Sasken Communication Technologies Ltd.

APRIL 30, 2011 | **RATING CHANGED TO NEUTRAL** | **PRICE Rs.161**

TECHNOLOGY

EARLIER RECO

Reco	Buy
Price	Rs.163
Target	Rs.325
Date	Jan 25, 2011

SHARE HOLDING (%)

Promoters	29.0
FII	6.8
FI / MF	9.8
Body Corporate	10.3
Public & Others	44.1

STOCK DATA

Reuters Code	SKCT.BO
Bloomberg Code	SACT.IN
BSE Code	532663
NSE Symbol	SASKEN
Market Capitalization*	Rs. 4,216 mn US$ 94.7 mn
Shares Outstanding*	26.19 mn
52 Weeks (H/L)	Rs.237 /149
Avg. Daily Volume (6m)	34,672 Shares

Price Performance (%)

1M	3M	6M
1	3	(15)

200 Days EMA: Rs.71

*On fully diluted equity shares

Part of Sushil Classic

ANALYST

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Disappointing Q4FY11 Results

Sasken reported disappointing performance during Q4FY11, on account of a sharp decline in its Revenues from products segment, sluggish business environment in Europe and change in strategy with one of its key customers (Nokia) to migrate its software platform, which had impacted its handset business. During Q4FY11, its consolidated Revenues (including forex gains/losses) declined by 7.6% QoQ & 18.8% YoY to Rs. 1,281.3 mn. Its Revenues from software services segment grew by just 0.3% QoQ, but declined by 23.2% YoY to Rs. 1,051 mn, while Revenues from telecom software products declined by 59.6% QoQ & 12.8% YoY to Rs. 87.3 mn. Its Revenues from network engineering services declined by 2.3% QoQ, but grew by 5.1% YoY to Rs. 113 mn. The employee utilization also fell to 62.1%, while attrition rate remained at an elevated level of 31.4%. However, the company has taken steps to curb the attrition and improve utilization, which is expected to get better gradually during FY12.

EBITDA Margins Drop on Decline in Product Revenues

During Q4FY11, Its consolidated EBITDA (including forex gains/losses) declined by 39.4% QoQ & 46.3% YoY to Rs. 168 mn, while its EBITDA margins fell sharply by 690 bps QoQ & 670 bps YoY to 13.1%. The sequential fall in its margins can be attributed to sharp decline in its high margin products business. However, its consolidated APAT stood at Rs. 187.8 mn, i.e. a growth of 19.4% QoQ and but a decline of 13.9 % YoY. The Company has a healthy balance-sheet with high net cash and cash equivalent in excess of Rs. 1,850 mn (i.e. about Rs. 70 per share) as of March 31st, 2011. Going forward, the management expects its Products business to generate Revenues in the range of USD 1.8-2.0 mn on quarterly basis but considering the uncertain business environment, the management did not provide overall Revenues growth guidance for FY12 but expects its EBITDA margins to be maintained at 18% level.

Nokia's move to Microsoft's Windows Mobile Platform to impact Sasken's Growth

Nokia is the largest customer of Sasken and contributes about USD 25 mn to its annual sales. The recent move of Nokia to transfer 3,000 of its employees to Accenture (by the end of 2011) to work on the Symbian operating system and eventually work on Nokia's implementation of Microsoft's Windows Phone OS is likely to have a negative impact on Sasken's growth going forward. Nokia contributes around 20% of its Revenues and Sasken may witness gradual decline in business from Nokia on the back of above development.

OUTLOOK & VALUATION

Sasken has delivered a muted performance for FY11 and could not meet it revised guidance. During the period, the growth of its software services business was adversely affected, primarily due to shifting of R&D base of some customers at high cost locations to low cost locations along with sluggish business in Europe, especially in countries such as Finland, Denmark & UK. During Q4FY11, Nokia's decision to switch to Microsoft's Windows Phone-7 software from its own Symbian software and a recent deal to outsource its Symbian software to Accenture is going to affect Sasken's future growth.

