

SASKEN COMMUNICATION TECHNOLOGIES

INR 425

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BUY



Sasken's Q2FY07 results were better than expectations. The services business, in particular, continued its improved performance with Q-o-Q revenue growth of 15.5% on organic basis and 27.2% including acquired revenues from its Botnia acquisition for one month. The company announced two more platform design wins for its products business, one each for its 'M-Series' and 'S-Series' product group. Services EBITDA margin expanded by 90bps Q-o-Q to reach 24%. This was achieved through a combination of billing rate hikes, achieving milestone in fixed-price projects, and some benefit from currency depreciation. We expect 2HFY07E services EBITDA margin to be at 22.3% compared to 23.6% in 1HFY07.

Sasken will report fully consolidated revenues in 2HFY07E from its Finnish Botnia Hightech acquisition. We understand that Botnia's business is growing at a healthy clip of 40% plus for FY07E, with a healthy outlook for FY08E. We also expect the company to have 15 platform design wins compared to 10 currently.

We see strong revenue growth trajectory in the services business and the option value in the products business to lead to the company having premium valuation compared to its peer group. At a P/E of 23.1x and 12.1x and EV/EBITDA of 13.9x and 7.8x for our FY07E and FY08E earnings, respectively, we maintain our 'BUY' recommendation.

Result highlights

- Revenue at INR 1.2 bn was up 29.0% Q-o-Q and 36.1% Y-o-Y. Services revenue showed a strong growth of 27.2% Q-o-Q at INR 1.1 bn (95% of total revenue), while product revenue stood at INR 63 mn, up from INR 36 mn last quarter.
- During the quarter, the company consolidated one month revenues of Botnia Hightech, which boosted the services revenue growth sequentially. On a standalone basis, services revenues showed impressive Q-o-Q growth of 15.5%.
- The company's EBITDA stood at INR 220 mn, up 68.4% Q-o-Q and 23.4% Y-o-Y. The EBITDA margin stood at 18.7%, which is a 440bps increase Q-o-Q. The services EBITDA margin increased from 23.1% to 24.0% Q-o-Q. Positive rupee impact, increase in billing rate, and completion of one of the fixed price contract that was recognized during the quarter led to margin expansion. We believe this (24%) level of margin in the services business is not sustainable. We estimate services business to report EBITDA margin of 22.1% and 22.4% in Q3FY07E and Q4FY07E, respectively.

Financials

Year to March	Q2FY07	Q1FY07	Growth %	Q2FY06	Growth %	FY07E	FY08E
Revenue (INR mn)	1,175	911	29.0	864	36.1	4,980	7,170
EBITDA (INR mn)	220	131	68.4	178	23.4	915	1,653
Net profit (INR mn)	119	86	37.5	117	1.8	516	984
EPS basic (INR)	4.3	3.1	37.5	4.8	(11.9)	18.4	35.0
P/E (x)						23.1	12.1
EV/EBITDA (x)						13.9	7.8
M. cap / Revenue (x)						2.4	1.7

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Market Data

52-week range (INR) : 462 / 240
Share in issue (mn) : 28.0
M cap (INR bn/USD mn) : 11.9 / 264.7
Avg. Daily Vol. BSE ('000) : 111.8

Share Holding Pattern (%)

Promoters : 27.1
MFs, Fls & Banks : 4.3
FIIs : 18.4
Others : 50.2

- ◆ At the operating level, product business continues to be in investment mode with negative EBITDA of INR 47 mn (down from negative INR 71 mn last quarter).
- ◆ The net profit stood at INR 119 mn, against our expectations of INR 95 mn. Higher contribution from Botnia and increased margins in the services business led to higher-than-expected net profit growth.
- ◆ New customer additions were 11 and the total number of active customers now stands at 53.
- ◆ The company incurred a loss INR 15.4 mn due to foreign exchange fluctuations. The current hedge position of the company stands at USD 44 mn.
- ◆ Utilization during the quarter fell from 79.1% to 74.4% Q-o-Q.
- ◆ The company added a gross of 675 (net 476) employees in the current quarter, taking the total headcount to 3,373. The attrition rate stood high at 23.2%, compared to 21.0% in Q1FY07.

*** Strong growth from services business**

Services business reported strong growth of 15.5% Q-o-Q and 42.7% Y-o-Y on an organic basis. Botnia numbers were consolidated for one month (September), which boosted the services revenues growth to 27.2% Q-o-Q. EBITDA margin in the services business increased by 90bps compared to the previous quarter to 24.0% mainly on account of the positive forex impact. Billing rate improvement and completion of fixed-price contract also helped the EBITDA margin to improve. Sasken did well in mining its clients further, with realisation from top 10 clients increasing by 28.7% Q-o-Q and realisations from beyond top 10 clients increasing by 15.8% Q-o-Q. We expect the positive traction to continue going forward.

