Q2 FY07 Analyst/Investor Conference Call
Sasken Communication Technologies Ltd

Date: Tuesday, October 31, 2006
Time: 11.00 AM

Ladies and Gentlemen, good morning to all of you. It is my pleasure to welcome you to the conference call and discuss the financial performance of the Sasken Group for the second quarter and half-year ended September 30, 2006. Firstly, let me wish you all a very Happy Diwali and Eid. Hope you all had a good festive time last week.

Before we begin, we must point out that certain statements made during the call concerning our future growth prospects are forward-looking statements, which involve a number of risks, and uncertainties that could cause actual results to differ materially from those in such forward-looking statements. Risks that could affect our future operating results are more fully described in our prospectus filed with the SEBI. The company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

I am joined on this call by my colleagues, Srikanth Kannankote who has come on board as President and COO joining us from Boston, Dr G Venkatesh, member of the Board of Sasken who is our Head (Products) and Chief Technology Officer, Ms Neeta Revankar, Chief Financial Officer, Mr Kumar Prabhas, President (Services), Swami Krishnan, CMO and Hari Iyer, Culture Officer.

Let me begin by summarizing the results for the second quarter

The consolidated revenues for the quarter ended Sep 30, 2006 stood at Rs 117.55 crore, in comparison to Rs 86.40 crore for the same period last year (Q2 FY06), registering a growth of 36%. The revenue growth on a sequential basis was 29% versus Q1 FY07. These numbers are including the performance of our Finnish acquisition, Botnia Hightech, the financials of which we have consolidated for one month of September 2006. Without Botnia, the Sasken group has consolidated revenues of Rs 107.36 crore for Q2, showing 24% YoY growth and 18% sequential quarter growth.

Organic revenue growth was fuelled by steady growth in volumes and marginal increases in billing rates with one of our customers. The exchange rate was also favourable this quarter contributing to a 1.2% upside.

Looking at the revenue picture for the first six months, we have reported 35% growth over the same period last year. On an organic basis, the growth rate is 29%.

At the Net Profit level, our PAT stood at Rs 11.88 crore, a sequential quarter growth of 37% and a corresponding quarter growth of 2%. PAT for Q2 without including Botnia was slightly higher at Rs 12.01 crore. This is primarily because we had a one-time charge of Rs 1.4 crore paid as transaction fees and processing charges for the debt raised to fund the acquisition. This expense will not recur next quarter.

For the first six months of this year, the Sasken group has delivered a Net Profit of Rs 20.53 crore, a growth of 25% over last year, resulting in an EPS of Rs 7.34/-.

Now, let me take you through the two major segments of our business.

Let me begin with Services, which contributed to 95% of revenues last quarter. The growth momentum here continued. The business delivered 16% sequential quarter growth on an organic basis, and 27%, including Botnia. For the half year, the growth was 43% organic and 57% including Botnia. Over the last two years, our services business has been growing at a CAGR of 63%.

The favourable exchange rate, along with a small drop in average compensation costs, meant that our operating margins in the services business increased to 24% from 23.1% last quarter. This is despite an expected cyclical drop in utilization. Services EBITDA margins have been 23.6% for the first six months, as compared to 20.3% for the same period last year. Botnia in Finland delivered operating margins of 22% for September 2006. Our revenue mix remained predominantly biased towards offshore. For the purposes of ease, we have classified Botnia revenues as Onsite for this quarter, though we are aiming to evolve a better segregation of our delivery locations going forward.

Continuing on locations, our Mexico centre ramped up to 57 people this quarter. The centre also turned profitable for us in Q2. For our China centre, a core team is in place and we expect to grow this centre going forward. In India, we continue to grow in Bangalore, Pune and Chennai.

We have also been aiming to expand our offering portfolio constantly. We recently launched a one-of-its kind pre-conformance protocol-testing offering called the Test Lab. This has starting generating revenues from Q2 onwards.

On Botnia Hightech, we completed the transaction on August 31, 2006. The financials have been consolidated for one month of September 2006. Post obtaining shareholder approval, we have utilized the IPO funds for part-financing the acquisition. The balance was paid through a Euro-denominated debt.

A dedicated integration team, with a full-time integration manager is in place and working on all aspects of the integration. All efforts are proceeding as per plan so far.

The services Tier 1 strategy continues to be focal point for us, and one of our customers has moved to the >3M$ per annum scale for us from Q2.

On the products side, licensing revenues have gone up from the last quarter. We had two design-ins last quarter; one each for our "S-Series", which is our multimedia applications suite, and for our "M-Series", which is our communication / protocol stack offering.

We continue to be on track to achieve milestones in the products business. We expect phones containing Sasken IP, our S-Series to start shipping from November / December 2006. More handsets containing our M-Series and S-Series should start shipping in the Jan/Feb/March quarter.

