

ANALYST MEET NOTE

Share Data

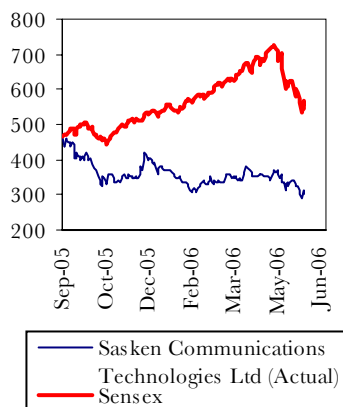
Reuters code	SACT.BO
Bloomberg code	SACT IN
Market cap. (US\$ mn)	166.4

Performance (%)	1m	3m	12m
Absolute	(19)	(11)	-
Relative	6	2	-

Major shareholders (%)

Promoters	26
Non-promoters	6
Foreign	46
Institutions	2
Public & Others	20

Relative performance



Sasken Communications

Not Rated

Price: Rs. 274

BSE Index: 9063

13th June 2006

We attended the Analysts Meet of Sasken Communications. Following are the key takeaways from the meet:

Riding the telecom wave

Sasken is a communication software company with presence in wireless and broadband software space. Their business model is a “hybrid model” which is a mix of software products and services. Services contributed 91% to revenue in FY06 and products contribution was 9%. Some of Sasken’s clients also include Fortune 500 companies such as Nortel, Motorola, Nokia, Intel, Sony, NTT, Texas Instruments, Philips, Hitachi, Toshiba, Sharp, Fujitsu, etc.

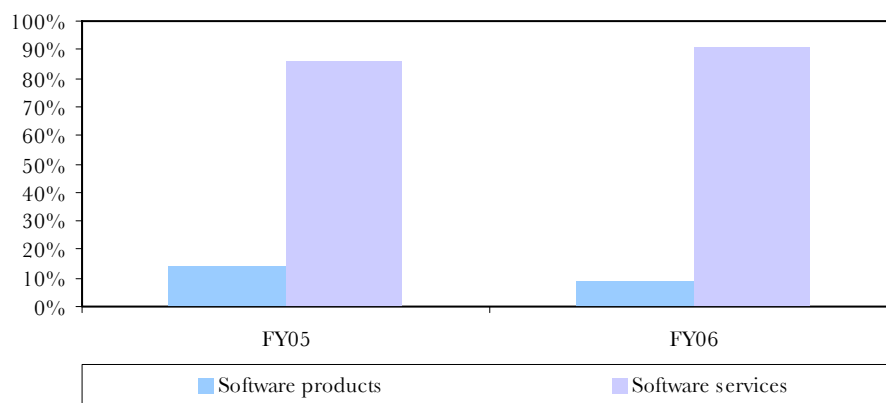
Services

They provide embedded R&D outsourcing services to players across the communication value chain viz. large network equipment manufacturers, semi-conductor vendors and mobile terminal vendors whereas its subsidiaries cater to non-R&D requirements of its clients.

Products

Its products are primarily targeted at the mobile handset space. The three product lines are: Wireless Modem Solutions (Protocol stacks for GSM/GPRS/EDGE and WCDMA based phones). Application Solutions (Multimedia and messaging subsystems for smartphones). Integrated Solutions (full software bundling Sasken and 3rd party components feature phones).

Revenue break-up



Key takeaways from the meeting

Products business still in evolution phase

The products segment is still in the investment mode and royalty based revenue will start flowing in a material way only in FY07 and stabilise the next year. To date, 8+ million phones across 31 models from manufacturers such as NEC, Panasonic, LG, Hitachi have been shipped across the world containing Sasken’s software.

Revenue model and royalty estimates

Sasken's R&D expenditure is on an average US\$ 10 mn per year and it employs around 300 people in its product division and plans to add another 20-30 people in FY07. Sasken is shifting from licence based revenue model to a royalty based revenue in which revenue will be charged on per unit shipped vis-à-vis licence based revenue in which revenue is recognised upfront. Consequently, the proportion of revenues from services has increased from 75% in FY04 to 91% in FY06. Sasken on an average gets a royalty of US\$ 1 per unit.

