

Sasken Communication Technologies

 BSE code: 532663
 NSE code: SASKEN

CMP: Rs 329
Target: Rs 417 ↓

BUY

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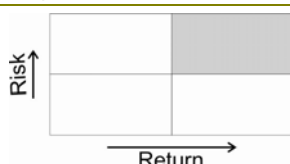
Company data

Particulars	
Market cap (Rs bn / US\$ mn)	9.4 / 239.0
Outstanding equity shares (mn)	28.5
52-week high/low (Rs)	624 / 307
2-month average daily volume	70,203

Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs mn)	4,750.8	6,006.6	7,780.6
Growth (%)	54.2	26.4	29.5
Adj net profit (Rs mn)	441.2	526.7	697.6
Growth (%)	92.5	19.4	32.5
FDEPS (Rs)	15.8	18.4	23.6
Growth (%)	81.7	16.7	28.2
P/E (x)	20.9	17.9	14.0
ROE (%)	10.9	11.8	14.2

Risk-return profile



Shareholding pattern

(%)	Jun-07	Mar-07
Promoters	26.4	26.4
FII's	17.0	17.5
Banks & FIs	12.0	6.9
Public	44.6	49.2

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Sasken	329	(4.0)	(33.7)	(37.7)
Sensex	19,059	22.1	24.5	39.2
BSET	4,712	5.9	(2.8)	(7.1)

 Company website: www.sasken.com

One-off receipt props up growth

Sasken Communication's Q2FY08 operational performance has been much better than expected. Though the volume growth was in line with our estimates, the EBITDA margin expansion and net profit growth was materially above expectations. A one-time receipt of Rs 105mn from a customer, reduction in R&D expenditure for products and higher employee utilisation resulted in an 866bps expansion in the EBITDA margin over Q1FY08. Also, higher-than-expected forex gains enabled the net profit to grow 124% QoQ.

We maintain our revenue and EPS estimates for FY08, but revise our FY09 projections to realign them to our new exchange rate estimates of Rs 39/US\$ (from Rs 40.5/US\$ previously). We reduce our FY09 EPS estimate and target price by 17% and 5% respectively, but maintain our Buy recommendation on the stock.

Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	1,432.3	1,363.8	5.0
EBIDTA	234.6	169.0	38.8
EBITDA margin (%)	16.4	12.4	400bps
PAT	143.3	73.9	93.9
EPS (Rs)	5.0	2.6	93.8

Source: Company, Religare Research

Quarterly results

(Rs mn)	Q2FY08	Q1FY08	% Chg QoQ	Q2FY07	% Chg YoY
Revenue	1,432.3	1,283.7	11.6	1,175.5	21.9
Cost of revenue	896.1	847.4	5.7	708.6	26.5
R&D expenses	50.0	90.0	(44.4)	42.1	18.8
Gross profit	486.2	346.3	40.4	424.8	14.5
SG&A expenses	251.7	247.3	1.8	204.6	23.0
EBITDA	234.6	99.0	136.9	220.2	6.6
Depreciation	67.7	67.3	-	49.4	-
Amortisation	35.5	37.1	-	6.5	-
EBIT	131.4	(5.4)	-	164.2	-
Other income	8.4	11.2	-	27.0	-
Exchange gain/(loss)	70.3	94.6	-	(15.4)	-
Interest expenses	10.1	10.1	-	23.6	-
Profit before taxes	200.0	90.3	121.4	152.2	31.4
Provision for taxes	56.7	26.5	114.0	33.4	70.0
Net profit	143.3	63.9	124.4	118.9	20.5
EPS (Rs)	5.0	2.3	122.9	4.2	19.0

Source: Company, Religare Research

Result highlights

Reasonable volume growth

Sasken's volumes grew by 6.7% QoQ while pricing remained stable as expected. However, the one-time payment of US\$ 2.6mn (Rs 105mn) from a key customer pushed up revenues by 12.8% and 39.5% YoY in dollar terms. Rupee revenues grew at 11.6% YoY after considering the 1.1% currency appreciation. Excluding the one-time receipt of Rs 105mn, rupee revenue growth would have been 3.4%, which is lower than our expectation.

One-time payment shores up margins

The company's operational performance during Q2FY08 has been much better than anticipated. The one-time receipt of Rs 105mn propped up profit margins as it had a direct impact on the bottomline with minimal costs attached. However, in the absence of this one-off item, the operational performance would have been marginally below our expectations.

