mn) on Wednesday in the aftermath of the Satyam fiasco, as per provisional data by BSE and NSE)
- **Risk premium on Indian equities to go up substantially, as does the expected rate of return**
- **As a result, we expect Indian markets to seek lower bottoms, before investors start looking at Indian equities again**
- **Our mid-term outlook on Indian equities therefore remains cautious**
- **Surprise upsides may come from the actions of the Indian regulatory authorities in the fire fighting exercise, as also from the acquisition of Satyam by a suitor, so as to protect to the extent possible, the interests of investors in Satyam who have not yet got the opportunity to exit the stock**

Removal of Satyam from key market indices

In our view, the decision of the BSE and the NSE, to remove Satyam from major indices viz., Sensex, Nifty, BSE 100, 200, 500 and NSE 100, 200, 500 is a step in the right direction and may lead to lower volatility in the markets.

These steps would reduce the impact of any further adverse news and developments in the stock.

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