Market share of 20% by 2009

Sasken has two tier-1 and some 3-4 tier-2 silicon partners as its customers and the addressable market in terms of volume shipped with their software embedded in the handset has been projected at 152m for CY07, 188m for CY08 and 231m for CY09 from its two tier-1 silicon partners but in this market, it again has to face competition from other players like Packet Video, Teleca, Sky Mobile, Pollex, so we cannot fully determine how much of the market would Sasken cater to but it plans to corner a market share of 20% by 2009.

Product portfolio

Complete product range

Sasken has no competitor in products segment in India as entry barriers to enter into such a technologically focused business segment are high. Globally, its competitors are Teleca, Packet Video, Sky Mobile, Pollex, TTP (Recently got acquired by Motorola) but none of these players have as many offerings as Sasken. The product portfolio of Sasken is more dense in terms of its offerings like multimedia codecs, connectivity protocols, stacks, applications etc. Sasken believes that its product portfolio is as of now complete to address the needs of its existing customers but with new technologies emerging, it can add on to its portfolio like it is planning to introduce television broadcast for handsets.

Future of products business

Shelf-life of mobile getting shorter

Sasken believes that there is a huge opportunity for its software as the shelf-life of mobile phones are becoming shorter and there is an increasing pressure on products companies for faster-time to market coupled with the need to introduce new products and new technologies to expand geographic reach. Sasken expects to get a market share of 20% by 2009 as Sasken believes its software has the features to fulfil all the dimensions of user experience viz. sound, sight, touch, mobility.

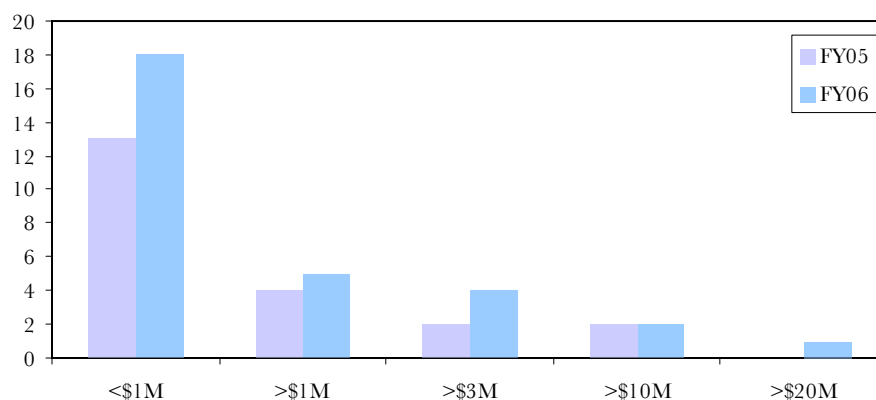
Services segment

Entered into an account of US\$ 20+ mn

Sasken's offerings in this segment are Radio Access Network services, Operations Support Systems (OSS) services and Network Engineering services.

Following its strategy to enter and grow tier-1 accounts across the value chain, Sasken entered four new accounts, scaled two accounts to over US\$ 3+ mn and one account to US\$ 20+ mn in annual revenues last year.

Customer distribution: Revenue-wise



Revenue model

Sasken now realises major portion of its revenue on Time and Material Basis as compared to Fixed Price Basis and its contribution was almost 90% in FY06.

