



Q3 FY 11

Earnings Conference Call

January 24, 2011

Members of Nucleus Management

- Mr. Vishnu R Dusad	Managing Director & CEO
- Mr. Niraj Vedwa	Chief Operating Officer
- Mr. Pramod K Sanghi	President Finance & CFO
- Mr. Ravi Verma	President and Head HR

Conference Call Participants

- Mr. Krupal	ICICI Securities
- Mr. Rakesh	Motilal Oswal
- Mr. Ashish	Motilal Oswal
- Mr. Neeraj	Share Khan Securities
- Mr. Anup	SBI Mutual Fund
- Mr. Nijhar	M3 Investments

Nucleus Software Exports Limited

Meenakshi

Thank you Vishwanath. I accord a warm welcome to all of you who have joined us for this investor conference call at Nucleus Software for the quarter and nine months ended December 31, 2010. We have with us today Mr. Vishnu R. Dusad, our CEO and Managing Director; Mr. Niraj Vedwa, our Chief Operating Officer, Mr. Pramod. K. Sanghi, President and Chief Financial Officer; and Mr. Ravi Verma, President and Head HR. We will begin with the opening comments on the performance of the company straight from the CEO, and after that, we will be open for the question and answer session. With this, I hand it over to Vishnu.

Vishnu

Thank you Meenakshi and good afternoon ladies and gentlemen. I am pleased to announce the results for Third Quarter and Nine Month ended December 31st, 2010.

Before I take you through the nos. , I would like to share some important news

- Annual Report of the Company for year ended March 31, 2010 was adjudged as the **BEST under the** Category - Service Sector (Other Than Banking & Insurance) (Turnover Less Than Rs. 500 crore) **of the 'ICAI Awards for Excellence in Financial Reporting'** by the Institute of Chartered Accountants of India (ICAI). **A GOLD SHIELD was awarded to the Company. Nucleus received the Gold Shield for the 3rd consecutive year.**
- South Asian Federation of Accountants (SAFA) adjudged Nucleus' Annual Report as the recipient of the joint first runner's up position for the Best Presented Accounts Award for the year 2009 under the Communication and Information Technology Sector Category.

The awards re-affirm our dedication towards pursuit of excellence, which is just not limited to our products and services but also in our business operations and is a clear testimony of our long standing belief in best corporate practices. This award reinforces our commitment to transparency in our statutory, legal and regulatory requirements and compliance with the accounting and financial reporting practices.

Now I will take you through the numbers.

- **Our Consolidated revenue** is at Rs.68.61 crore against Rs. 68.47 crore in the corresponding quarter previous year.
- **Revenue from product business** for the quarter is at Rs. 51.12 crore, 75% of the total revenue against Rs. 39.69 crore, 58% of the total revenue for the corresponding quarter previous year. This is a yoy growth of 29% and combined with a better order book and positive market conditions is a key highlight of the results
 - **Product revenue from own business**, for the quarter is Rs. 48.83 crore, 71 % of the total revenue against Rs. 35.96 crore 53% of revenue for the corresponding quarter previous year.
 - **Projects and services business revenue** for the quarter is Rs. 17.49 crore, 25% of total revenue against Rs. 28.78 crore, 42% of the revenue for the corresponding quarter previous year. This decline is a matter of concern and while the order book has improved with a large order , we need to move back to positive traction in this line of business .
- **EBITDA** for the quarter is Rs. 10.10 crore, 14.73% of revenue against Rs. 12.24 crore, 17.88 % in the corresponding quarter previous year.
- We continue investing in people and products in selling and marketing expenses. The improvement of the order book is evident and we are simultaneously focusing on completing the product implementation
- **Net profit** for the quarter is Rs.7.71 crore (11% of revenue), against Rs. 9.20 crore (13 % of revenue) in the corresponding quarter previous year.
- **EPS** for the quarter at Rs.2.38 as compared to Rs. 2.84 in the corresponding quarter previous year.
- **For the nine month period, our consolidated revenue from software products and services** is Rs. 204.94 crore against Rs. 219.76 crore for corresponding period last year.
- **Revenue from the product business** for the nine month period is at Rs. 144.65 crore, 71% of the total revenue against Rs. 126.07 crore, 57% of the total revenue for corresponding period last year. There is a YoY growth of 14.73%
 - **Product revenue from own business**, Nucleus IP based business , for the nine month period is Rs. 137.13 crore, 67% of the total revenue against Rs.115.25 crore , 52 % of revenue for corresponding period last year.
 - **Projects and services business revenue** for the nine month period is Rs. 60.29 crore, 29 % of total revenue against Rs. 93.68 crore, 43 % of the revenue for corresponding period last year.

