

Sasken Communication

Ashish Aggarwal

+91 22 67069925

ashish.aggarwal@investsmartindia.com

Sanket Dalvi

+91 22 67069900

sanket.dalvi@investsmartindia.com

Shareholding (%)

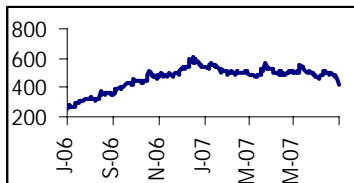
Indian Promoters	21.9
Foreign Promoters	4.5
FII's	17.5
MFs	5.1
Others	51.0

Share price performance

52-week high/low (Rs)	624/253
	-1m -3m -12m
Abs (%)	-11.1 -19.5 65.4
Rel* (%)	-19.7 -32.6 10.7

*to Nifty

Stock chart



Results below expectations; downgrade to 'Sell'

Sasken Communications Technologies Ltd. reported 5.5% and 38.0% sequential decrease in revenue and net profit in Q1FY08 to Rs1.28bn and Rs64mn respectively. However, at EBIT level, the company posted loss of Rs5mn as against a profit of Rs93mn in Q4FY07.

We are reducing FY08E and FY09E EPS estimate by 34.7% and 38.7% to Rs12.0 and Rs23.6 respectively. We are doing this to account for lower royalty revenue in FY08E, lower services revenue, higher taxes and higher amortisation of product development cost.

Currently, the stock is quoting at 35.4x FY08E and 18.0x FY09E earnings. The stock has already fallen more than 10% in the last two trading days. We believe that there is still some downside to the stock, as the current valuation is expensive. Therefore, we downgrade the stock from 'Buy' to 'Sell' with a price target of Rs377, which is 16x FY09E PER.

Key highlights of Q1FY08 results are:

- ▲ **Services revenue fell 5.5% sequentially:** Though the company reported 2% sequential increase in revenue in dollar terms in Q1FY08, due to a rupee appreciation of more than 7%; services revenue fell 5.5% sequentially in rupee terms to Rs1.19bn. The 2% growth (in dollar terms) in services business was driven by 1% volume growth and 1% pricing gains.
- ▲ **Records highest royalty revenue:** Sasken reported royalty revenue of Rs20mn in Q1FY08, highest in its history. License revenue also increased 64.8% QoQ to Rs52mn. However, lower customisation revenue of Rs14mn (as against Rs37mn in Q4FY07) led to 0.8% sequential drop in products revenue. Royalty revenue is expected to increase considerably from the second half of FY08E.

Sell

Rs423

July 24, 2007

Market cap

Rs bn 12

US\$ mn 292

Avg 3m daily volume

216,536

Avg 3m daily value

US\$ mn 3

Shares outstanding (mn)

28

Reuters

SKCT.BO/SASKEN.NS

Bloomberg

SACT IN

Sensex

15,732

Nifty

4,619

Sasken Communication

Table 1. Milestones – targets and status at the end of Q1FY08

	Application frame- work	Wireless protocol stacks- 2.5G	Wireless protocol stacks- 3.0G	Multimedia sub system
No. of platform design-ins as of date	1-Lenovo Mobile (April 07)	5	2	4-5 (April 07)
No. of phone models launched (design-win) as of date	None	None	None	6-8
Tentative phone shipment schedule	Lenovo-First Shipment in Q3/Q4FY08	First Shipment in Q4FY08	Global Tier 1- end Q2FY08/Early Q3FY08, Global Tier 2-Q4FY08	Wistron: Q2FY08 NTT DoCoMo FOMA N902i (NEC): 3 models in FY06 and 1 in FY07 NTT DoCoMo FOMA N903ii (NEC): 1 model in FY07, NTT DoCoMo FOMA N903ix (PMC): April 19 2007 NTT DoCoMo FOMA N904i (NEC): Shipping since May 2007, Global Tier 1: June 2007,
Royalty bearing phone models shipping till date	None	None	None	

Source: IISL research, company

▲ **EBITDA margin decreases by 680bps:** Sasken's EBITDA margin decreased by 680bps on account of:

- Salary hikes
- Rupee appreciation impacting services margin by 500bps
- Higher R&D expenses on account of salary increases in products business and investment in TACO Sasken Automotive Electronics business


Margin in services business decreased 830bps to 12.4%. However, losses in products business reduced further and the company reported an EBITDA loss of Rs40mn in Q1FY08 as against Rs52mn in Q4FY07. The company also incurred a loss of Rs9mn due to its investment in the TACO JV and ConnectM.