Considering its FY11 muted performance, the current business situation and uncertainty about Nokia's business, we expect FY12E to remain challenging for Sasken as it has to address the attrition issue along with along with replacing the fall in Nokia's Revenues from growth in the android space / other accounts. Hence, we have reduced our FY12E Revenues & APAT estimates. The CMP of Rs. 161 discounts its FY12E earnings of Rs. 22.7 by 7.1x. Considering the sudden change in the scenario for Sasken, we believe its performance in the coming few quarters might remain muted & the stock may underperform in the interim period. Hence, we change our rating on the stock to Neutral (from Buy) and recommend investors to liquidate their holdings at the current price.

KEY FINANCIALS

Y/E Mar. (Consl)	Revenue (Rs mn)	APAT (Rs mn)	AEPS (Rs)	AEPS (% Ch.)	P/E (x)	ROCE (%)	ROE (%)	P/BV (x)
FY10	5,909.8	755.2	27.9	31.4	5.8	17.1	14.4	0.8
FY11	5,537.9	732.8	28.0	0.5	5.8	18.8	17.2	1.0
FY12E	**5,418.6**	**595.6**	**22.7**	**(18.7)**	**7.1**	**16.6**	**12.9**	**0.9**

QUARTERLY RESULTS (Consolidated)

(Rs.mn)

Y/E March	Q4FY10	Q3FY11	Q4FY11
Total Revenue	**1,578.2**	**1,386.9**	**1,281.3**
% Ch. QoQ	7.0	2.6	(7.6)
Gross Profit	518.7	465.6	358.6
% Ch. QoQ	10.6	4.8	(23.0)
% of STO	32.9	33.6	28.0
SG&A Expenditure	205.8	188.3	190.6
% Ch. QoQ	5.3	(0.8)	1.3
EBITDA	**312.9**	**277.3**	**168.0**
% Ch. QoQ	**14.4**	**8.9**	(39.4)
% of STO	19.8	20.0	13.1
Interest	4.7	2.5	1.9
% Ch. QoQ	(15.3)	(20.6)	(26.2)
Depreciation	67.7	68.0	54.6
% Ch. QoQ	(3.8)	(0.9)	(19.6)
Amortization	16.9	15.2	0.0
% Ch. QoQ	1,200.5	(11.2)	(100.0)
Other Income	**31.7**	**20.4**	36.9
% Ch. QoQ	100.5	(1.3)	80.5
EBTA incl. OI	**255.3**	**212.0**	**148.3**
% Ch. QoQ	20.3	13.7	(30.0)
Tax	37.2	54.7	(39.5)
% of PBT	14.6	25.8	(26.6)
APAT	**218.2**	**157.3**	**187.8**
% Ch. QoQ	27.3	0.1	19.4
Extra ord. Exp/(Inc)	0.0	0.0	0.0
RPAT	**218.2**	**157.3**	**187.8**

PROFIT & LOSS (Consolidated)

(Rs.mn)

Y/E March	FY09	FY10	FY11	FY12E
Total Revenue	**6,551.9**	**5,909.8**	**5,537.9**	**5,418.6**
Soft. Dev. Exp.	4,384.2	3,993.2	3,721.2	3,716.8
% of STO	66.9	67.6	67.2	68.6
Gross Profit	2,167.7	1,916.6	1,816.7	1,701.8
% of STO	33.1	32.4	32.8	31.4
SG&M Exp.	967.7	721.4	774.3	779.5
% of STO	14.8	12.2	14.0	14.4
EBITDA	**1,200.0**	**1,195.2**	**1,042.4**	**922.3**
% Ch. YoY	23.5	(0.4)	(12.8)	(11.5)
% of STO	18.3	20.2	18.8	17.0
Interest	38.2	26.1	11.3	6.1
% of STO	0.6	0.4	0.2	0.1
Depreciation	371.8	295.3	272.5	234.2
% of STO	5.7	5.0	4.9	4.3
Amortization	2.1	21.3	49.1	45.5
% of STO	0.0	0.4	0.9	0.8
Other Income	72.2	76.7	102.6	140.0
% Ch. YoY	33.0	6.3	33.7	36.4
EBTA incl. OI	**860.2**	**929.2**	**812.0**	**776.5**
% Ch. YoY	51.4	8.0	(12.6)	(4.4)
% of STO	13.1	15.7	14.7	14.3
Tax	**285.2**	**174.1**	**79.3**	**180.9**
% of PBT	33.2	18.7	9.8	23.3
APAT	**574.9**	**755.2**	**732.8**	**595.6**
% Ch. YoY	46.0	31.4	(3.0)	(18.7)
Extra ord. Exp/(Inc)	152.0	0.0	0.0	0.0
RPAT	**423.0**	**755.2**	**732.8**	**595.6**
% of STO	6.5	12.8	13.2	11.0

