

Sasken

Rs526
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs15bn; US\$361m

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Result: Q4FY07

Comment: Disappointing quarter; Outlook on product business intact

Last report: 04 April 2007 (Price Rs474; Recommendation: Outperformer)

Key financials

Year to 31 March (Rs m)	Net revenues	yoy change (%)	Net profit	EPS (Rs)	yoy change (%)	PER(x)
2006	3,081	27.4	297	10.6	-21.3	49.4
2007	4,771	54.8	443	15.6	47.0	33.6
2008E	6,422	34.6	743	26.0	66.1	20.2
2009E	7,917	23.3	996	34.9	34.1	15.1

Sasken's Q4FY07 results were disappointing. Revenues grew 3.3% qoq (+5.7% in \$ terms) to Rs1.35bn lower than our expectation of Rs1.43bn. Services revenues (93.6% of total) remained broadly flat at Rs1.27bn (+2.1% qoq in \$ terms) – we expected 6.1% qoq growth – while recently acquired Botnia (~25% of services revenues) witnessed 18% qoq growth in \$ terms, revenues ex Botnia declined sequentially. The margins in services business declined sharply by 220bp to 20.7% due to rupee appreciation, lower utilization and higher proportion of revenues from Botnia, having lower margins. The company expects slower growth in network infrastructure business (40-50% of services revenues), while Botnia and terminal devices business are witnessing good growth. During FY07 services business reported a strong organic growth of 33.5%yoy in \$ terms. Products revenues at Rs87m were in line with our expectations, but the royalty component was below street expectations. Developments on product side during the quarter include two new Design Ins (Lenovo being one of them) and launch of new handsets by NTT DoCoMo carrying Sasken's Multimedia Solution. We have downgraded both revenue and earning estimates for FY08 and FY09 by ~10% to account for rupee appreciation and slower growth in services business. The stock price has gone up by ~10% in April 07 till date. We expect stock to Outperform over 12-18 month horizon as the outlook on growth potential in product business remain intact - Outperformer.

KEY HIGHLIGHTS

□ Muted organic growth in services; Botnia growing better than expectations

Revenues grew 3.3% qoq to Rs1.35bn due to strong growth in products revenue (almost doubled sequentially to Rs87m). Services revenues remained largely flat at Rs1.27bn (-0.2% qoq).

Services revenues grew 2.1% qoq in \$ terms. Botnia (integrated during Q2FY07) grew 18% qoq, while organic revenues declined 2.3% sequentially in \$ terms. The company expects slower growth in network infrastructure business which is 40-50% of services revenues. Nevertheless, terminal equipment manufacturers and handset businesses are growing fast (witnessed double digit growth sequentially during the quarter). Notably, organic business witnessed a strong growth of 33.5% yoy in FY07. In addition, Botnia is also witnessing good growth (grew 18% sequentially during Q4FY07). The company has guided for 1,000 employee addition during FY08.

Revenue from products business grew 110% qoq to Rs87m, in line with our expectations. However, the royalty based revenues of Rs18.7m was below street expectations. During the quarter Sasken reported two Design Ins – One for Application framework with featured phones for Lenovo Mobile and one for Multimedia Subsystem. NTT DoCoMo, Japan has announced a new FOMA P903iX mobile handset developed by Panasonic Mobile Corporation in Japan with Saken's Multimedia Solution; the phone was launched on April 19, 2007.

□ EBITDA margins increased 70bp to 15.5%.

Despite 220bp decline in margins in services business the overall margins increased by 70bp on account of lower losses (at Rs52m v/s Rs96m in last quarter) in products business.

We believe the 220bp decline in EBITDA margins in services business was driven by rupee appreciation, decline in utilization (-210bp qoq to 71.5%) and higher contribution of revenue from low margin Botnia (25% of revenues v/s 21.6% in last quarter) which has also resulted in higher onsite (increased from 34% of revenue in last quarter to 34.8% during the current quarter). Company will be effecting 10-12% offshore wage hike and 4% onsite wage hike during Q1FY08.

Losses in products business at EBITDA level declined to Rs52m from Rs96m in last quarter primarily on strong growth in revenues.