The company has geography-led and service-led growth drivers ahead. Finland, Mexico, and China centers are at an expansion stage. The Mexico centre achieved break-even in the current quarter and contributed INR 30 mn to revenues. Network OEMs, semi conductor manufacturers and handset manufacturers prefer vendors to have global presence due to high region-specific customization needs. We see scaling in these near shore locations to aid growth and margin sustenance.

Sasken launched its new service offering Test Lab in Q1FY07, which is aimed at 2G/2.5G pre-conformance protocol testing for silicon vendors and terminal device manufacturers. Both silicon vendors and terminal device manufacturers need to go through rigorous pre-conformance testing before their products appear before the accredited bodies. This offering has started contributing revenues and we expect it to contribute to revenue growth and margins in the coming quarters.

*** High growth trajectory in Botnia expected to continue**

Management stated that the growth rate in Botnia is likely to be on similar lines as the one achieved earlier. Over FY04-06, Botnia grew its revenues at a CAGR of 49.6%. The profitability of the operations is likely to be maintained, in our view. The current operating margins of Botnia stand at 21.5%. We expect regular flow of part of existing and new projects to be delivered from offshore. We understand that Botnia will continue to expand its operations and head count in Finland as well, to cater to the healthy demand it is experiencing.

* Product business update

The products business continued to achieve the key milestones set for the second half of the year. During the quarter, Sasken won two more design-ins, one each in 'M-series' and 'E-series'. Now, the company's software stands adopted on ten platforms. We expect this to increase to 15 by the end of the current fiscal. We also expect the company to have 2-3 wins on its 'E-series', which is an integrated product suite bearing twice the royalty rate compared to 'M-series' and 'S-series'. During the quarter, product revenues stood at INR 63 mn, up 73.9% Q-o-Q, but down 59.7% Y-o-Y.

Table 1: Products—Milestone targets and status

Milestones	2.5G	2.5G	3G	3G
	'E-Series'	'M-Series'	'M-Series'	'S-Series'
Identify Lead Semiconductor Partner	Done	Done	Done	Done
Product Demo on lead chipset	Done	Done	Done	Done
First Design In	*	Done	Done	Done
First Design Win	*	*	*	Done
No. of Platform Design-ins as of date	None	4	2	4
No. of Platform Design-wins as of date	None	None	None	2

** not disclosed as it is forward looking*

Source: Company

* Valuations

We see strong revenue growth trajectory in the services business and the option value in the products business to lead to the company having premium valuation compared to its peer group. We expect the company's margin to improve steadily through the forecast period, thus improving the valuations. At a P/E of 23.1x and 12.1x and EV/EBITDA of 13.9x and 7.8x for our FY07E and FY08E earnings, respectively, we maintain our 'BUY' recommendation.

Financials snapshot

Year to March	(INR mn)							
	Q2FY07	Q1FY07	Growth(%)	Q2FY06	Growth(%)	FY06	FY07E	FY08E
Total revenues	1,175	911	29.0	864	36.1	3,081	4,980	7,170
Cost of revenues	709	599	18.4	488	45.1	1,887	3,055	3,937
R & D expenses	42	29	44.7	42	(0.9)	132	146	233
Stock compensation exp	-	-		1	(100.0)	3	-	-
SG & A	205	153	33.9	153	33.4	578	863	1,348
EBITDA	220	131	68.4	178	23.4	482	915	1,653
Depreciation	56	47	19.3	48	16.7	179	253	341
EBIT	164	84	95.8	131	25.8	303	662	1,312
Other income	12	8	48.0	20	(42.7)	64	23	18
Interest expense	24	0	8,961.5	0	8,593.7	1	50	78
Extra-ordinary Exp	-	-		-		68	-	-
PBT	152	91	66.5	150	1.2	298	635	1,252
Tax	33	5	572.4	34	(1.0)	69	119	268
Net profit	119	86	37.5	117	1.8	229	516	984
EPS basic (INR)	4.3	3.1	37.5	4.8	(11.9)	9.1	18.4	35.0
as % of net revenues								
Cost of revenue	60.3	65.7		56.5		61.2	61.4	54.9
SG & A	17.4	16.8		17.8		18.7	17.3	18.8
EBITDA	18.7	14.3		20.7		15.6	18.4	23.1
EBIT	14.0	9.2		15.1		9.8	13.3	18.3
PBT	13.0	10.0		17.4		9.7	12.8	17.5
Net profit	10.1	9.5		13.5		7.4	10.4	13.7
Tax rate	21.9	5.4		22.4		23.0	18.8	21.4

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Sunil Jain	- 2286 4308	Alternative & Quantitative	Ravi Pilani	- 4009 4533
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Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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