



Q3 FY 12 Earnings Conference Call January 30, 2012

Members of Nucleus Management

- Mr. Vishnu R Dusad
- Mr. Pramod K Sanghi
- Ms. Viveka Ragukumar
- Mr. Mukesh Batra

Managing Director & CEO
President Finance & CFO
Executive VP, Global Delivery
Senior VP, Product Development &
Management Group

**Meenakshi:**

Thank you, Anchal, and a warm welcome to all of you who have joined us for this Nucleus Software Earnings Conference Call for the quarter and nine months ended December 31st 2011. We have with us today for discussion Mr. Vishnu R. Dusad, our CEO and Managing Director; Mr. Pramod K. Sanghi, President Finance and Chief Financial Officer; Ms. Viveka Ragukumar, who is the Executive VP, Global Delivery and Mr. Mukesh Batra, Senior Vice President, Product Development & Management Group.

As you are aware, we do not provide specific revenue and earnings guidance. Anything said during this call which reflects our outlook for the future or which can be construed as a forward-looking statement must be reviewed in conjunction with the risks that the company faces. We will now begin with the opening comment on the performance of the company straight from the CEO, and post that we will be open to the Q&A session. With this I would like to pass it on to Vishnu.

Vishnu:

Thank you Meenakshi and good afternoon ladies and gentlemen. I am pleased to once again connect with you all at this earnings call for the Third Quarter & Nine Months Ended December 31, 2011.

- Annual Report and Accounts of the Company for year ended March 31, 2011, have been adjudged as the **BEST** under the Category XI – Service Sector (other than financial services sector and transport services (Turn over less than Rs. 500 crore) of the '**ICAI Awards for Excellence in Financial Reporting**'. Nucleus Software has won **GOLD SHIELD** for the fourth consecutive year.
- South Asian Federation of Accountants (SAFA) adjudged Nucleus' Annual Report as the recipient of 'Certificate of Merit' for the Best Presented Accounts and Corporate Governance Disclosures Award 2010 in the category 'Communication & Information Technology'.
- The Company was ranked amongst the Top 5 Companies for Best Corporate Governance Practices in India by IR Global Rankings (IRGR), a comprehensive ranking system for investor relations websites, online annual reports, corporate governance practices and financial disclosure procedures.

The above recognitions are a clear testimony of our commitment to a strong governance philosophy based on trust, accountability and ethics. Our endeavor is not only to comply with the statutory requirements, but also voluntarily formulate and adhere to a set of strong corporate governance practices. Our investors' and customers' trust is extremely valuable to us,



and such recognitions, therefore, endorse our corporate governance framework and practices. We aim to build stronger policies for corporate governance in the years to come and set new milestones for the industry.

- **Our Consolidated revenue** for the quarter is at Rs. 74.00 crore up by 8 % against Rs. 68.61 crore in the corresponding quarter previous year.
- **Revenue from product business** for the quarter is at Rs. 52.33 crore, 71 % of the total revenue against Rs. 51.11 crore, 75 % of the total revenue in the corresponding quarter previous year.
- **Product revenue from own business**, for the quarter is at Rs. 51.07 crore, 69 % of the total revenue against Rs. 48.83 crore, 71 % of total revenue in the corresponding quarter previous year.
- **Projects and services business revenue** for the quarter is at Rs. 21.67 crore, 29 % of total revenue against Rs. 17.49 crore, 26 % of total revenue in the corresponding quarter previous year.
- **EBITDA** for the quarter is at Rs. 10.05 crore, 14 % of total revenue against Rs. 10.10 crore, 15 % of total revenue in the corresponding quarter previous year.
- **Taxes including withholding taxes** are at Rs. 5.51 crore against Rs. 2.23 crore, in the corresponding quarter previous year.
- **Net profit** for the quarter is at Rs. 10.07 crore, 14 % of total revenue, up by 31 % against Rs. 7.71 crore, 11 % of total revenue in the corresponding quarter previous year.
- **EPS** for the quarter is at Rs. 3.11 against Rs. 2.38 in the corresponding quarter previous year.