Revenue break-up

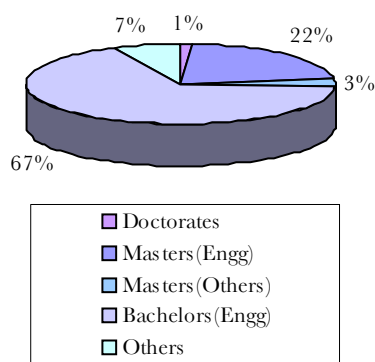
(Rs. mn)	Q1FY05	Q2FY05	Q3FY05	Q4FY05	FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	FY06
Products revenue split										
Licencing	31.5	24.2	28.1	72.4	156.2	23.1	123.9	14.1	20.4	181.5
Royalty	7.7	7.0	9.7	9.7	34.1	10.7	6.8	0.7	9.9	28.1
Customisation	54.2	30.0	41.7	23.1	149.0	20.4	24.5	6.7	14.0	65.6
Services Revenue split										
T&M onsite	108.3	134.7	100.5	120.1	463.6	118.8	143.7	127.0	103.4	492.9
T&M offshore	239.2	286.4	292.8	348.4	1166.7	420.9	484.2	566.3	570.3	2041.7
Fixed price	61.7	107.4	107.0	171.8	448.0	83.5	80.9	44.6	62.7	271.6

Attrition and hiring plans

Attrition rate of Sasken is high (23% in FY06) as compared to other players in the industry like Wipro, Flextronics. It expects to add additional head count of about 700-750 lateral hires in FY07 plus campus freshers. Sasken also has the highest no. of technical professionals (engineers) on its rolls in % terms, given the specialised nature of work done in developing products and delivering services.

Highest % technical professionals

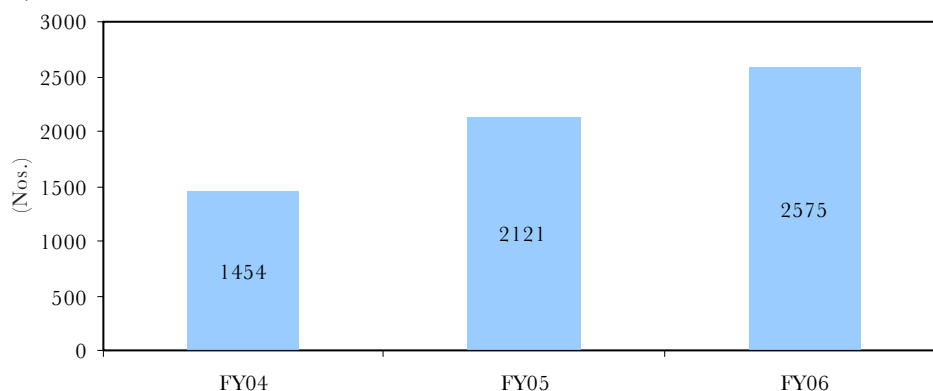
Employee profile (FY06)



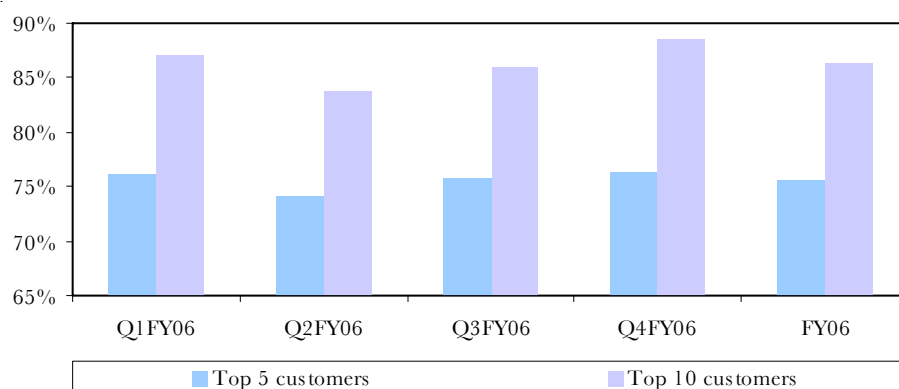
76% of revenue from top 5 customers

Reduced time-to-market products

Consolidated employee strength



Customer concentration



Customer concentration of Sasken is also high and it garners around 86% of its revenue from its top 10 customers and is also reflected in its small no. of absolute clients.

Growth drivers

Indian R&D services market and software product exports is currently valued at US\$ 3.1 bn which is 1.5% of the worldwide market and is expected to post a CAGR of 16% over 2008-10 because of the impetus provided by the strong global demand for embedded software and systems, and the increasing demand for offshore product development.

