

**NUCLEUS
SOFTWARE**

Q4 & FY 11 Earnings Conference Call May 2, 2011

Members of Nucleus Management

- Mr. Vishnu R Dusad
- Mr. Pramod K Sanghi

Managing Director & CEO
President Finance & CFO

Conference Call Participants

- Mr. Ashish
- Mr. Chandra
- Mr. Nirav
- Mr. Sanjeev
- Mr. Anoop
- Mr. Sharvan

TATA Securities
Equity Master
Share Khan Securities
Share Khan Securities
SBI Mutual Fund
UTI Mutual Fund

Nucleus Software Exports Limited

Meenakshi

Thank you Triveni and a warm welcome to all of you who have joined us for this Nucleus Software Investor Conference Call for the quarter and year ended March 31, 2011. We have with us today Mr. Vishnu R. Dusad, our CEO and Managing Director; and Mr. Pramod K Sanghi, the President Finance and CFO.

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 risk that the Company faces. We will now begin with the opening comments on the performance of the Company straight from the CEO, and post that, we will be open for the Q&A session. With this, I would like to hand it over to Vishnu.

Vishnu

Thank you Meenakshi and good afternoon ladies and gentlemen. I am pleased to announce the results for fourth quarter and year ended March 31, 2011.

Before I take you through the nos. , I would like to share some of the accolades that we have won during the year.

- **Forrester** recognized Nucleus as a “**Global Pursuer**” and stated it “**regained traction in 2010**”. Based on the number of deals and regions covered, Nucleus was ranked among top Banking Platform providers.
- Nucleus Software’s FinnOne™ ranked for the third consecutive year as the ‘**World's No 1 Selling Lending Software product**’ (for year 2010) by IBS Publishing.
- Annual Report and Accounts of Nucleus Software for year ended March 31, 2010 have been adjudged as the **BEST under Category VII- 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 has received the Gold Shield for the 3rd consecutive year.**
- **South Asian Federation of Accountants (SAFA)** has adjudged Nucleus’ Annual Report as the recipient of the joint first runner’s up position for the Best Presented Accounts and

Corporate Governance Disclosures Award 2009 under the Communication and Information Technology Sector Category.

- HDFC Bank, Nucleus Software customer, won the prestigious **Celent 2010 Model Bank Award** for its loan origination system, FinnOne™.

Our IPR led strategy and focus on creation of best in class products has positioned us with a high brand equity and our customer focused approach has led to high customer satisfaction levels. This award is a testimony to our commitment to innovation and co-creating value for our customers.

Now I will take you through the numbers, first the quarterly figures.

- **Our Consolidated revenue** is at Rs.65.54 crore against Rs. 72.25 crore in the corresponding quarter previous year.
- **Revenue from product business** for the quarter is at Rs. 48.92 crore, 75% of the total revenue against Rs. 48.11 crore, 67% of the total revenue in the corresponding quarter previous year.
 - **Product revenue from own business**, for the quarter is Rs. 44.20 crore, 67% of the total revenue against Rs. 36.11 crore 50% of total revenue in the corresponding quarter previous year. This momentum continues.
 - **Projects and services business revenue** for the quarter is Rs. 16.62 crore, 25% of total revenue against Rs. 24.15 crore, 33% of total revenue in the corresponding quarter previous year. This line of business has declined substantially.
- **EBITDA** for the quarter is Rs. 3.95 crore, 6% of total revenue against Rs. 13.83 crore, 19% of total revenue in the corresponding quarter previous year. We continue investing in product development and in markets.
- **Net profit** for the quarter is Rs.4.44 crore, 7% of total revenue, against Rs. 9.19 crore 13 % of total revenue in the corresponding quarter previous year.
- **EPS** for the quarter at Rs.1.37 as against Rs. 2.84 in the corresponding quarter previous year.

For the Year, our consolidated revenue from software products and services is Rs. 270.48 crore against Rs. 291.78 crore in the previous year.