For the Nine Month period ended December 31, 2011, our consolidated revenue from software products and services is at Rs. 212.19 crore up by 4 % against Rs. 204.94 crore in the corresponding period last year.

- **Revenue from product business** for the nine month period is at Rs. 154.59 crore, 73 % of the total revenue against Rs. 144.65 crore, 71 % of the total revenue in the corresponding period previous year.
- **Product revenue from own business**, for the nine month period is at Rs. 150.71 crore, 71 % of the total revenue against Rs. 137.13 crore, 67 % of total revenue in the corresponding period previous year. This line of business has grown by 10 % on a YoY basis for the nine month period.



- **Projects and services business revenue** for the nine month period is at Rs. 57.60 crore, 27 % of total revenue against Rs. 60.29 crore, 29 % of total revenue in the corresponding period previous year.
- **EBITDA** for the nine month period is at Rs. 26.28 crore, 12 % of revenue against Rs. 26.53 crore, 13% of revenue in the corresponding period previous year.
- **Taxes** including withholding taxes for the nine month period are Rs. 11.83 crore against Rs.3.67 crore, in the corresponding period previous year.
- **Net profit** for the nine month period is at Rs. 26.55 crore, 13 % of total revenue, up by 21% against Rs. 21.90 crore, 11 % of total revenue in the corresponding period previous year.
- **EPS** for the nine month period is at Rs. 8.20 as against Rs. 6.77 in the corresponding period last year.
- **Our total Current investments and bank position** is at Rs. 197.56 crore as on Dec 31, 2011 against Rs. 190.34 crore as on Sep 30, 2011
- In terms of **manpower**, we are at 1677 as on Dec 31, 2011 against 1599 as on Sep 30, 2011.

The new order wins in this quarter coupled with recognition by industry bodies, highlight our leadership position amongst the organizations that offer niche technology solutions to the banking and financial services sector in the industry. We are optimistic about receiving new opportunities from regions across the globe. We will further capitalize our reach in the emerging markets and new services in the coming quarters, with a continued investment in employee engagement.

Now an update on Sales and Markets

We have been continuously investing in sales and marketing in existing and new markets. We have bagged some important orders this quarter based on our strength and ability to innovate and customize products. This quarter, we won 7 new product orders for 22 modules and added 5 new customers. For the nine months, 17 new product orders and 10 new customers have been added for 43 product modules.

During the quarter, we participated in the 8th Annual CEE Retail Banking event held at Budapest. The event provided an insight into banking strategies, potential growth areas and profitability in the CEE region with the best case studies on business strategies and retail banking products in this region. We also attended the Bank 2.0 organized by Computer Sweden and Business World and at Marketforce and the IEA's 14th Annual Conference, Future of Retail Banking.

With this I would hand it over to Pramod for a detail on the numbers.



Pramod:

Good afternoon everyone.