- **EBITDA** for nine month period is Rs. 26.53 crore, 13% of revenue against Rs. 40.22 crore, 18% of revenue in the corresponding period last year. Lower revenue and investments in people, products and sales and marketing have resulted in this decline and management is extremely conscious of the need to achieve better profitability
- **Net profit** for nine month period is Rs. 21.90 crore, 11% of revenue against Rs. 29.21 crore, 13.29% of revenue for corresponding period last year.
- **EPS** for nine month period is at Rs. 6.77 against Rs. 9.02 for corresponding period previous year.
- **Our total Current investments and bank position** is at Rs. 195 crore as on December 31, 2010 against Rs. 184 crore as on September 30, 2010.
- In terms of **manpower**, we are at 1647 as on December 31, 2010 against 1562 as on September 30, 2010.

Sustained improvement in top line and margins remains a challenge and we believe the business environment is conducive for the same. We continue to focus on an IPR led growth and have taken major initiatives to offer best functionalities and technology to our customers. We have been investing substantially into next generation banking products with a vision to deliver higher value to our customers. With newer products and market expansion, we would be able to deliver higher brand value and returns to our stakeholders.

Over to you Pramod.

Pramod

Good afternoon everyone. This is Pramod Sanghi and welcome to the conference call.

- **On a sequential basis, revenues** at Rs. 68.61 crore decreased by 2.26% compared to Rs. 70.19 crore previous quarter.
- **Product revenue** at Rs. 51.11 crore (74.50% of revenue), 1.05 % up against Rs. 50.58 crore (72.07 % of revenue) previous quarter
 - **Traded revenue from products** included in this product revenue is Rs. 2.29 crore against Rs. 1.80 crore previous quarter.
 - **Revenue from own Products** is Rs. 48.82 crore almost flat growth in comparison to previous quarter, Rs. 48.78 crore.
- **Revenue from projects and services** is at Rs. 17.49 crore, 25.50% of revenue against Rs. 19.60 crore, 27.92% of revenue previous quarter.