- **Revenue from the product business** for the year is at Rs. 193.57 crore, 72% of the total revenue against Rs. 173.95 crore, 60% of the total revenue previous year. This has grown 11.28 %
- **Product revenue from own business**, Nucleus IP based business , for the year is Rs. 181.33 crore, 67% of the total revenue against Rs.151.12 crore , 52 % of total revenue previous year. This has also grown 20 %
- **Projects and services business revenue** for the year is Rs. 76.91 crore, 28 % of total revenue against Rs. 117.83 crore, 40 % of the total revenue previous year. This has declined 35%. These details clearly show that while the Product business has shown traction during the years, the projects and services business has declined by a far larger number and overall top line has fallen. For the company overall revenue growth is critical and we are conscious of the need to achieve the same.
- **EBITDA** for year is Rs. 30.48 crore, 11% of total revenue against Rs. 54.08 crore, 19% of total revenue previous year. Lower revenue and investments in people, products and sales and marketing have resulted in this decline. Overall expense remains under control though there is continued pressure on employee remuneration.
- **Net profit** for the year is Rs. 26.34 crore, 10% of total revenue against Rs. 38.40 crore, 13% of total revenue previous year.
- **EPS** for year is at Rs. 8.13 against Rs. 11.86 for previous year.
- **Our total Current investments and bank position** is at Rs. 188 crore as on March 31, 2011 against Rs. 162.40 crore as on March 31, 2010
- In terms of **manpower**, we are at 1720 as on March 31, 2011 against 1647 as on December 31, 2011.

Now an update on sales, market development, partner development and operational efficiency.

This year has been full of achievements, with various accolades and awards, highest no. of product order wins and orders from all across the globe. They have been from North Africa and the Mediterranean region, America, Europe, Australia and Middle East. This quarter, we have closed 11 new product orders for 37 modules and if you look at the twelve month period, we are at 48 product orders for 155 new modules. We added 6 new customers in this quarter and for the 12 months, the new customers are 32. During the quarter, we gave more than 69 demonstrations of our products in different markets and total number of RFPs that we received and submitted to the customers is 45. For the twelve month period, we gave more than 285 demonstrations for our products across the world and total RFPs submitted were 158. During

the course of the quarter, we implemented 15 product modules, and for the twelve month period, we implemented 61 modules across the globe. We have been investing a lot into sales and marketing in terms of the newer regions. During the year, we also launched the FinnOne Pro edition. As updated to you last quarter, the first version of the product is now available.

Both Europe and North America are a sharper focus for us now. We are also looking at tying up with larger Companies especially in Europe for a better access to the markets. Product environment is good; there is a market which is available with increased acceptability of Nucleus products, primarily due to our very successful installed base. We feel that we are in a good position to leverage our strength to be able to win business in the coming quarters. We wish to lay additional focus on deeper penetration of our products with the existing customers. Acquisitions is still a focus area for us and we wish to start with a smaller acquisition first.

As an IPR-led company we continue to focus on aligning our intellectual capital to the dynamic banking business requirement and being a trusted partner of choice for our clients to capitalize on opportunities arising out of new market trends. With a strong business traction in place, we will continue to generate new business from both existing customers and new customers and new markets.

Our globally recognized services and solutions are well suited to help our customers in the financial services sector. We are glad to mention that in most cases our offerings have exceeded customer expectations around the world to be able to enhance our business further; we will continue to invest in research and innovation to maximize the value delivered to our clients.

Over to Pramod Sanghi, our President Finance and CFO.

Pramod

Thank you Vishnu and good afternoon everyone. We will talk about the sequential numbers first.

- **On a sequential basis, revenues** for the quarter at Rs. 65.54 crore lower by 4.46% against Rs. 68.61 crore previous quarter.
- Total Revenue for the year is Rs. 270.48 crore 7.30% lower than Rs. 291.78 crore previous year.
- **Product revenue** at Rs. 48.93 crore for the quarter, decreased by 4.28 % against Rs. 51.11 crore previous quarter.

- **Traded revenue from products** included in this product revenue is Rs. 4.73 crore for the quarter, against Rs. 2.29 crore previous quarter.
- **Revenue from own Products** is Rs. 44.20 crore for the quarter, against Rs. 48.82 crore previous quarter.
- Product Revenue for the year Rs. 193.57 crore (71.57 % of revenue) increased by 11.28% against Rs. 173.95 crore (59.62% of revenue) previous year.
- For the year Traded revenue from products Rs. 12.24 crore (4.53% of revenue) against Rs. 22.83 crore (7.82% of revenue) previous year.
- **For the year revenue from own products is Rs. 181.33** crore (67.04% of revenue) against Rs. 151.12 crore (51.79% of revenue) previous year. This has grown by 20% over previous year
- **Revenue from projects and services** is at Rs. 16.62 crore, (25.35% of revenue) against Rs. 17.49 crore, (25.50% of revenue) previous quarter.
- Projects and Services Revenue for the year is Rs. 76.91 crore (28.43% of revenue) against Rs. 117.83 crore (40.83% of revenue) previous year. This has fallen by Rs. 41 crore, 35% and is the primary reason for the decline in top line.
- **Cost of delivery** is 69.94 % of revenue, largely flat, at 67.33 % previous quarter. In absolute terms this is Rs. 45.84 crore against Rs. 46.20 crore previous quarter.
- **For the year**, it is Rs. 183.40 crore (67.81% of revenue) against Rs. 196.16 crore (67.23% of revenue) previous year. This includes development cost in both the years. With fall in top line, development cost absorption is on a lower base and results in a lower margin.
- **Marketing expenses** are at 11.96% of revenue this quarter, against 11.39 % of revenue previous quarter. In absolute terms, this is Rs. 7.84 crore against Rs. 7.81 crore previous quarter.
- For the year, they are Rs. 30.21 crore (11.17% of revenue) against Rs. 22.67 crore (7.77% of revenue) previous year. The run rate is reflecting the increased spend on sales and marketing that was planned for the year.
- **G&A expenses** are at 12.07% of revenue this quarter, against 6.54% of revenue previous quarter. In absolute terms, this is Rs. 7.91 crore against Rs. 4.49 crore previous quarter.
- For the year, they are Rs. 26.38 crore (9.75% of revenue) against Rs. 18.87 crore (6.47% of revenue) previous year. G&A expenses include provisioning of Rs. 4.02 crore against Rs. 1.52 crore in the previous year