- **On a sequential basis, revenue** for the quarter is at Rs. 74.00 crore, marginally higher than Rs. 73.91 crore previous quarter.
- **Product revenue for the quarter** is at Rs. 52.33 crore, 70.71% of revenue, down by 5.16% against 55.18 crore, 74.65% of revenue, previous quarter.
 - **Revenue from own Products** for the quarter is at Rs. 51.07 crore, 69.01 % of revenue, against Rs. 53.03 crore, 71.75 % of revenue, previous quarter.
- **Revenue from projects and services** for the quarter is at Rs. 21.67 crore, 29.29 % of revenue, up by 15.66 % against Rs. 18.74 crore, 25.35% of revenue, previous quarter.
- **Cost of delivery** including development cost is 68.11% of revenue, 66.90% of revenue in the previous quarter. In absolute terms this is Rs. 50.40 crore against Rs. 49.44 crore previous quarter. For the nine month period, it is Rs. 144.45 crore (68.08% of revenue) against Rs. 137.56 crore (67.12% of revenue) for the corresponding period previous year.
- **Marketing expenses** are at 8.77% of revenue this quarter, against 10.16% of revenue previous quarter. In absolute terms, it is at Rs. 6.49 crore against Rs. 7.51 crore previous quarter. This reduction is largely because the SIBOS event was in the previous quarter. For the nine month period, they are Rs.22.19 crore (10.46% of revenue) against Rs. 22.37 crore (10.92% of revenue) for the corresponding period previous year. On an absolute basis the marketing expense for nine months period are more or less similar to previous year.
- **G&A expenses** are at 9.53% of revenue this quarter, against 8.41% of revenue previous quarter. In absolute terms, it is at Rs. 7.05 crore against Rs. 6.21 crore previous quarter. Increase is largely due to additional conservative provisioning for doubtful debts in this qtr. For the nine month period, they are at Rs. 19.26 crore (9.08% of revenue) against Rs. 18.48 crore (9.02% of revenue) for the corresponding period previous year.
- **Total expenses** for the quarter are at Rs. 63.95 crore, against Rs. 63.16 crore previous quarter. For the nine month period, total expenses are at Rs. 185.90 crore against Rs. 178.41 crore for the corresponding period previous year.
- **EBITDA** is at Rs. 10.05 crore, 13.59% of revenue this quarter, against Rs. 10.75 crore, 14.54 % of revenue previous quarter. There is a reduction of approx. 100 basis points. For the nine month period, EBITDA is at Rs. 26.28 crore, 12.39 % of revenue as compared to Rs. 26.53 crore, 12.95% of revenue for the corresponding period previous year.



- **Depreciation** is at Rs. 1.74 crore against Rs. 1.94 crore previous quarter. For the nine month period, it is Rs. 5.69 crore against Rs. 7.08 crore for the corresponding period previous year.
- **Other income from investments** is at Rs.2.95 crore against Rs. 2.47 crore previous quarter. **Total other Income** is Rs. 3.97 crore against Rs. 3.14 crore last qtr. For the nine month period, **Other income from investments** are at Rs. 8.67 crore against Rs. 5.77 crore for the corresponding period previous year while **total of other income** is Rs. 10.39 crore against Rs. 6.32 crore for the corresponding period previous year.
- **There is a foreign exchange gain** of Rs. 3.29 crore against a gain of Rs. 4.06 crore previous quarter. This is due to translation of net foreign currency denominated current assets at the qtr. end rate of 53.15 Rupees to the US Dollar. This excludes hedging gains or losses which are booked to revenue. Other income figure given earlier excludes foreign exchange gains.
- Dollar closed end of Dec at 53.15, while it was at 48.97 end of Sep 2011, 44.90 at the end of Dec 10.and 44.68 as on March 31, 2011. For the nine month period, there is a foreign exchange gain of Rs. 7.39 crore in Other Income against a loss of Rs. 19.38 lakhs for the corresponding period previous year. There is tremendous volatility in the markets and the rupee is today quoting at 49.60.
- **Total taxes including withholding** are at Rs. 5.51 crore, 35.36% of PBT against Rs. 4.57 crore, 28.52% of PBT previous quarter. For the nine month period, taxes are at Rs. 11.83 crore, 30.82% of PBT against Rs. 3.67 crore, 14.36% of PBT for the corresponding period previous year. This change is due to all STPI units becoming taxable this year from first April.
- **PAT** is at Rs. 10.07 crore for the quarter, 13.60% of revenue against Rs. 11.45 crore, 15.49% of revenue previous quarter. For the nine month period, it is Rs. 26.55 crore, 12.51% of revenue against Rs. 21.90 crore, 10.69% of revenue for the corresponding period previous year.
- In terms of foreign currency hedges, we had on Dec 31, USD 11.75 million dollars of forward contracts at an average rate of 49.45 which are designated as highly probable forecast transactions. There is a mark-to-market loss of Rs. 5.41 crore which is taken to hedging reserve in the balance sheet.
 - Sep 2011 we had a total hedge of USD 12 million at an average rate of 46.91
 - Current hedge position is US \$ 12.75 million at an average rate of 49.73
- With regard to **receivables**, we are at Rs. 38.32 crore against Rs. 40.02 crore previous quarter and the **DSR** as on 31st Dec is at 48 days against 49 days as on Sep 30th, 2011.