▲ **Higher other income propels net income:** Even though Sasken reported a net loss of Rs5mn at the EBIT level, the company posted net income of Rs64mn. This was on account of higher other income, as the company posted forex gains of Rs94.6mn.

▲ **Forecast:** During the last two quarters, Sasken posted low single digit sequential growth in services business, on account of sluggishness in network equipment and semiconductor businesses. Though the company expects sluggishness in NEM space to remain, it believes that the semiconductor business could post moderate growth. However, the company expects major growth in handset and handset integration space going forward.

Sasken Communication

Nevertheless, we are decreasing FY08E and FY09E EPS estimates by 34.7% and 38.7% to Rs12.0 and Rs23.6 respectively. The decrease in estimates is on account of a) lower growth in services business, b) higher tax-rate, c) higher amortisation of product development cost and d) lower royalty revenue. Our estimates imply a two-year EPS growth of 25.4%. In our model, we have assumed that there wouldn't be any net forex gains going forward.

 **Valuation:** Currently, the stock is quoting at 35.4x and 18.0x FY08E and FY09E earnings respectively. The stock has corrected sharply over the last two days on account of lower than expected results. Though the products business is expected to be a major growth driver and is expected to turn profitable in FY09E, we believe that the current valuation takes into account the upside. Therefore, we downgrade the stock from 'Buy' to 'Sell' with a price target of Rs378, which is 16x FY09E earnings. We are also concerned about the low visibility in the products business. However, key risk to our call is higher than expected royalty revenue in products business.

Sasken Communication

Table 2. Quarterly result table

Rs mn	Q1FY08	Q4FY07	QoQ (%)	Q1FY07	YoY (%)
Revenue	1,284	1,354	-5.2%	911	40.9%
Products	87	87	-0.8%	36	140.5%
Services	1,197	1,267	-5.5%	875	36.8%
Cost of revenue	847	839	1.0%	599	41.6%
R&D expense	90	75	20.0%	29	209.2%
Gross Profit	346	440	-21.3%	284	22.1%
GPM	27.0%	32.5%		31.1%	
SG&A	247	244	1.3%	153	61.8%
EBITDA	99	196	-49.4%	131	-39.7%
EBITDA margin	7.7%	14.5%		14.4%	
Depreciation	67	64	4.9%	43	58.0%
Interest	10	11	-3.6%	0	3792.3%
Amortisation	37	39	-3.6%	4	767.1%
Other income	106	47	123.2%	8	1253.8%
PBT	90	130	-30.6%	91	-1.2%
Provision for tax	26	27	-2.6%	5	433.9%
Tax rate	29.3%	20.9%		5.4%	
PAT before exceptional items	64	103	-38.0%	86	-26.2%
NPM	5.0%	7.6%		9.5%	
Exceptional items	-	-		-	
PAT after exceptional items	64	103	-38.0%	86	-26.2%

Source: IISL research, company

Table 3. Forecasts

Rs mn	FY06	FY07	FY08E	FY09E
Net sales	3,081	4,751	5,626	7,117
% change	27.4	54.2	18.4	26.5
Net income	229	441	341	671
% change	0.6	92.6	-20.2	97.0
EPS (Rs.)	8.5	15.8	12.0	23.6
% change	-37.3	85.8	-20.2	97.0
P/E (x)	38.5	28.3	35.4	18.0
ROE (%)	11.3	10.6	7.8	14.1
ROCE (%)	11.8	10.9	6.3	15.7

Source: IISL research, company

IISL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report or may make sale or purchase or other deals in the securities from time to time or may deal in other securities of the companies/ organizations described in this report

Certification of Research Analyst

We, Ashish Aggarwal & Sanket Dalvi, hereby certify that: the views expressed in the attached research report accurately reflect our personal views about Sasken Communication and its securities, and our compensation is not directly or indirectly, related to the specific views or recommendations expressed in the research report.

Disclaimer Clause

This report has been prepared by the Research Department of IL&FS Investsmart Securities Limited (IISL). E*TRADE Financial Corporation holds an equity interest in IISL. E*TRADE and the asterisk logo are registered trademarks of E*TRADE Financial Corporation or its subsidiaries and are used with permission.