- **Total expenses** for the quarter are at Rs. 61.59 crore, against Rs. 58.50 crore previous quarters.
- **For the year**, they are Rs. 239.99 crore against Rs. 237.70 crore previous year.
- **EBITDA** is Rs. 3.95 crore, 6.03% this quarter as compared to Rs. 10.10 crore, 14.73% in the previous quarter.
- For the year, EBITDA at Rs. 30.48 crore is at 11.27% as compared to Rs. 54.08 crore 18.53% for the previous year.
- **Other income from investments** is at Rs. 3.08 crore against Rs. 2.09 crore previous quarter.
- **For the year it is Rs. 9.40** crore against Rs. 9.62 crore previous year.
- **There is a foreign exchange loss** of Rs. 0.54 crore against a Rs. 0.02 crore loss previous quarter.
- For the year there is a foreign exchange loss of Rs. 0.74 crore against Rs. 8.03 crore loss previous year. Dollar has closed March at 44.68. It had closed at 44.89 in Dec'10 and was at 44.91 March 2010
- **Withholding taxes** are at Rs. 1.21 crore against Rs. 1.07 crore last quarter.
- For the year, they are Rs. 2.69 crore against Rs. 0.43 crore previous year.
- **Total taxes including withholding taxes for the quarter** are negative at Rs. 0.14 crore, a negative of 3.37% of PBT against Rs. 2.23 crore, 22.47% of PBT last quarter.
- For the year they are Rs. 3.53 crore, 11.81 % of PBT against Rs. 5.94 crore, 13.39% of PBT previous year.
- **Depreciation** is at Rs. 2.20 crore against Rs. 2.24 crore previous quarter.
- For the year, it is Rs. 9.28 crore against Rs. 11.33 crore for the previous year.
- **PAT** is Rs.4.44 crore for the quarter, 6.77% of revenue against Rs. 7.71 crore, 11.23 % of revenue previous quarter.
- For the year, it is Rs. 26.34 crore against Rs. 38.40 crore previous year.

The reasons for decline in margins are:

- a) Reduction in top line primarily due to reduction in projects and services business.
 - b) The product business, while growing, requiring investments in development and marketing.
 - c) Provisioning for doubtful debts Rs. 4.02 crore against Rs. 1.52 crore in the previous year which is not a normal incidence.
 - d) Under utilization of infrastructure and manpower.
- In terms of **foreign currency hedges**, we had on Mar 31, USD 13.75 million dollars of forward contracts at an average rate of 46.73 which are designated as highly probable forecast transactions. There is a mark-to-market gain of Rs. 161.80 lakhs which is taken to hedging reserve in the balance sheet. We do not have any option outstanding as on Mar 31, 2011.
- Dec 2010 we had a total hedge of USD 12.52 million.
 - Current hedge position is US \$ 14.00 million at an average rate of 46.76.
- With regard to **receivables**, we are at Rs. 32.35 crore against Rs. 37.87 crore previous quarter and the **DSR** as on 31st March is at 44 days against 50 days as on 31st December. This however is a net number and the gross number net of provisioning is Rs. 32.45 crore.
- **Top 5 clients** at 53 % against 54% last quarter.
- **The order book position** is Rs. 275.27 crore including Rs. 157.86 crore of products business and Rs. 117.40 crore of projects and services business, against Rs. 276.44 crore last quarter with Rs. 150.97 crore of products and Rs. 125.47 crore of services. In Mar 10, order book was for Rs. 164 crore including Rs. 117 crore of products business and Rs. 47 crore of projects and services business. **The services order book** includes ten year contract
- Total Cash and cash equivalents is Rs. 187.51 crore. The breakup of cash and cash equivalents is as follows :
- Cash in current accounts of Rs. 21.38 crore.
 - Liquid fund schemes of mutual funds is Rs. 42.04 crore
 - Fixed maturity plans of mutual funds is Rs. 83.73 crore
 - Fixed deposits with banks is Rs. 40.37 crore

Now, I will hand over to Mita Brahma, who is currently looking after our HR activities.

