NUCLEUS SOFTWARE

NUCLEUS SOFTWARE

Q2 FY 12
Earnings Conference Call
October 24, 2011

Members of Nucleus Management

- Mr. Vishnu R Dusad	Managing Director & CEO
- Mr. Pramod K Sanghi	President Finance & CFO
- Ms. Viveka Ragukumar	Executive VP, Global Delivery

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 half-year ended September 30th 2011. We have with us today for discussion Mr. Vishnu R. Dusad, our CEO and Managing Director; Mr. Pramod K Sanghi, the President and Chief Financial Officer; Ms. Viveka Ragukumar who is the Executive VP, Global Delivery.

As you are aware, we do not provide specific revenue and earnings guidance. Anything said during this call which reflects 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 pass it on to Vishnu.

Vishnu:

Thank you Meenakshi and good afternoon ladies and gentlemen. I am pleased to announce the results for Second Quarter & Half Year Ended September 30, 2011.

Let me take you through the numbers, first the quarterly figures.

- **Our Consolidated revenue** is at Rs.73.91 crore against Rs.70.19 crore in the corresponding quarter previous year. This is an increase of 5 %.

  - **Revenue from product business** for the quarter is at Rs. 55.18 crore, 75 % of the total revenue against Rs.50.58 crore, 72% of the total revenue in the corresponding quarter previous year.

  - **Product revenue from own business,** for the quarter is at Rs. 53.03 crore, 72 % of the total revenue against Rs. 48.78 crore, 70% of total revenue in the corresponding quarter previous year.

    - **Projects and services business revenue** for the quarter is at Rs. 18.74 crore, 25 % of total revenue against Rs. 19.61 crore, 28% of total revenue in the corresponding quarter previous year.

- **EBITDA** for the quarter is at Rs. 10.75 crore, 15 % of total revenue against Rs. 11.71 crore, 17% of total revenue in the corresponding quarter previous year.

NUCLEUS SOFTWARE

- **Taxes including withholding taxes** are at Rs. 4.57 crore against Rs. 0.80 crore, in the corresponding quarter previous year.

- **Net profit** for the quarter is at Rs. 11.45 crore, 15 % of total revenue, up by 29 % against Rs. 8.90 crore 13 % of total revenue in the corresponding quarter previous year.

- **EPS for t**he quarter is at Rs. 3.54 against Rs. 2.75 in the corresponding quarter previous year.

For the Half Year ended September 30, 2011, our consolidated revenue from software products and services is at Rs. 138.19 crore against Rs.136.33 crore in the corresponding half year of the previous year.

- **Revenue from product business** for the half year is at Rs. 102. 26 crore, 74 % of the total revenue against Rs.93.53 crore, 69% of the total revenue in the corresponding half year of the previous year.

- **Product revenue from own business,** for the half year is at Rs. 97. 64 crore, 71 % of the total revenue against Rs. 88.30 crore, 65 % of total revenue in the corresponding half year of the previous year. This line of business has grown by 11 % on a YoY basis for the half year.

- **Projects and services business revenue** for the half year is at Rs. 35.93 crore, 26 % of total revenue against Rs. 42.80 crore, 31% of total revenue in the corresponding half year of the previous year. This line of business has declined by 16 % on a YoY basis for the half year

- **EBITDA** for the half year is at Rs. 16.23 crore, 12 % against Rs. 16.43 crore, which was also at 12% in the corresponding half year of the previous year.

- **Taxes** including withholding taxes are Rs. 6.32 crore against Rs.1.44 crore, in the corresponding half year of the previous year.

- **Net profit** for the half year is at Rs. 16.48 crore, 12 % of total revenue, up by 16 % against Rs. 14.20 crore 10 % of total r**e**venue in the corresponding half year of the previous year.

NUCLEUS SOFTWARE

- **EPS for t**he half year at Rs. 5.09 as against Rs. 4.39 in the corresponding half year of the previous year.

- **Our total Current investments and bank position** is at Rs. 190.34 crore as on Sep 30, 2011 against Rs. 190.36 crore as on Jun 30, 2011

- In terms of **manpower,** we are at 1599 as on Sep 30, 2011 against 1638 as on June 30, 2011.