Over 60% of the world's leading companies including Samsung, TI, Delphi source a part of their embedded system requirements from India whose market is currently valued at US\$ 25 bn and is estimated to post a CAGR of 15%.

Increasing pressure on companies to bring their products faster into the market and to introduce new products and new technologies.

Outlook

Products business of Sasken is still in investment mode and may take another two years to turnaround. Moreover, revenues for products are based on royalties, which are linked to the successes of their customers, thereby exposing Sasken to developments in global market place. Sasken stands to gain on its royalty based revenue only when the handset clicks in the market.

On the services front, Sasken has head-on-competition with an established and large player like Wipro which outperforms Sasken on various parameters, like revenue, productivity and EBITDA margins. Another competitor of Sasken operating in the same domain is Flextronics Software Systems which recently got acquired by KKR, New York-based private equity firm. (The comparison of Sasken with Flextronics is thus done for Q2FY06.)

Comparative financials

	Flextronics	Sasken	Wipro
	Q2FY06	Q4FY06	Q4FY06
Services (% of revenues)	81	94.3	92.7
Products (% of revenues)	15	5.7	
Others (%)	4		7.3
Consolidated			
Revenues (Rs. mn)	1448	781	31130
PAT (Rs. mn)	321	63	6180
Margin (%)	22.1	8.1	19.9
Revenue from top 5 clients (%)	69	76	16
Revenue from top 10 clients (%)	78	89	28.7
Attrition (%)	20	23.3	10
Employees (Nos.)	Approx. 3,500	2,575	32,286

Attrition rate of Sasken is also high and its inability to maintain attrition rates at acceptable levels may prevent the company from sustaining its competitive advantage and might put further pressure on its profit margins. The reason attributed by Sasken for its high attrition level is poaching of its employees by MNC captives. Sasken focuses on high-end tech segments in communication and emerging technologies could lead to obsolescence of its current offerings and moreover, focus on only one vertical makes Sasken vulnerable to any downturn in the telecom industry.

Sasken's products are targeted at 2.5-3G mobile terminals which are yet to see growth. Once the market for such products picks up, we see a good opportunity for the company. 3G handsets account for <10% of total handsets equipments, but with increased technological acceptance, volumes for 3G technology are expected to rise and this would be a positive trigger for Sasken. Sasken estimates the total addressable handsets market size for its products to be 152 mn for CY07 and 188 mn for CY08. Better visibility on products and increasing traction in services is also likely to give a positive impetus to Sasken's earnings.

Valuations

The stock has corrected by 52% from a high of Rs. 575. At the current price of Rs. 274, the stock trades at 30.2x FY06 consolidated EPS.

We do not have a rating on the stock.

Segmental revenues

(Rs. mn)	Q1FY05	Q2FY05	Q3FY05	Q4FY05	FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	FY06
Software Services	409.2	528.5	487.7	609.6	2,034.9	574.4	659.8	680.9	667.3	2,582.4
Software Products	93.4	61.2	79.6	105.2	339.4	54.2	155.2	21.5	44.2	275.1
Network Engg Services	—	—	12.7	30.7	43.4	48.8	48.9	57.0	69.1	223.8
Total	502.6	589.6	580.0	745.5	2,417.7	677.4	863.9	759.4	780.5	3,081.3
PBIT										
Software Services	142.6	226.7	143.0	247.4	759.8	171.3	210.6	259.7	233.3	874.9
Software Products	17.6	(15.1)	(5.9)	44.5	41.1	(15.3)	65.1	(43.1)	(49.1)	(42.4)
Network Engineering Services	—	—	(0.1)	6.1	6.0	27.1	19.1	18.8	20.4	85.4
Total	160.2	211.6	137.0	298.1	806.9	183.1	294.9	235.4	204.6	917.9
Capital Employed										
Software Services	413.3	413.3	402.7	490.1	490.1	947.3	947.3	568.3	703.5	703.5
Software Products	80.7	80.7	94.6	61.2	61.2	172.9	172.9	217.4	274.4	274.4
Network Engineering Services	—	—	23.4	40.7	40.7	69.3	69.3	90.0	107.7	107.7
Total	494.1	494.1	520.7	591.9	591.9	1,189.6	1,189.6	875.7	1,085.6	1,085.6
Unallocable Corp Assets	1,057.2	1,057.2	1,052.4	999.8	999.8	2,827.6	2,827.6	3,116.3	2,938.7	2,938.7
Less: Corp Liabilities	(207.5)	(207.5)	(210.6)	(172.4)	(172.4)	(186.6)	(186.6)	(128.5)	(174.1)	(174.1)
Total	1,343.7	1,343.7	1,362.5	1,419.4	1,419.4	3,830.6	3,830.6	3,863.5	3,850.2	3,850.2