- **Cost of delivery** is 67.34% of revenue against 63.93 % previous quarter. In the absolute terms it is Rs. 46.20 crore against Rs. 44.88 crore previous qtr. Cost of delivery for the qtr. has increased largely due to increase in personnel cost in delivery.
- For the nine month period, it is Rs. 137.56 crore (67.12% of revenue) against Rs. 148.14 crore (67.41% of revenue) for the corresponding period previous year.
- **Marketing expenses** are at 11.39% of revenue this quarter, against 9.82 % of revenue previous quarter. In absolute terms, this is Rs. 7.81 crore against Rs. 6.90 crore previous qtr.
- For the nine month ended, December 2010, they are Rs. 22.37 crore (10.92% of revenue) against Rs. 17.72 crore (8.06% of revenue) for the corresponding period previous year. The current run rate is reflecting the increased spend on sales and marketing planned this year and we have spoken about in during all our calls.
- **G&A expenses** are at 6.54% of revenue this quarter, against 9.56% of revenue previous quarter. In absolute terms, this is Rs. 4.49 crore against Rs. 6.71 crore previous qtr. There were some provisioning items in the previous quarter and therefore this number has come down. As committed, we have been looking at better controls on the same to improve profitability.
- For the nine month period, they are Rs. 18.48 crore (9.02% of revenue) against Rs. 13.68 crore (6.22% of revenue) for the corresponding period previous year, because of some exceptional items.
- **Total expenses** in the quarter are at Rs. 58.50 crore, similar to Rs. 58.48 crore previous quarter.
- For the nine month period, they are Rs. 178.41 crore against Rs. 179.54 crore for the corresponding period previous year. There is basically no change in expense level, either on a QoQ basis or on a nine month basis. The key remains top line growth for us and while there is inflationary pressure and there is wage inflation happening and increases have take place, we have still been able to keep total expense at a level similar to the previous year.
- **EBITDA** at 14.73% this quarter as compared to 16.69% in the previous quarter. For the nine month period, EBITDA is at 12.95% as compared to 18.30% for the corresponding period previous year.
- Vishnu has already spoken about the investments in people, products and marketing and sales and the need to grow top line from these initiatives.
- **Other income** is at Rs. 2.09 crore against Rs. 2.04 crore previous quarter.

- **There is a very marginal foreign exchange loss** of Rs. 1.56 lakhs against a Rs. 162 lakhs loss previous quarter. Dollar has closed at quarter end at 44.90 at a level similar to September. Today it is running at 45.50 plus, which is a positive but volatility is extremely high and foreign currency management remains a key area for us.

For the nine month period there is a foreign exchange loss of Rs. 19.38 lakhs against Rs. 560 lakhs loss for the corresponding period previous year.

- **Total taxes including withholding taxes** are 22.47% of PBT against 8.23% of PBT last qtr at a group level.
- For the nine month period they are 14.36 % of PBT against 12.11% of PBT in the earlier year . We have been running between 10-15 of PBT on an overall basis.
- **Depreciation** is Rs. 2.24 crore against Rs. 2.37 crore previous quarter. For the nine month period, it is Rs. 7.08 crore against Rs. 8.97 crore for the corresponding period previous year.
- **PAT** is Rs. 7.71 crore, 11.23% of revenue against Rs. 8.90 crore, 12.68 % of revenue previous quarter. For the nine month period, it is Rs. 21.90 crore against Rs. 29.21 crore for the corresponding period previous year.
- In terms of **foreign currency hedges**, we had on Dec 31, USD 12.52 million dollars of forward contracts at an average rate of 46.83. There is a mark-to-market gain of Rs. 149.20 lakhs which is taken to hedging reserve in the balance sheet. As of today we are running a hedge position of USD 14.77 million at an average rate of 46.87.
- With regard to **receivables**, we are at Rs. 37.87 crore against Rs. 40.90 crore previous quarter and the **DSR** as on 31st December is at 50 days against 53 days earlier.
- **Top 5 clients** at 54 % against 57% in the last quarter.
- **The order book position** is Rs. 276.44 crore including Rs. 150.97 crore of products business and Rs. 125.47 crore of projects and services business, against Rs. 199.59 crore last quarter with Rs. 164.14 crore of products and Rs. 35.45 crore of services. Niraj will talk about increase in order book.
- The breakup of cash and cash equivalents is as follows :

Liquid fund schemes of mutual funds is Rs. 62.06 crore and Fixed maturity plans of mutual funds is Rs. 76.55 crore. They are largely upto 90 days and about 10% of the total FMP's are for 180 days. Fixed deposits with banks is Rs. 28.33 crore.

Niraj

Thank you Pramod and good afternoon to everybody. I will talk about 2 areas. One is sales, market development and partner development and the second area I would speak about is the operational efficiency and all the departments involved in the operations.