Mita:

Thank you Pramod. Good afternoon ladies and gentlemen.

The focus for HR during the year has been on increasing product and domain competency in the organization. Hiring focus has been for solution architects, domain experts, and business analysts. Professional certifications in banking, technology and project management, and internationally validated personality assessment tools are used in the selection process. As an outcome of a re-hiring drive, several ex-Nucleites have joined back to add to the pool of domain experts. At the junior level, resource requirements have been met through the NSBT (Nucleus School of Banking and Technology) Program. In the last quarter, 132 NSBT trained freshers were inducted into the company. Manpower numbers have increased from 1647 to 1720 during the year. A review of roles along with span of control was also completed to drive greater efficiency in the organization.

Training and Development initiatives demonstrate the same focus on Product Knowledge, Emerging Technologies, Project Management, and Business Analysis. A role-wise training initiative, SOUL (Self driven, On the job, Unique Learning) further ensures that competency gaps in individuals as well as fresh lateral hires are addressed. To measure these gaps, an internal assessment drive has been started to assess the “skill inventory” of the organization.

The Appraisal process has been completed on 31 Mar 2011 for all employees based on their skills and product knowledge to bring them on par with the market. “Business HR representatives” aligned to each of the business and functional units ensured process adherence as well as objectivity in the process. A succession planning initiative for critical roles was also completed along with the annual appraisals. Due care was taken to provide an unbiased, fair and equitable consideration to all employees. Going ahead, a Project Incentive policy has been launched to recognize contribution to deliver quality.

Regular communication with employees was facilitated through regular “Open House” sessions, and through the business HR representatives. Some addressal mechanisms initiated during the year are launch of a sexual harassment policy, a grievance policy, and a whistleblower policy. However, attrition levels were on increase as per the industry trends. Nucleus has been able to meet resource demands without impacting business, both because of hiring initiatives attracting fresh talent, as well as a better utilization of existing resources without impacting business. The focus for the year will remain on a good utilization, along with a strong sense of purpose and alignment to the organization. Thank you.

Meenakshi

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

Ashish Aggarwal from Tata Securities

Ashish: just wanted to find out any impact of the recent crisis in Japan on your business?

Vishnu: Yes, we did have some impact of the calamities that took place in Japan; however the picture would be clearer over the next few quarters in terms of how the reconstruction starts after the huge calamity. We will come to know about the exact scenario over the period.

Ashish: Do you expect any impact on your current order book because of the current scenario?

Pramod: if you look at even the current quarter, the quarter which has just passed, there was no specific impact of the incidents in Japan. Few people came back, and instead of onsite, became offshore, and then subsequently have partly gone back in April. But as of today, our customer requirements have not changed. Going forward, how banks look at outsourcing, etc., in view of such calamities, is something we will see.

Anoop from SBI Mutual Fund

Anoop: If you could comment on the outlook for the services segment, the kind of order book accretion that we have seen and some medium term trends.

Pramod: We have spoken about it for a number of years that revenue from our projects and services segment has largely been coming from two clients, one in Japan, and one in the South East Asia region in Singapore. This year we have seen a fall in revenue from both these clients and that has resulted in the entire services revenue coming off very strongly by 35% YoY. Part of it is due to vendor consolidation, and part due to client budget changes. We do not foresee any major increase happening with these clients at the levels we are currently. Therefore for new services business, we are only looking at our existing products' client base rather than looking at new clients per se in the services business. We are unlikely to go to a bank in Europe to sell services, but yes, we will go to our customers in Middle East or Africa or South East Asia to sell services because he is already a product customer. So, today, we don't see any immediate major change in our services run rate. We expect growth to come in from the product space.

Anoop: Would that imply sort of a negative trend in the margins going forward in services, because due to the growth in the overall industry, we would have to have wage hikes for employees in the services segment.

Pramod: No, I don't think that there would be any impact. In fact, margins in the product business over a longer period are definitely better than the services business. In the services

segment margins, we would expect it to remain where they are today. We would keep the costs variable to that extent in terms of people. And if there are any surplus people, they would be redeployed within the Company in the products space, because even the services we do are in the banking space.