Overall this quarter revenue has improved both on a YoY and a QoQ basis. There is volume growth in constant Dollar terms as well as value growth due to favorable currency movements. Operating margins have also improved on a QoQ basis, though we are lower on a YoY basis.

On a half yearly basis, revenue is marginally up from the first half of the previous year and the margins have improved.

We have to deliver sustained growth on a full year basis and challenges do remain , both in the macro environment due to fears of slow growth / recession in the US and Europe due to sovereign debt , austerity and fiscal deficit overhang, and at customer level . While contribution of US and Europe to our top line is 15 %, we cannot wish away the impact on other markets including Japan and emerging markets

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 4 new product orders for 10 modules and added 3 new customers. We successfully implemented 37 product modules across the globe. During the quarter, we gave 51 demonstrations of our products in different markets and we received 30 RFPs and submitted 19 across the globe.

For the first six months, 10 new product orders and 5 new customers have been added for 21 product modules. We successfully implemented 60 product modules during the half year.

During the quarter, we participated in SIBOS, the world's largest banking technology event, which was held in Toronto, Canada. SIBOS brings together influential leaders across the globe from financial institutions, multinational corporations and technology partners to do business and shape the future of the financial industry. We also attended the 2nd Annual Islamic Banking Conference at Malaysia.

Our Jaipur unit at SEZ in Jaipur commenced operations during the quarter.

As a niche player in the BFSI segment, we are fortunate to have built strong client relationships and are optimistic about the upcoming market opportunities for Nucleus Software across Japan, Latin America, Europe, Middle East, South East Asia and Africa. We will continue to help our clients achieve a competitive edge through our innovative and customized software solutions.

Before I hand it over to Pramod, I would like to introduce Mukesh Batra, who joined us as Senior Vice President during the quarter and is responsible for spearheading the Product Development & Management Group. Mukesh has versatile experience in software development and brings expertise in Products, Projects, Programs, Presales, Operations and Business Management. An agile enthusiast, he is a Certified Scum Master and brings in rich experience of organizing and transforming software development teams into highly productive agile feature teams.

Over to you, Pramod.

Pramod:

Good afternoon everybody. This is Pramod and I welcome you all to this conference call.

- **On a sequential basis, revenue** for the quarter is at Rs. 73.91 crore, up by 14.99% against Rs. 64.27 crore previous quarter. Volume growth is around 10% and the balance is due to the favorable currency movement.

- **Product revenue for the quarter is** at Rs. 55.18 crore, 74.65% of revenue up by 17.19% against 47.08 crore, 73.25% of revenue, previous quarter.

    - **Traded revenue from products** included in this product revenue is at Rs. 2.15 crore 2.91 % of revenue for the quarter, against Rs. 2.47 crore 3.85 % of revenue previous quarter.

NUCLEUS SOFTWARE

- **Revenue from own Products** for the quarter is at Rs. 53.03 crore, 71.75% of revenue, against Rs. 44.61 crore, 69.40 % of revenue, previous quarter.

- **Revenue from projects and services** for the quarter is at Rs. 18.74 crore, 25.35% of revenue, 9% increase against Rs. 17.19 crore, 26.75% of revenue, previous quarter.

- **Cost of delivery** is 66.90% of revenue, 69.40 % of revenue in the previous quarter. In absolute terms this is Rs. 49.44 crore against Rs. 44.61 crore previous quarter. For the half year, it is Rs. 94.05 crore (68.06% of revenue) against Rs. 91.36 crore (67.01% of revenue) for the corresponding half year of the previous year.

- **Marketing expenses** are at 10.16% of revenue this quarter, against 12.74% of revenue previous quarter. In absolute terms, it is at Rs. 7.51 crore against Rs. 8.19 crore previous quarter. For the half year, they are Rs.15.70 crore (11.36% of revenue) against Rs. 14.56 crore (10.68% of revenue) for the corresponding half year of the previous year.

- **G&A expenses** are at 8.41% of revenue this quarter, against 9.33% of revenue previous quarter. In absolute terms, it is at Rs. 6.21 crore against Rs. 6.00 crore previous quarter. For the half year, they are at Rs. 12.21 crore (8.84% of revenue) against Rs. 13.99 crore (10.26% of revenue) for the corresponding half year of the previous year.