As we have been mentioning earlier also, we have been investing a lot into sales and marketing in terms of the newer regions and as you have heard from Pramod that the order book position has increased to Rs. 276 crore, so there is a substantial improvement in the order book. This quarter, we have closed 10 new product orders for 34 modules and if you look at the nine month period, we are at 40-product orders for 126 new modules. We added 8 new customers in this quarter for product business and for the 9 months, the new product customers are 31. During the quarter, we gave more than 49 demonstrations of our products in different markets and total number of RFPs that we received and submitted to the customers is 36. For the nine month period, we gave more than 216 demonstrations for our products across the world and total RFPs submitted were 113. This only goes to show that there is a market which is available and there is increased acceptability of Nucleus products in the market, primarily due to our very successful installed base and we feel that we are in a good position to leverage all our strengths to be able to win business in the coming quarters. During the quarter, we also participated in some very large events including SIBOS which is one of the world's premier financial and banking event. We were able to generate more than 50 leads during this summit and the other summit which is the auto finance summit that we participated in.

During the course of the quarter, we implemented 35 product modules, and for the nine month period, we implemented 46 modules across the globe. So whatever orders have been coming are now getting into a full execution mode and we have seen increase in the number of modules that are getting live. We also launched the FinnOne Pro edition and we are now talking to some customers about the implementation plan which is the new service oriented architecture and platform independent version of our product. The first version of the product is now available and discussions with customers have already started for some of the new orders for the implementation. As far as the large markets are concerned, we are following up on a lot of large deals both in Europe as well as in Japan. These are two areas where we are focusing heavily as far as getting large engagements are concerned. We have also put in a very special team to look at these large accounts to be able to generate some substantial business from these accounts. We have taken a number of steps to improve our operational efficiency and as Pramod said that there has been a very strong control and focus on costs. At the same time, we are focusing heavily into the quality to deliver through the new unit that we had created, which is our Delivery Assurance Group, our QA group, our Quality Testing Group and our technology group. There is a very close coordination happening between all those, different divisions within Nucleus, to ensure that we have absolutely impeccable quality delivery to customers and this has already started showing a lot of good results. Having said this, I would now handover to Ravi Verma who will take us through the HR.

Ravi

Q3 has been a quarter for business growth challenges and consolidation. We have continued our focus to manage most of our requirements with the internal resource movements as far as possible and improving productivity of the existing teams. We have also increased our focus on hiring to meet the new business needs as well as to take care of the vacant positions against employee separation. Manpower numbers have therefore been on increase to meet new business needs and have increased from 1562 to 1647. Market conditions are volatile for lateral hiring. However we have been able to meet the increased requirements through lateral hiring and we are focusing on taking freshers through our NSBT (Nucleus School of Banking and Technology) Program. We have already inducted 105 NSBT trained freshers in the IBU in the month of December 2010. We also plan to induct 150 more trained freshers in March this year from the current training batch of NSBT students.

Development and Training focus continued on Product Knowledge, Project Management, Business Analysis and Role realignment of employees. Midterm salary revision was undertaken to correct the compensation of employees based on their skills and product knowledge to bring them in par with the market. Due care was taken to provide an unbiased, fair and equitable distribution to all employees and additional increases were given to star performers and employees with critical skills

We had initiated more measures to improve the productivity of employees. In this regard we have already issued the Project Incentive policy for recognizing the good projects and creating excitement amongst employees to achieve superior project completions on time, on budget and on schedule with high customer satisfaction. Regular communication with employees through open house and through the business HR representatives in the respective IBU's has ensured effective and positive employee engagement levels. Attrition levels were on increase as per the industry trends; however we have been able to meet the business needs by hiring new talents and better utilization of existing resources without impacting business.

Meenakshi

Thank you Ravi and with this we are open for the Q&A session.

Mr. Anup from SBI Mutual Funds

Anup: Good evening sir. I just wanted to get some color on the services business which has seen on some kind of decline for quite some time now. So, if you could just provide some understanding on what could be the reason for the sustained decline and how soon can one expect the segment to start showing some growth?