Substantial margin growth QoQ led by a one-off customer payment and cost efficiencies

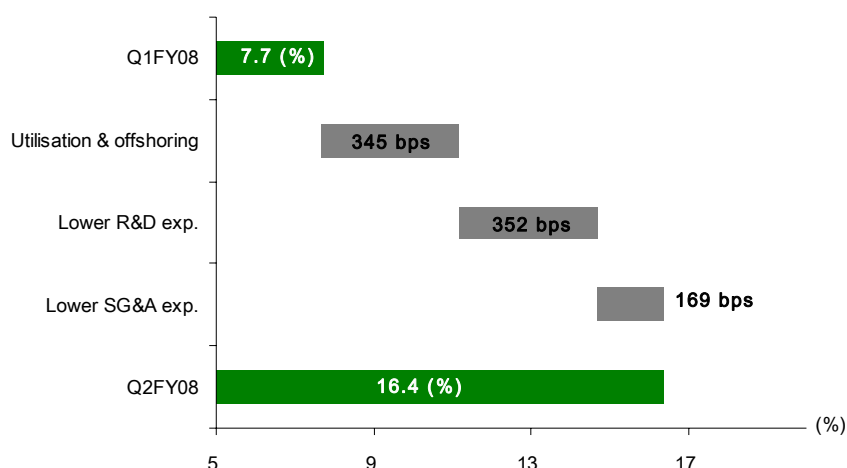
This apart, cost efficiencies from higher utilisation, rationalisation of SG&A expenses and a decrease in R&D expenses resulted in a 137% QoQ growth in operating profit and an 866bps rise in the EBITDA margin. The margin expansion was followed up by forex gains of Rs 70.3mn, which allowed net profit to grow at 124% QoQ, with a margin of 10% as compared to 5% witnessed in Q1FY08.

Profit margin movement

(%)	Q2FY08	Q1FY08	QoQ chg (bps)	Q2FY07	YoY chg (bps)
Gross profit margin	33.9	27.0	697	36.1	(219)
EBITDA margin	16.4	7.7	866	18.7	(235)
EBIT margin	9.2	(0.4)	960	14.0	(480)
Net profit margin	10.0	5.0	503	10.1	(11)

Source: Company, Religare Research

Q2FY08 EBITDA margin expansion



Source: Religare Research

Services grew at 11.2% QoQ, shedding the lethargy seen in the last two quarters

Services pick up to record 11.2% QoQ growth

Helped along by the one-time income, revenues in the services segment recovered from the lethargy witnessed in the previous two quarters to log 12.5% and 11.2% QoQ growth in dollar and rupee terms respectively. The growth came on the back of increased contribution outside of the top 10 clients. These clients (ex-top 10 accounts) grew at 33.5% QoQ as compared to 8.5% growth witnessed in the top 10 group.

Segmental performance

	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08
Revenue (Rs mn)					
Software Services	1,112.9	1,268.6	1,266.7	1,197.2	1,331.7
Growth (%)	27.2	14.0	(0.2)	(5.5)	11.2
Products	62.6	41.6	87.3	86.5	100.5
Growth (%)	73.9	(33.6)	110.0	(0.8)	16.1
EBITDA (Rs mn)					
Software Services	266.9	290.2	262.3	148.6	265.9
Growth (%)	32.0	8.8	(9.6)	(43.3)	78.9
Products	(46.7)	(96.2)	(52.3)	(40.3)	(23.1)
EBITDA margin (%)					
Software Services	24.0	22.9	20.7	12.4	20.0
Products	(74.7)	(231.5)	(60.0)	(46.5)	(23.0)
EBIT margin (%)					
Software Services	20.3	19.0	16.3	7.0	15.3
Products	(87.4)	(244.8)	(76.3)	(92.3)	(63.8)

Source: Company, Religare Research

Royalties in product segment remain low

Dollar and rupee revenues from the product segment grew by 17.4% and 16.1% over Q1FY08 respectively. The royalty revenues decreased by 24% to Rs 15mn in Q2FY08. We believe that royalties for a phone bearing Sasken's application framework that was launched by a tier-1 handset player in Europe have not been booked in the quarter. We thus expect royalty revenues to start flowing in from the next quarter onwards.

Product revenue break-up

(Rs mn)	Q2FY07	Q3FY07	Q4FY07	Q1FY08	Q2FY08
License fees	47.5	27.6	31.8	52.4	65.6
Royalties	12.8	6.7	18.7	19.8	15.0
Customisation	2.2	7.3	36.8	14.3	19.8

Source: Company

8 mobile phone models bearing Sasken's software in shipment; 6 more to be launched in FY08

Product pipeline robust but Lenovo launch delay a concern

The pipeline in the product segment remains robust. Sasken now has eight mobile phone models using its proprietary software products in shipment. The pipeline has grown stronger as the company had two more design-ins in its application framework and protocol stacks modules respectively. The management expects six more mobile phones using Sasken's software to be launched in FY08. At the same time, the launch of Lenovo's phone has been delayed indefinitely, which is a cause for concern.