- **Total expenses** for the quarter are at Rs. 63.16 crore, against Rs. 58.79 crore previous quarter. For the half year, total expenses are at Rs. 121.96 crore against Rs. 119.91 crore for the corresponding half year of the previous year.

- **EBITDA** is at Rs. 10.75 crore, 14.54% of revenue this quarter as compared to Rs. 5.48 crore, 8.53 % of revenue in the previous quarter. For the half year, EBITDA is at Rs. 16.23 crore, 11.74% of revenue as compared to Rs. 16.43 crore, 12.05% of revenue for the corresponding half year of the previous year.

- **Depreciation** is at Rs. 1.94 crore against Rs. 2.01 crore previous quarter. For the half year, it is Rs. 3.95 crore against Rs. 4.84 crore for the corresponding half year of the previous year

NUCLEUS SOFTWARE

- **Other income from investments** is at Rs.2.47 crore against Rs. 2.91 crore previous quarter. **Total other Income** is Rs. 3.14 crore against Rs. 3.28 crore last qtr. For the half year, **Other income from investments are** at Rs. 5.38 crore against Rs. 3.85 crore for the corresponding half year of the previous year while **total of other income** is Rs. 6.42 crore against Rs. 4.23 crore for the corresponding half year of the previous year.

- **There is a foreign exchange gain** of Rs. 4.06 crore against a gain of Rs. 3.96 lakhs previous quarter. This is due to translation of net foreign currency denominated current assets at the qtr end rate of 48.97 Rupees to the US Dollar. This excludes hedging gains of Rs. 33.09 lakhs in the Sep. 11 qtr. which is booked to revenue.

- Dollar closed end of Sep at 48.97, while it was at 44.74 end of June 2011, 44.90 at the end of Sep 10.and 44.68 as on March 31, 2011. For the half year there is a foreign exchange gain of Rs. 4.10 crore in Other Income against a loss of Rs. 17.83 lakhs for the corresponding half year of the previous year.

- **Total taxes including withholding** are at Rs. 4.57 crore**,** 28.52% of PBT against Rs. 1.75 crore **(**25.80%) of PBT previous quarter, For the half year taxes are at Rs. 6.32 crore, 27.71% of PBT against Rs. 1.44 crore, 9.20% of PBT. Taxes have increased due to the expiry of tax holiday in India in March 2011. Our SEZ operations for new business have just started in August 2011.

- **PAT** is at Rs. 11.45 crore for the quarter, 15.49% of revenu**e** against Rs. 5.03 crore, 7.83% of rev**en**ue previous quarter. For the half year, it is Rs. 16.48 crore, 11.93% of revenue against Rs. 14.20 crore, 10.41% of revenue for the corresponding half year of the previous year.

- In terms of **foreign currency hedges**, we had on Sep 30, USD 12.00 million dollars of forward contracts at an average rate of 46.91 which are designated as highly probable forecast transactions. There is a mark-to-market loss of Rs. 318.96 lakhs which is taken to hedging reserve in the balance sheet. We do not have any option outstanding as on Sep 30, 2011.

    - June 2011 we had a total hedge of USD 12.75 million at an average rate of 46.74
    - Current hedge position is US $13.50 million at an average rate of 47.29

- With regard to **receivables,** we are at Rs. 40.02 crore against Rs. 30.66 crore previous quarter and the **DSR** as on 30th Sep is at 49 days against 43 days as on June 30th, 2011.

NUCLEUS SOFTWARE

- **Top 5 clients** at 47% against 50% last quarter.

- **The order book position** is Rs. 237.25 crore including Rs. 117.30 crore of products business and Rs. 119.95 crore of projects and services business, against Rs. 265.55 crore last quarter with Rs. 146.49 crore of products and Rs. 119.06 crore of services. In Sep 10, order book was for Rs. 199.59 crore including Rs. 164.14 crore of products business and Rs. 35.45 crore of projects and services business. The decline in the product order book is also due to postponement / partial cancellation of certain orders in the Middle East and North Africa.