From a people perspective, we had a net total of 476 people joining us in Q2; 272 of these were due to Botnia. The gross adds were 675, taking our total strength to 3,373 people as on September 30, 2006. We plan to keep the momentum on the recruitment front.

Attrition continues to be an area of focus for us. We had 23.2% attrition last quarter. Management is committed to looking into this and taking the appropriate steps to contain attrition. We are putting in initiatives for increasing touch time, enhancing training, reviewing compensation and performance-based rewards. Indeed with demand forecasts looking robust, we believe that attracting and retaining talent will be our single biggest "key success factor" in the quarters ahead.

We continue to receive encouraging and positive signals from all our customers, especially the Tier-1s and are looking forward to the second half of the year.

Thank you so much for your patient hearing, and my colleagues and I will now be happy to answer any queries that you may have. Also, here's wishing you a Merry Christmas and a very Happy New Year since we will interact on this forum again in January 2007 for our Q3 call. Over to the moderator.

We regret that due to an unforeseen technical glitch, we are unable to reproduce the exact transcript of the Q&A. We have however, reproduced below the salient points of discussion that occurred during the call.

Services Business

Margins: Increase in Q2 largely driven by favorable exchange rate. Marginal improvement in billing rates and small drop in average compensation cost due to freshers intake, countered a drop in utilization. Expect to sustain margins at 22~23% in the near-term, provided exchange rates do not fluctuate too widely.
Volume Growth: Came from all top customers, specifically from our semiconductor and terminal devices customers
Botnia: Had revenues of Rs 10.2 crore for the month of September 2006. The margins were at 22% and the small loss at PAT level was due to one-time loan syndication and processing fee of Rs 1.4 crores, which will not recur. Avenues to improve margins at Botnia are by increasing employee utilization and lab utilization. The strategy on Botnia is led on three axes:

- Growing the existing Tier 1 customer business through greater staffing in Finland
- Cross-selling competencies in Botnia with other customers in the Sasken ecosystem
- Offshoring incremental work from Finland to India / other low cost locations

Mexico Centre: We have ramped up to 57 people. Revenues in Q2 were Rs 31M and it was profitable for the quarter
Test Labs: We currently have one customer and the revenues in Q2 were $135,000
iSoftTech: The revenue for Q2 was Rs 28.05 Million and the centre was profitable
Phase Transition: One of our customers ahs moved to >3M$ pa basis trailing 12 months' revenues
Billing Rates: We had offshore billing rate hike of about 2.8%. We expect low single-digit billing rate increases from our customers
Recruitment: 136 freshers were recruited in Q2. Total Net Adds excluding Botnia were 204 for Q2.
Onsite/Offshore revenue mix - For the current quarter, revenues from Botnia have been classified as onsite revenue. We will revisit the classification by the next quarter
Revenue Growth: Expect to continue services business growth excluding Botnia at industry rates (30~35%) for the full year this year

Products Business

Royalties: In Q2, royalties were almost flat because of the NEC phone shipment volumes tapering off
Shipments: Expect royalty-bearing phones containing S Series (multimedia applications) to start shipping in December 2006. More phones containing S and M Series software will ship in Q4 07/ Q1 08
Sign-ups: Signed up an ODM called Wistron for our S Series, and another ODM/Tier 2 customer for our M-Series

Licensing: Licensing revenues increased in Q2 due to achievement of milestones and accrual of license fees with a Tier 1 semiconductor player, and one more customer
Capitalization: We have capitalized Rs 66M in Q2 towards E Series expenses. This will continue in Q3 and for two months of Q4. We expect to start amortizing from March. We will determine the period of amortization based upon the life span of the product / expected revenues.
E Series: We have proven the solution on two semiconductor platforms. Three handset customers (Tier 2 / ODM) are currently testing the product. We will do a software release to them later in November and if we pass the quality milestones, we will get into commercial discussions. The earliest we can expect to announce a sign-up is in Q4 FY07.
Break Even: Breaking even in Q4 FY07 is subject to sign-up of E Series customers and deriving licensing revenues. If this milestone gets pushed, then we may not be able to break-even in Q4.

Financials

Botnia Funding: Post shareholder approval, re-utilized IPO funds, and took a debt of Euro 13M for the balance
Goodwill: Goodwill on the books is Rs 185 crore. We are examining the accounting standards for treatment, and we will periodically check for impairment of goodwill

HR

Attrition: Attrition has been high. We are working on a plan to implement various measure on increasing touch time, enhancing training, reviewing compensation and performance-based rewards. These will take some time before we see an impact. Attrition is an industry problem that we have to deal with
Recruitment: We have had organic net adds of approx 400 in the first half, and as mentioned in the beginning of the year, we are on track to do about 750~800 organic Net Adds

Others

The strategy on all acquisitions will be driven by the 3Cs approach:
Customer – Whether we get access to Tier 1 customers
Competency – Whether we get enhanced competencies
Co-location – Whether we get significant location advantages through the acquisition

In Botnia's case, it fulfilled all three parameters.