Management maintains product break-even target for FY08

The management expects the product business to break even at the EBITDA level in FY08 via increased revenues in H2FY08 as well as cost reduction in product expenses. However, considering the rupee appreciation in H1FY08, we believe that break even would be achieved only much later in Q2FY09.

Other highlights

- ❖ The management has maintained its guidance of 20–25% growth in dollar terms in the services business over the annual run rate of US\$ 115mn in Q4FY07.
- ❖ Sasken has made gross employee additions of 476 personnel (143 net) during the quarter taking the total employee count to 3,656.
- ❖ The company has added 9 clients during the quarter taking the total number of active clients on LTM basis to 89.
- ❖ Utilisation levels in the services segment increased to 76.2% from 74.4% in Q2FY07, suggesting that the company is using utilisation as an important lever to maintain margins.
- ❖ Higher offshoring volumes helped Sasken to keep a check on costs and improve margins. Cost of revenue dipped from 66% of revenues in Q1FY08 to 62.6%.
- ❖ Revenue from the North American geography grew by 39.5% QoQ and accounted for 35% of total turnover as compared to 28% in Q1FY08.
- ❖ The company has US\$ 46.6mn in foreign currency hedges at an average rate of Rs 43.7/US\$. These hedges will offer adequate insulation against forex fluctuations for the next two quarters.

Utilisation in services increased 180bps YoY to 76.2%, serving as an important margin lever

Future outlook

The key verticals that Sasken caters to like network equipment manufacturers and the semi-conductor industry continue to witness sluggish growth. The handset industry, on the other hand, is growing at a robust pace due to the introduction of new mobile phones globally. We expect the slow volume growth in the services segment to continue in H2FY08, with further light shed on the demand scenario only in the beginning of FY09. In the product segment we expect the design-in to design-win cycle to remain slow, requiring at least three quarters for a phone to reach from design-in to now-shipping state.

We realign our estimates at Rs 39/US\$

In view of our revised FY09 exchange rate assumption of Rs 39/US\$ for IT services companies (from Rs 40.5/US\$ earlier), we are lowering our FY09 revenue and EPS estimates for Sasken by 3.7% and 17% respectively. The downward EPS revision is higher than that witnessed on an average by our IT services universe due to the company's higher offshoring effort, which limits the natural hedge available.

Revenue and EPS estimates cut by 3.7% and 17% resp. to factor in the stronger rupee

Revised estimates

(Rs mn)	FY08E			FY09E		
	Earlier	Revised	% Chg	Earlier	Revised	% Chg
Revenue	6,006.6	6,006.6	-	8,079.9	7,780.6	(3.7)
EBITDA	986.0	986.0	-	1,490.3	1,317.6	(11.6)
Net profit	526.7	526.7	-	839.6	697.6	(16.9)
EPS (Rs)	18.4	18.4	-	28.4	23.6	(17.0)

Source: Religare Research

Target price reduced; maintain Buy

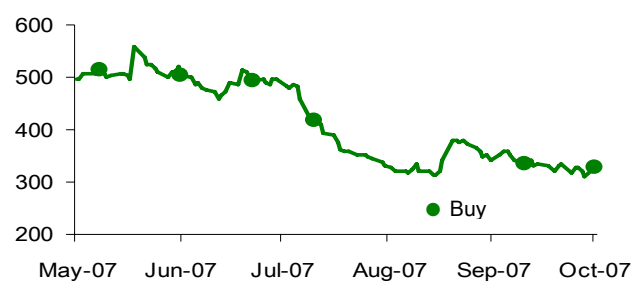
Following the downward revision of our estimates, we are revising our one-year target price for the stock from Rs 440 earlier to Rs 417 now, a reduction of 5.2%. At the current price of Rs 329, Sasken is trading at 17.9x and 14x its expected FY08 and FY09 earnings. We maintain our Buy recommendation on the stock.

Recommendation history

Date	Event	Reco price	Tgt price	Reco
22-May-07	Initiating Coverage	507	647	Buy
18-Jun-07	Company Update	505	647	Buy
09-Jul-07	Sector Update	494	606	Buy
25-Jul-07	Results Update	418	516	Buy
25-Sep-07	Company Update	335	440	Buy
16-Oct-07	Results Update	329	417	Buy