Segmental details

	Q4 FY06	Q1 FY07	Q2 FY07	Q3 FY07	Q4FY07
Revenue (Rs m)	781	911	1,175	1,310	1,354
Services	736	875	1,113	1,269	1,267
Products	44	36	63	42	87
% of total					
Services	94.3	96.1	94.7	96.8	93.6%
Products	5.7	3.9	5.3	3.2	6.4%
EBITDA (Rs m)	105	131	220	194	210
Services	179	202	267	290	262
Products	(74)	(71)	(47)	(96)	(52)
EBITDA margin (%)	13.5	14.3	18.7	14.8	15.5%
Services	24.4	23.1	24.0	22.9	20.7%
Products	-167.9	-198.4	-74.7	-231.5	-60.0%

Source: Company

□ PAT declined qoq despite 8.2% qoq growth in EBITDA on higher depreciation and amortization

PAT declined 1.4% qoq to Rs117m (our estimate was Rs125m) against EBITDA growth of 8.2% qoq on account of higher depreciation and amortization (7.6% of revenues against 4.7% in last quarter), the impact of which was partly offset by higher exchange gains (Rs38.8m against Rs15.9m in last quarter) and lower effective tax rate (18.8% against 22.8% in the last quarter). Depreciation was higher due to new facility on lease and amortization was higher due to beginning of amortization of capitalized cost of E series product.

KEY POINTS

- Sasken added 107 employees taking total employee strength to 3,611 – of which 2,997 are in services, 255 are in products and rest in supports.
- Utilization declined 210bp to 71.5%.
- Attrition declined to 19.6% from 21.3% in the previous quarter.
- Revenue from top 5 clients declined to 75% from 81% in the previous quarter. \$20m+ accounts increased to two from one.
- The company has hedged net forex exposure upto December 2007 at Rs45.88/US \$.

□ Valuations and view

Sasken's Q4FY07 results were disappointing. Revenues grew 3.3% qoq (+5.7% in \$ terms) to Rs1.35bn lower than our expectation of Rs1.43bn. Services revenues (93.6% of total) remained broadly flat at Rs1.27bn (+2.1% qoq in \$ terms) – we expected 6.1% qoq growth – while recently acquired Botnia (25% of services revenues) witnessed 18% qoq growth in \$ terms the revenues declined organically. The margins in services business declined sharply by 220bp to 20.7% due to rupee appreciation and higher proportion of revenues from Botnia having lower margins. The company expects slower growth in network infrastructure business (40-50% of services revenues). During FY07 services business reported a strong organic growth of 33.5%yoy in \$ terms. Products revenues at Rs87m were in line with our expectations, but the royalty component was below street expectations. Developments on product side during the quarter include two new Design Ins (Lenovo being one of them) and launch of new handsets by NTT DoCoMo carrying Sasken's Multimedia Solution.

We have downgraded both revenue and earning estimates for FY08 and FY09 by ~10% to account for rupee appreciation and slower growth in services business. The stock price has gone up by 11% in April 07 till date. We expect stock to Outperform over 12-18 month horizon as the outlook on growth potential in product business remain intact - Outperformer.

Quarterly results

Year to 31 March (Rs m)	Q4 FY06	Q1 FY07	Q2 FY07	Q3 FY07	Q4 FY07	FY 2007	FY 2008E
Sales	781	911	1,175	1,310	1,354	4,771	6,422
Cost of revenue	514	599	709	827	828	2,976	3,841
% of revenue	65.8	65.7	60.3	63.1	61.2	62.4	59.8
R&D	22.3	29.1	42.1	50.3	74.0	195.5	256.9
% of revenue	2.9	3.2	3.6	3.8	5.5	4.1	4.0
Gross Profit	245	284	425	433	452	1,600	2,324
SG&A	139	153	205	239	242	843	1,070
% of revenue	17.9	16.8	17.4	18.3	17.8	17.7	16.7
EBITDA	105	131	220	194	210	758	1,254
Depreciation and Amortization	48	47	56	61	103	267	408
EBIT	57	84	164	133	107	491	846
PBT	73	91	152	154	144	543	903
Tax	11	5	33	35	27	101	160
PAT	63	86	119	119	117	443	743
qoq growth (%)							
Sales	2.8	16.7	29.0	11.5	3.3	0.0	0.0
EBITDA	(13.1)	24.4	68.4	(11.9)	8.2	0.0	0.0
PAT	3316.5	37.6	37.5	(0.1)	(1.4)	0.0	0.0
yoy growth (%)							
Sales	4.7	34.5	36.1	72.5	73.5	54.8	34.6
EBITDA	(26.0)	68.9	23.4	60.5	99.9	57.2	65.5
PAT	(42.6)	81.2	1.8	6352.7	86.3	93.2	67.8
EBITDA margin (%)	13.5	14.3	18.7	14.8	15.5	15.9	19.5
PAT margin (%)	8.1	9.5	10.1	9.1	8.6	9.3	11.6
Tax rate (%)	14.5	5.4	21.9	22.8	18.8	18.5	17.7

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1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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