- Contribution from **Top 5 clients** at 53% against 47% last quarter.
- **The order book position** is Rs. 266.69 crore including Rs. 119.40 crore of products business and Rs. 147.29 crore of projects and services business, against Rs. 237.25 crore last quarter with Rs. 117.30 crore of products and Rs. 119.95 crore of services. We have booked additional services orders in the US on the client where we are giving services on our SAS model for credit card applications.
- **Total Cash and cash equivalents** are Rs. 197.56 crore against Rs. 190.34 crore as on September 30, 2011. The breakup of cash and cash equivalents is as follows:
 - a. Cash in current accounts of Rs. 27.53 crore
 - b. Liquid fund schemes of mutual funds is Rs. 66.46 crore
 - c. Fixed maturity plans of mutual funds is Rs. 62.65 crore
 - d. Fixed deposits with banks is Rs. 40.92 crore

I will now hand over to Viveka for her comments. Thank you.

Viveka:

Thank you, Pramod, and a very good afternoon to all of you. I will just give a quick update about the delivery.

For the Quarter Ended December 31, 2011 we have implemented 18 product modules across the globe and 78 products for the nine months period ending December 31, 2011. On the development side, the focus has been on process, streamlining the engineering process, bringing in a lot of engineering discipline and scanning the delivery structures to cater to the requirement of our customers.

With respect to Agile, we have completed the Agile training. Around 75% of the delivery organization is aware of Agile process and the training for remaining will be done during the month of February. Almost all of the projects are now in the process of moving into adopting Agile process. Some of them are fully into Agile and the others over a period of time will move into Agile process. This process has been brought in primarily to make sure that we have a clear visibility and we reduce rework percentage, also to increase customer satisfaction. Our VOC team has been doing a great job. They have been going to almost all customers in multiple geographies and getting feedback from them. We have got appreciation from customers regarding the same, they are impressed with the type of questions asked and also the responses that we provide to our customers. We have put in place a separate team with SLAs to respond to the customers on time so that the overall satisfaction level of the customers goes up.

On the services side, we have been offering services around our products to the customers. Now we are planning to enhance it by offering more services to customers around products and also



integrating our products with other products that customers might need as an end-to-end solution for the bank. On the ASP/SAS model, we have also set up the FinnOne core product as the SAS model which can benefit our small and mid-sized customers who are not in a position to buy the complete products by paying the license fee. Then they could use the product on a "Pay as you use" model. This is the update from my side on the delivery front. Thank you so much. Now I would like to now pass it on to Mukesh, who will give you update on the new products.

Mukesh:

Thank you Viveka. Good Afternoon everybody. I will be completing six months in Nucleus soon. It has been very enriching experience so far and I am very excited about our product journey.

We have re-organized our product teams and strengthened our product management function. We have also created working groups spanning across organization functions to stream line feature definition, organization and prioritization process. It is helping us leverage the knowledge and implementation experience from across the organization in a very collaborative way. We have adopted agile methodology for product development and organized our teams into smaller scrum teams. More than 90% of our product teams are trained on agile methodologies now. We did two rounds of development sprints with new methodology and have found it to be very relevant to us. It is helping us improve team productivity and ensuring timely and quality feature deliveries as per the plan. It is also helping us expose any risks earlier in the cycle and enabling to take necessary corrective actions.