BALANCE SHEET (Consolidated)

(Rs.mn)

As on 31st March	FY09	FY10	FY11	FY12E
Equity Share Capital	271.1	271.1	261.9	261.9
Share Application	27.4	13.2	15.1	0.0
ESOP Outstanding	0.0	39.4	73.2	73.2
Reserves & Surplus	4,530.6	4,912.1	3,915.3	4,296.4
Net worth	**4,829.0**	**5,235.8**	**4,265.4**	**4,631.5**
Total Debt	637.2	340.5	124.9	84.9
Capital Employed	**5,466.2**	**5,576.3**	**4,390.3**	**4,716.4**
Fixed Assets	**3,197.8**	**2,893.0**	**1,340.2**	**1,464.7**
Investments	202.0	1,590.7	1,487.2	1,487.2
Net Deferred Tax	21.7	40.5	82.8	82.8
Sundry Debtors	1,389.7	977.9	970.4	1,018.9
Cash & Bank Bal	1,171.5	373.0	487.5	597.7
Loans & Advances	849.0	844.0	1,073.6	1,181.0
Inventories	10.0	28.5	41.8	43.9
Current Assets	**3,420.2**	**2,223.5**	**2,573.3**	**2,841.5**
Current Liab. & Prov.	1,375.4	1,171.2	1,093.1	1,159.8
Net Current Assets	**2,044.8**	**1,052.2**	**1,480.1**	**1,681.7**
Total Assets	**5,466.2**	**5,576.4**	**4,390.4**	**4,716.4**

Source: Company, Sushil Finance Research Estimates

FINANCIAL RATIOS (Consolidated)

Y/E March	FY09	FY10	FY11	FY12E
Growth (%)				
Net Sales	11.4	(9.8)	(6.3)	(2.2)
APAT	46.0	31.4	(3.0)	(18.7)
EBITDA	23.5	(0.4)	(12.8)	(11.5)
Profitability (%)				
EBITDA Margin	18.3	20.2	18.8	17.0
Adj. PAT Margin	8.8	12.8	13.2	11.0
ROCE	16.4	17.1	18.8	16.6
ROE	8.8	14.4	17.2	12.9
Per Share Data (Rs.)				
Adj. EPS	21.2	27.9	28.0	22.7
Adj. CEPS	29.0	39.5	40.3	33.4
BVPS	178.1	193.1	162.9	176.9
Valuations (X)				
PER	7.6	5.8	5.8	7.1
PEG	0.1	0.2	12.4	(0.4)
P/BV	0.9	0.8	1.0	0.9
EV / EBITDA	3.0	2.3	2.3	2.4
EV / Net sales	0.6	0.5	0.4	0.4
Dividend Yield (%)	2.5	3.7	4.3	4.3
Turnover Days				
Debtors days	71	75	65	67
Creditors days	40	53	45	42

Rating Scale

This is a guide to the rating system used by our Equity Research Team. Our rating system comprises of six rating categories, with a corresponding risk rating.

Risk Rating

Risk Description	Predictability of Earnings / Dividends; Price Volatility
Low Risk	**High predictability / Low volatility**
Medium Risk	**Moderate predictability / volatility**
High Risk	**Low predictability / High volatility**

Total Expected Return Matrix

Rating	Low Risk	Medium Risk	High Risk
Buy	**Over 15 %**	**Over 20%**	**Over 25%**
Accumulate	**10 % to 15 %**	**15% to 20%**	**20% to 25%**
Hold	**0% to 10 %**	**0% to 15%**	**0% to 20%**
Sell	Negative	Negative	Negative
Neutral	Not Applicable	Not Applicable	Not Applicable
Not Rated	Not Applicable	Not Applicable	Not Applicable

Please Note

- Recommendations with “Neutral” Rating imply reversal of our earlier opinion (i.e. Book Profits / Losses).
- ** Indicates that the stock is illiquid With a view to combat the higher acquisition cost for illiquid stocks, we have enhanced our return criteria for such stocks by five percentage points.