- **Total Cash and cash equivalents** are Rs. 190.34 crore. The breakup of cash and cash equivalents is as follows :

  a. Cash in current accounts of Rs. 25.29 crore
  b. Liquid fund schemes of mutual funds is Rs. 55.93 crore
  c. Fixed maturity plans of mutual funds is Rs. 73.65 crore
  d. Investment IN FMP of Rs. 9.65 crore made prior to Sept 30 but shown in other current assets, as the units are allotted in Oct 2011
  e. Fixed deposits with banks is Rs. 25.81 crore

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

Viveka:

Thank you, Pramod. Good afternoon and welcome you all to the conference call. I have completed a little over five months in Nucleus. My focus has been on strengthening delivery and the focus continues to be the same for this quarter. The focus is going to be on people, process, delivery and customer delight. On the people side, as mentioned before, we should have a right mix of skills and technology domain, so we deliver right solution to the customers. The focus now is going to be on creating a performance-oriented culture, and parameters with respect to performance orientation have been implemented. Hiring technical and techno-functional teams are in the process. We are also working on bringing employee-friendly culture in the organization. Changes in the structure are initiated to leverage the strength of senior executives and bring in friendly culture within the organization.

On the process side many trainings have been conducted on Agile and the delivery function is geared up to follow the Agile process and the practice has been any new project that we start from now on, we follow Agile process which would really bring in a lot of visibility and deliver value to customer. While we also continue to trim and refine the process to be leaner, the focus is on reducing redundancy and increasing efficiency. On the delivery side, we are working on increasing quality consciousness within the delivery organization. This is by way of introducing more standards, starting from the lower most level; holding, testing and almost all phases of product life cycle. We would introduce more standard tools and testing methodologies to ensure the delivery that we make to our customers, of utmost quality. The last point that I want to talk about is customer delight. The focus this quarter is going to be on increasing communication with the customers; try and address their concerns and deliver more value for the price that they pay for. Customer delight and focus on employee satisfaction are the two key focus for the coming quarter. With this, I complete my update and I pass it on to Mita for HR update. Thank you.

Mita:

Thank you, Viveka. Good afternoon, all of you and welcome. In line with the company's focus on product development and enhancement, HR is working on aligning structures, systems and culture towards a flexible and learning organization. Training initiative has been focused on the quarter in improving functional and product competency and e-learning initiative was launched to increase domain competency in banking and finance, and training was also conducted on 'Agile Scrum' framework. The role and responsibility areas, performance parameters and incentive policies have all been reviewed across departments and realigned at the senior level with organization goal. This activity would now cascade down to all levels.

Policies related to manpower allocation have also been reviewed and improved with more objective decision parameters. Senior level hiring in the quarter included the Head for Product Development as well as senior delivery person for the Japan business. At fresher level, 70 joinees from the 2011 batch were inducted. Campus drives are in progress in Delhi, NCR, Jaipur and other cities for 2012 joinees. Manpower numbers were at 1,599 at the end of the quarter in line with business projections. Nucleus celebrated its 25th anniversary on 9th July 2011. Celebrations for Nuc day and other special events were designed on the theme of "Creativity and Innovation". This theme is being reinforced in special awards on the floor for immediate and spontaneous recognition in on boarding initiatives to engage lateral hires; and in motivational sessions with high performers.

For the next quarter, focus would be on selective hiring of seniors as well as fresher hiring. The presence at Jaipur campus would be doubled over the next quarter. The enhanced definition of performance parameters and measurement criteria would be cascaded downwards to each individual and along with learning initiative would help create a performance-driven organization. Thank you. With that I complete my update and I would now hand over to Mukesh Batra.

Mukesh:

Thank you, Mita. Good afternoon, everybody. I joined Nucleus a couple of months back and I am very excited to be part of this team. Prior to joining Nucleus, I headed India operations of Open Solutions which is an American banking products company. I led their product development initiatives in the areas of Core banking, Financial Accounting, Loan Origination and Customer Relationship Management. Earlier, I worked with HCL Technologies in multiple roles and locations, providing solutions around global, leading products like Filenet, Documentum and ILOG.