We plan to improve our productivity and quality by using the best software development practices and introduction of the state of the art tools to the teams. We have already introduced such tools in the areas of feature management and regression testing automation areas and plan to add more in other areas going forward.

Mr. Dhiraj Sachdev from HSBC

Dhiraj:

Just wanted to understand the last few quarters including this one; there has been a very muted or sluggish revenue growth. Besides, we have also seen a margin correction. Can you just explain what is causing this? Is it pricing pressure, competitive pressure, delays in discretionary spending or higher cost? Can you elaborate and what's the way forward?

Vishnu:

Let me talk about the top line sluggishness. I think one of the clear reason is the uncertainty in the global environment and hence the delays in decisions and that of course resulting into the top line not growing at the pace that it should be. As far as the bottom line is concerned, I think the cost pressure is going to continue to build; there is no debate about that. Only thing is, we need to make sure that the top line grows faster so that we are able to maintain the bottom line and improve it further.



Pramod:

When the top line growth is muted as you say, it was Rs. 64.27 crore 30th June, then we moved up to Rs. 73.92 last quarter and then Rs. 74 crore now. At this level of revenue, the development cost which runs at Rs. 6.5-7 crore a quarter is a constant figure. It doesn't change. We are now going to cut down that. Of course, selling and marketing expense also remains at Rs. 7.5-8 crore range. It just leaves us with G&A expense. Our manpower cost has not changed significantly on a quarter on quarter this year, but yes we do appreciate the point that margins could be better. I think the way out is to get a growth at top line.

Dhiraj:

Can you elaborate whether there is any kind of pricing pressure? What is the kind of licensing booking or what is the kind of volume growth? If you have to break the revenue side, what has been the kind of volume growth or what is the kind of pricing and growth that we are witnessing?

Vishnu:

As far as pricing pressure is concerned, I think it is both ways, in some of the markets which are smaller; there is clearly pricing pressure, no doubt about that. But in some other markets, we are able to get reasonable prices. That is what I would like to say as far as pricing is concerned. Going forward, we do think that pricing will get more aligned with the value add and hence this apparent paradox will go away and if it is a smaller customer we would be able to act as what Viveka has already highlighted. We would be able to offer them pricing on the SAS model and this issue would get addressed in a meaningful manner.

Pramod:

The product order book went down from Rs. 150-160 crore, and it touched Rs. 117 crore in September, which was one of the lowest for years and now it has just about moved up this quarter. Therefore, while revenues in delivery area remain at a steady pace, license revenue definitely moves along with new product order booking. Today we feel that the market is coming back, it has always been there in Southeast Asia and India and Middle East. Middle East of course was muted for about eight, nine months from January onwards with the Arab Spring. Opportunities in Egypt, Morocco, Tunisia and Bahrain definitely got postponed but it seems to be settling down.

Dhiraj:

Can we assume the early signs of revival compared to a couple of last quarter's? Is this sustainable going forward?



Vishnu:

We think so. The only uncertainty lies today is with the currency movement which can be very volatile on a quarter to quarter basis.

Dhiraj:

Just a couple of balance sheet questions. What is the kind of working capital that you are carrying in the balance sheet and cash?

Pramod:

The cash we are carrying is about Rs. 197 crore. Regarding Debtors, we run at about 48-49 days. There is a similar component of income accrued which is not billed but this is an item which keeps on happening every month/quarter as such. Total current assets are Rs. 189 crore excluding investments of Rs. 130 crore and current liabilities are about Rs. 65 crore. Balance sheet remains as it has always been.

Meenakshi:

We would like to thank everybody for joining us in this conference call and would like to pass it on to Vishnu for his closing comments now.

Vishnu:

I would like to take this opportunity to thank you very much for your interest in Nucleus Software and as always we will strive to deliver value to all our stakeholders on an ongoing basis. Thank you very much.