Niraj: On the services business, primarily our engagements have been with very few customers, and one of them of course is part of our top five and as Pramod had mentioned before, the contribution from the top five customers has gone down to 54%. This is primarily because of the global consolidation where there is a mandate to work with, certain organizations, software companies, which have minimum threshold limit of say 20,000 people or so. So, because of that mandate, our

business has been dropping. However, what we have done is that we have created a team and a strategy to go and win services business across our existing customers and these are in three or four areas. One is application development and maintenance, second is project management, third is testing and fourth is infrastructure services and support. We have more than 20 presentations which have been made to customers over the last couple of months and have started receiving some business now and one of the order that we have got as Pramod had already mentioned has resulted in the order book on services going up to Rs. 125 crore. This order is primarily on account of a large services deal that we have picked up from our customer and the revenues of course will be spread over a 10-year period as we have contracted for a ten year period. We have seen some improvement, in the services side, and our strategy is very straight forward, that we are going to all our existing customers to offer our services and I think this strategy seems to be showing traction.

Anup: - Just to confirm the numbers, the services order book would have gone up from Rs. 35 core at the end of last quarter to Rs. 125 core now.

Niraj That is right.

Anup: On the product side in terms of the average deal sizes or ticket sizes or in terms of the competition, has there been any change in the past three months because of pick-up in demand?

Niraj - As you have seen we have had 40 orders and there is some reduction in the pricing as well as the competitive pressures we were facing in the past, the pricing pressures are not really strong or a very important factor for a decision. Of course, competitive pressures will always remain there in any market, whether market is good or bad, there will always be intense competition from local players as well as from the big players. We continue to manage and we feel is that our new product, the FinnOne Pro would be able to give us a competitive advantage and bring in additional business for us.

Anup: On the attrition side, if you could provide an understanding of what would have been the quarterly annualized attrition and what would have been the magnitude of salary hike that you would have given in the quarter?

Ravi As far as our magnitude is concerned, whatever salary hike has been given, we have been able to absorb it, and as far as attrition is concerned, it is around 22% to 23%.

Neeraj from Sharekhan

Neeraj:

Sir, now in the second quarter, you had spoken that the ACOM new network system has been rolled out. Has that impacted the revenues in any way?

Pramod

I do not think we spoke anything about ACOM network system?

Neeraj:

It is there in the press release I think a quarter back or so, has that impacted the revenues in any way, the top clients in any way?

Pramod

I am sorry, but I am unable to get the connection of any press release talking about ACOM systems by clients' name.

Neeraj:

Anyways has that had any impact on the revenues or no?

Pramod

No, I am unable to understand your question.

Neeraj:

Sir, another question on the G&A. Now, if you see the G&A has been around the Rs. 5.5-6.5 crore, in this quarter it is Rs. 4.5 crore, I just wanted to know why they have come down.

Pramod

As I mentioned that, we did have some provisioning effect in the last quarter which was approximately Rs. 2 crore.

Rakesh from Motilal Oswal

Rakesh:

I would like to know what is the order book position at the end of Quarter three?

Pramod

Order book position is at Rs. 276.44 crore.

Rakesh:

How much is the out of it is for products?

Pramod

Rs. 151 crore is product and Rs. 125 is services.

Rakesh:

There is an increase from the last quarter, by Rs. 35 crore which I suppose is the services order book.

Pramod

That is correct.

Rakesh:

And you have added Rs. 90 crore in services and actually the order book for product has de-grown?

Pramod

That is correct.

Rakesh:

What is the reason for this, Rs. 90 crore, and because this is I suppose the highest services order book I am ever seeing?

Pramod

That is correct and Niraj has already mentioned that we have entered into a ten-year services deal with a customer.

Rakesh:

Ten-year services deal ?

Pramod

We have entered into a ten-year services deal with a new customer.