Source: Religare Research

Stock performance



Source: Religare Research

Consolidated financials

Profit and Loss statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Revenues	3,081.3	4,750.8	6,006.6	7,780.6
Growth (%)	27.4	54.2	26.4	29.5
EBITDA	481.8	755.0	986.0	1,317.6
Growth (%)	35.7	56.7	30.6	33.6
Depreciation	179.1	266.4	437.7	449.4
EBIT	302.7	488.5	548.3	868.2
Growth (%)	42.0	61.4	12.2	58.3
Interest	1.4	44.7	44.5	45.8
Other income	64.1	98.0	157.8	29.9
EBT	365.4	541.8	661.7	852.3
Growth (%)	48.9	48.3	22.1	28.8
Tax	68.6	100.6	135.0	154.7
Effective tax rate	18.8	18.6	20.4	18.1
Adj net income	229.1	441.2	526.7	697.6
Growth (%)	0.6	92.5	19.4	32.5
Shares outstanding (mn)	26.4	28.2	29.1	29.9
FDEPS (Rs)	8.7	15.8	18.4	23.6
DPS (Rs)	3.0	4.0	5.0	6.0
CEPS (Rs)	15.4	25.1	33.1	38.4

Source: Company, Religare Research

Cash flow statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Net income	229.1	441.2	526.7	697.6
Depreciation	179.1	266.4	437.7	449.4
Other adjustments	(18.7)	-	1.8	-
Changes in WC	(306.0)	(394.7)	(393.3)	(389.9)
Operating cash flow	83.5	313.0	572.8	757.1
Capital expenditure	(471.9)	(466.7)	(505.0)	(680.0)
Investments	(1,799.5)	1,497.0	-	-
Other investing inc/(exp)	-	(2,035.0)	-	-
Investing cash flow	(2,271.5)	(1,004.6)	(505.0)	(680.0)
Free cash flow	(2,188.0)	(691.7)	67.8	77.1
Issue of equity	2,291.5	112.7	130.5	105.0
Issue/repay debt	(3.1)	904.5	-	-
Dividends paid	(57.6)	(128.3)	(163.7)	(201.8)
Others	-	-	-	-
Financing cash flow	2,230.8	889.0	(33.2)	(96.8)
Beg. cash & cash eq	108.7	151.4	348.8	383.4
Chg in cash & cash eq	42.8	197.3	34.6	(19.7)
Closing cash & cash eq	151.4	348.8	383.4	363.7

Source: Company, Religare Research

Balance sheet

(Rs mn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	151.4	348.8	383.4	363.7
Accounts receivable	652.9	1,108.2	1,462.1	1,723.2
Inventories	33.5	8.0	-	-
Others current assets	385.3	747.0	974.7	1,148.8
Current assets	1,223.1	2,212.0	2,820.2	3,235.7
LT investments	1,865.1	368.1	368.1	368.1
Net fixed assets	1,011.2	2,995.5	3,200.2	3,534.7
CWIP	143.3	339.0	196.9	6.3
Total assets	4,242.7	5,914.6	6,585.3	7,144.8
Payables	266.4	502.1	682.3	804.2
Others	114.6	275.8	275.8	275.8
Current liabilities	381.0	777.9	958.1	1,080.0
LT debt	11.5	916.0	916.0	916.0
Other liabilities	-	3.2	3.2	3.2
Equity capital	279.4	285.0	291.0	299.0
Reserves	3,570.8	3,932.5	4,417.0	4,846.6
Net worth	3,850.2	4,217.5	4,708.0	5,145.6
Total liabilities	4,242.7	5,914.6	6,585.3	7,144.8
BVPS (Rs)	145.6	149.6	161.8	172.1

Source: Company, Religare Research

Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	15.6	15.9	16.4	16.9
EBIT margin (%)	9.8	10.3	9.1	11.2
Net profit margin (%)	7.4	9.3	8.8	9.0
FDEPS growth (%)	(36.1)	81.7	16.7	28.2
Receivables (days)	77.3	85.1	88.8	80.8
Inventory (days)	4.0	0.6	-	-
Payables (days)	31.6	38.6	41.5	37.7
Current ratio (x)	3.2	2.8	2.9	3.0
Interest coverage (x)	213.2	10.9	12.3	19.0
Debt/equity ratio (x)	0.0	0.2	0.2	0.2
ROE (%)	6.0	10.9	11.8	14.2
ROCE (%)	6.0	10.8	10.6	12.7
ROAE (%)	7.1	8.3	8.3	12.2
EV/Sales (x)	3.2	2.1	1.7	1.3
EV/EBITDA (x)	20.6	13.2	10.1	7.5
P/E (x)	38.0	20.9	17.9	14.0
P/BV (x)	2.3	2.2	2.0	1.9
P/CEPS (x)	21.3	13.1	9.9	8.6

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< - 5%	Returns	Absolute
	BUY	SELL		
Mid-caps**	> 25%	< 10%		

**Market cap over US\$ 1bn **Market cap less than US\$ 1bn*

Religare Securities

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