The information and opinions contained herein have been compiled or arrived at based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guarantee, representation or warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This report has been produced independently of any company or companies mentioned herein, and forward looking statements, opinions and expectations contained herein are entirely those of IISL and given as part of its normal research activity and not as a Manager or Underwriter of any Offering or as an agent of the subject company (the "Company") or any other person. Accordingly if any such Company should at any time commence an Offering of securities, any decision to invest in any such Offer or invitation to subscribe for or acquire securities of any such Company must be based wholly on the information contained in the Final Prospectus issued or to be issued by any such Company in connection with any such Offer or invitation and not on the contents hereof. This document is for information purposes only and is provided on an "as is" basis. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer, or solicitation of an offer, to buy or sell any securities or other financial instruments. We are not soliciting any action based on this research report.

IISL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of the shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or would subject IISL or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently sent or has reached any individual in such country, the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purpose without prior written approval of IISL.

Foreign currency denominated securities, if any, wherever mentioned are subject to exchange rate fluctuations which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs or GDRs, the values of which are influenced by foreign currencies effectively assume currency risk. Certain transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors.

This research report is for the general information and does not take into account the particular investment objectives, financial situation or needs of any individual customer, and it does not constitute a personalized recommendation of any particular security or investment strategy. Before acting on any advice or recommendation in this research report, a customer should consider whether it is suitable given the customer's particular circumstances and, if necessary, seek professional advice. Certain transactions, including those involving futures, options, and high yield securities, give rise to substantial risk and are not suitable for all investors.

E*TRADE Capital Markets, LLC, E*TRADE Canada Securities Corporation, E*TRADE Securities Limited and E*TRADE Securities (Hong Kong) Limited (together with E*TRADE Financial Corporation and collectively "E*TRADE") do not represent or endorse the accuracy or reliability of any of the information or content of the research report and reliance upon it is at your own risk. E*TRADE expressly disclaims any and all warranties, express or implied, including without limitation warranties of merchantability and fitness for a particular purpose with respect to the research report and any information in it. E*TRADE shall not be liable for any direct, indirect, incidental, punitive or consequential damages of any kind with respect to the research report.

Distribution of this report into the United States is intended to be solely to "major U.S. institutional investors" pursuant to Rule 15a-6 under the U.S. Securities Exchange Act 1934, as amended. All U.S. persons that receive this report, by their acceptance thereof, represent and agree that they are a major U.S. institutional investor and understand the risks associated in executing transactions in securities. U.S. persons wishing to obtain further information or effect transactions in any securities mentioned in the attached report should contact E*TRADE Capital Markets, LLC, 135 East 57th Street, 14th Floor, New York, NY 10022, Telephone Number- 646-840-8730, Fax - 646-840-8701.

Research, analysis, charting, reports, estimates, commentary, information, data, views, opinions, news and other content (collectively, the "Research") provided to you by E*TRADE Canada Securities Corporation ("E*TRADE Canada") is for informational purposes only. The Research provided herein by E*TRADE Canada has been prepared by IISL, but such research has been prepared independently from E*TRADE Canada and its employees. Accordingly, the Research may not have been, and no representation is made that such Research has been, prepared in accordance with Canadian disclosure requirements. Neither the Research nor the profiles of the third party research providers have been endorsed or approved by E*TRADE Canada, and E*TRADE Canada is not responsible for the content thereof or for any third party products or services. Some Research may contain financial information, but nothing in the Research constitutes a recommendation by E*TRADE Canada to buy, sell or hold any security discussed therein, and the Research neither is, nor should it be construed as, an offer or a solicitation of an offer to buy or sell securities by E*TRADE Canada. E*TRADE Canada does not provide investment advice or recommendations of any kind, nor advice regarding the suitability or profitability of any investment. You are fully responsible for any investment decisions that you make and any profits or losses that may result. Any opinions, views, advice, services or other content provided by a third party are solely those of such third party, and E*TRADE Canada neither endorses nor accepts any liability in respect thereof.

E*TRADE Securities Limited is a company registered in Scotland No. SC103238 with its principal place of business at 42nd Floor, One Canada Square, London E14 5AA, United Kingdom. Registered Office: 24 Great King Street, Edinburgh EH3 6QN, United Kingdom. E*TRADE Securities Limited is a member of the London Stock Exchange and is authorised and regulated by the Financial Services Authority.

E*TRADE Securities (Hong Kong) Limited is licensed by the Hong Kong Securities & Futures Commission under Central Entity Number: ACT 764. Registered Office: Suite 2401-12 Two Pacific Place, 88 Queensway, Admiralty, Hong Kong.