Rakesh:

One more thing, this 1647 employees that you have mentioned, can you give the breakup in terms of your operations people, those involved in implementation, development, services etc.?

Pramod

We have about 950 people in products and 287 in projects and services.

Rakesh:

These ten new orders which you have booked for this quarter, what will be the monetary value for them?

Pramod

No, we do not give specific value of orders.

Neeraj from Sharekhan.

Neeraj:

Could you comment on the GMAC implementation, how is it going on ?

Niraj

The GMAC implementation is going extremely well and we have currently got multiple implementations happening in parallel. France, Germany, Austria, and Brazil are the countries which are under the final stages of implementation and we expect them to go live by the end of next quarter. We have been receiving very high Voice of Customer satisfaction ratings from them, which are between 9-10 on a scale of 0-10, so we have received a very high Voice of Customer ratings, showing that they are extremely happy with our implementations.

Neeraj:

Where do you see your top five clients, and where do you see their share of revenues settling down, which has been coming down continuously quarter-on-quarter?

Pramod

Over a long-term we are targeting 40%.

Krupal from ICICI Securities.

Krupal

i just wanted to know what is the reason for a drop in the product order book from Rs.164 crore to Rs. 151 crore this quarter?

Pramod

We are implementing projects and revenues keep on getting booked. In some quarters, the product booking would be slightly lower than the revenue. So, there is a decrease in that booking, but I am sure that Niraj will confirm that we will make it up.

Niraj

As I have said before, we have done 34 product module implementations this quarter, which is the highest. There are large number of orders that we have been following up and we are in the final stages of discussions with customers, and we do expect that this quarter we will bring in enough product business.

Krupal

Out of this Rs. 151 crore, how much would be for the next 12 months?

Pramod

We have not determined that number as yet. We will release it a little later.

Krupal

And out of Rs. 125 crore of services revenue, how much would be for next one year?

Pramod

Again, the same answer, Krupal it is like giving guidance.

Obviously, there is a component of regular services which we do, which has always been a part of our order book and there is a component of a larger order which is over a ten year period, but at this stage I cannot disclose any further details.

Krupal

What is the expected tax rate for next year?

Pramod

Next year STPI benefit is getting over and while we will start some operations from our 250-seater SEZ facility coming up at Jaipur, overall, the India tax rate will move to 25% - 30%

Nijhar Handa from M3 Investment.

Nijhar

I just wanted to understand that, your services revenue has declined in the first nine months from say Rs. 94 crore to Rs. 60 crore. Is this due to vendor consolidation in one of the largest Singapore based clients?

Pramod

It is due to some vendor consolidation and it is also due to some large projects getting over.

Nijhar

Is the impact of this largely over in the first nine months, or is there going to be some further impact of these two factors?

Pramod

It has slowed down. For the last quarter, we did 19, and this quarter, we have done 17 and odd whereas earlier the decline was much larger.

Nijhar

Secondly, you mentioned that you want the services business to be roughly 40% of your total revenue?

Pramod

No, we mentioned that we want contribution from top five clients to come to 40%.

Nijhar

But you do not have any targeted mix between products and services?

Pramod

We are comfortable at 65% to 70% product and 30% services, something like that.

Ashish Chopra from Motilal Oswal.

Ashish

I just wanted to know that our cash position currently is very strong at Rs. 195 odd crore. How are we planning to utilize the same?

Vishnu

As we had mentioned earlier, we are looking at to begin with one acquisition and for that we have been exploring few opportunities and as soon as we are able to find a meaningful opportunity, we will put at least part of this cash to use.

Ashish

Any particular targets we have in terms of say a geography or in terms of the size of the acquisition as of now?

Vishnu

Essentially, we are looking at product companies which are either in Europe or developed part of the world and which would complement our product functionality and in the process also create a reach for us.

Meenakshi

Thank you everybody for joining us in this conference call. Thank you.