Anoop: Over the last one or two years, we have been working on some new product modules, etc., on risk management for example. What is the status of those new products?

Pramod: Vishnu will brief you a little further on that, but largely we have been working on the new version of our FinnOne Retail loan suite. New version is logically superior, database independent and with multiple Company working possibilities. This is the product which is now under beta and we have not been working on additional offerings like risk. I don't think we talked about risk at any stage.

Vishnu: We did talk about a module called FinnOne™ Forecaster which essentially takes care of analysis of data generated by the transaction processing model, which could be substantial and coming up with some intelligence on the portfolio.

Anoop: Finally, if you could also comment on the growth drivers for the product segment?

Vishnu: With the number of orders that we are winning and also with deeper penetration of our products with the existing national as well as international customers, we continue to be bullish on the growth of product business.

Pramod: The growth drivers would be,

- a) Alignment with much larger system integrator or services companies in Europe especially, to sell our products along with their services to larger banks there. It was due to an approach based on this focus that we had a win in Europe in the current year and we wish to take this forward with other large players too.
- b) Apart from, our bread and butter business of single-country implementations from emerging markets would continue but the focus has to be on picking up large deals.

Sanjeev from Sharekhan Limited

Sanjeev: One question on the margin side. What kind of margin profile are we looking at in FY' 12?

Pramod: As mentioned in the beginning of the call, we don't give revenue guidance. We did 18% plus previous year, and did 11% this year, so our first effort would be to go towards that margin, but then we will see how it works on a quarter-on-quarter basis.

Sanjeev : What kind of wage hike you are planning for FY' 12?

Pramod: For offshore we have talked about 11% but onsite would be very restricted. We in fact, do not have too much of an onsite presence except in Singapore. There it would be closer to single digits.

Sanjeev: You have just said that it will be our intent to get back to the margin profile of FY' 10, but next quarter again we are going for a wage hike and our revenue is on the lower side, so we are facing more headwinds actually. Hence the margin seems to be on the lower side going forward in FY' 12 also, if you could comment on it.

Pramod: While you are right that any increase in manpower bill less than 11% can add approximately Rs. 9 to 10 crore per annum to my wage bill,. But you have to keep in mind that we are performing much below capacity and there is scope for us to do better and faster delivery of the order book in hand, and the top line will drive that. You are right that it can take a month or two more, but there is no other way.

Sanjeev: What is the attrition you are facing right now?

Pramod: We are noticing the attrition coming down in the last quarter, but still it remains at 20 plus.

Sanjeev : So going forward in FY' 12, if you could comment broadly on what kind of revenue trajectory we are looking at, will we be getting back to the earlier years of growth?

Pramod: We had a CAGR of growth if you go back more than 10 years. But the last 3 to 4 years, our revenues have remained in the range of Rs. 280 to Rs. 320 crore. We have to break out of that, it would be tough. We thought we would do better this year, but it has not changed. While we are optimistic, I don't think we would like to give numbers.

Sanjeev: My last question is on the inorganic growth side; have you shortlisted any of the candidates?

Pramod: We have been looking at some companies, one proposal we took to a particular stage and dropped, it is a continuing process. There are one or two companies under evaluation at the moment, but dates we will not be able to, at the moment, give any idea here.

Mr. Chandra from Equity Master

Chandra: Can you just reiterate your order book number once again, just missed out?

Pramod: Order book position is Rs. 275.27 crore, which includes Rs. 157.86 crore of product business and Rs. 117.40 crore of projects and services business.

Mr. Nirav Dalal from Sharekhan

Nirav: I just wanted your views on the cash that you are holding. Why don't you give a special dividend or do buyback of shares rather than wait or hold on to that cash for such a long time?

Pramod: I think buyback is a Board decision, price sensitive matter. We cannot talk about it on the call. Whether it creates value or not is a much debated item in India. Dividend we have maintained at 25% despite poor profitability.

Nirav: But then still, you are holding on to that kind of cash.

Pramod: We are keeping some availability for possible acquisition and once we finalize that, then we will take a view.

Mr. Shravan Goyal from UTI Mutual Fund

Shravan: What kind of tax rate you are assuming for FY' 12?

Pramod: For FY' 12, we would assume a tax rate of not less than 25%.

Shravan: What percentage of revenue comes from Japan and out of that what is the proportion of product and services revenue?

Pramod: Revenue from Japan for the year is 36%.

Meenakshi: I would like to thank everybody for joining us on this call and with this; I would like Vishnu to have his closing comments.

Vishnu: I would like to take this opportunity to thank you all for your interest in Nucleus Software and we assure you of our commitment to building a strong organization. Thank you. Bye.