Income statement (Consolidated)

(Rs. mn)	FY02	FY03	FY04	FY05	FY06
Revenues	1,086	1,093	1,661	2,418	3,081
Growth (%)	—	0.6	52.1	45.5	27.4
Cost of revenues	663	650	1,103	1,618	2,017
R&D Expenses	57	12	19	27	152
Gross Profit	366	431	538	773	912
Margin (%)	33.7	39.5	32.4	32.0	29.6
Selling & Marketing	154	206	189	249	211
General & Admn.	300	150	192	310	389
Operating Income	(88)	75	157	214	312
Margin (%)	(8.1)	6.9	9.5	8.8	10.1
Interest	(44)	(36)	(8)	(5)	(1)
Amortisation of non-compete fee	—	—	—	—	(9.4)
Other Income	15	1	13	37	64.1
PBT (before exceptional items)	(117)	40	162	246	365
Exceptional items	—	—	—	—	(68)
PBT	(117)	40	162	246	298
Provision for income taxes	40	28	(21)	17	69
PAT/Net Income	(156)	13	184	228	229
Margin (%)	—	1.2	11.1	9.4	7.4
Growth (%)	—	—	1,344.2	24.2	0.4

Balance Sheet (Consolidated)

(Rs. mn)	FY02	FY03	FY04	FY05	FY06
SOURCES OF FUNDS					
Share Capital	127	127	152	168	279
Share Application	—	164	—	3	—
Reserve & surplus	779	721	986	1,248	3,571
Unsecured Loans	2	0	—	10	—
Secured Loans	352	267	4	5	12
Total Liabilities	1,259	1,280	1,142	1,434	3,862
APPLICATION OF FUNDS					
Gross Block	1,191	1,315	1,360	1,603	1,895
Less: Accumulated Depreciation	410	494	591	733	918
Net Block	781	821	769	870	977
Capital Work in Progress	114	2	12	8	34
Capitalised s/w product cost (net)	96	58	12	—	141
Investments	34	1	26	6	1,865
Current Assets, Loans & Advances					
Inventories	9	25	5	2	33
Sundry Debtors	293	310	337	541	653
Cash and Bank	29	160	27	109	151
Loans and Advances	78	58	157	237	385
Total Current Assets	409	553	526	889	1,223
Less: Current Liabilities and Provisions					
Current Liabilities	135	137	148	254	266
Provisions	39	19	56	84	115
Total Current Liabilities	174	155	203	338	381
Net Current Assets	235	398	323	551	842

Sushil Sharma
sushil.sharma@bksec.com
Tel.: 91-22-4007 6213

Shradha Agrawal
shradha.agarwal@bksec.com
Tel.: 91-22-4007 6223

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B & K SECURITIES INDIA PRIVATE LTD.

Equity Market Division: 12/14, Brady House, 2nd Floor, Veer Nariman Road, Fort, Mumbai-400 001, India. Tel.: 91-22-2289 4000, Fax: 91-22-2287 2767.

Registered Office: Room No. 3/4, 7 Lyons Range, Kolkata-700 001. Tel.: 91-033-2243 7902.

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