My focus area in Nucleus is the new product development. Since I have joined, I have been studying the current product development organization, products, people, skills and processes. We have a strong need to continuously enrich our products with new features and provide regular upgrades to our clients frequently. I have identified a few key roles and I am in the process of restructuring the product organization. My emphasis is on a strong Product Management function. It will help in better capture, organization and prioritization of product features requirements.

I plan to improve our development methodologies and use modern agile software development techniques which are important to any product development team in today's world. It will help our teams deliver better quality and higher productivity. It will also enhance team flexibility and reduce risks associated with longer development cycles. I also plan to improve our engineering practices and increase automation in testing and build processes for better efficiency and faster release cycles.

This is update from me right now.

Mr. Sandesh Trivedi from Banyan Tree

Sandesh:

I want to understand that we being a product development company, there is some lumpiness in revenues. So, are we moving towards more transaction-based pricing which is more recurring in nature?

NUCLEUS SOFTWARE

Pramod:

There is no lumpiness in revenue because our revenues from the product licensing and implementation are accrued on a percentage-completion basis; they are not milestone-based. So, there is no lumpiness as such in the revenue. On the other part; whether we are moving towards transaction-based pricing which would of course yield to a larger share of the customer wallet if his business grows, let me ask Vishnu to answer that question though we have taken some steps.

Vishnu:

Yes, more and more of our customers, especially prospective customers, are asking us about this kind of an offering and we are responding to them in a positive manner. One of our existing customers has helped us take step in that direction by asking us to host their application at our data centre which we have been doing for more than two years now. And now we are taking the next step which is transaction-based pricing.

Sandesh:

Currently, what percentage of revenues would be coming from such kind of transaction-based pricing?

Pramod:

Currently, they would be negative. At the moment, the model is enterprise license followed by maintenance. Apart from one major contract which we are doing in the Americas now which is on a hosted model for a credit card processing, those revenues are now accruing on a monthly basis rather than licensed-based.

Sandesh:

Some banks which are already using products like Finacle and Flexcube , but still they go for products like FinnOne. So, I just wanted to understand is it because FinnOne can very easily integrate with the core banking solutions that genuine banks prefer FinnOne?

Vishnu:

Absolutely. Our product is implemented with number of core banking solutions including Finacle, Flexcube and Misys and so on and so forth. The other reason that they go in for FinnOne is the rich functionality for this specific business objective that they need to fulfill; which is retail lending and that is where they find it worthwhile to look at and deploy FinnOne.

Sandesh:

Who are the competitors in this retail lending market?

Pramod:

Oracle Financial Services has a retail loan solution apart from their core banking offering. We have Polaris, 3i Infotech, Indus out of Pune. These are the Indian players who tend to be present across emerging markets as well as in Europe but there would be players in each country also, whether it is Indonesia or it is Malaysia or it is Singapore. There are always local players whom we have to compete against and then if you look at Europe, there is SAP which offers retail loan solutions.

Mr. Dhiraj Sachdev from HSBC

Dhiraj:

Can you give us a sense on the product pipeline trend especially after your three-year contract on GMAC expired, and how is the trend building up on products?

Pramod:

The GMAC contract is still alive and kicking. Of course, the initial contract which started in 2005 got over in 2008 but since then we have been doing various implementations for them and even currently implementations are on in at least three countries. And there are three more countries lined up after this. So, this GMAC relationship is continuing almost at a higher level than what it used to be four years ago.

Vishnu:

We are engaging with all our large customers in a far more intense manner; which is creating opportunities for us to deploy existing products in multiple ways and in

NUCLEUS SOFTWARE

multiple geographies, in the process creating even more value for the same existing customers. The other thing that we are doing is; that we have now at least 15 countries where we have only single implementations. So, we are focusing on these 15 countries to create deeper penetration in those respective economies because by default we have high customer satisfaction with those single implementations. All that we need to do is convert that high customer satisfaction into more orders.

Dhiraj:

Can you specify in terms of numbers on how is the pipeline looking like and how it has grown, the orders that you have won?

Pramod:

We have given the products order book number which includes of course product orders and the implementation as well maintenance and so on. So, the product order book is at about Rs. 117 crore which was at about Rs. 146 crore last quarter. And if you look at macro, we find that across the emerging markets, there is reasonable demand still and there is no visible effect. The Middle East has been slower than usual since January because once the Egypt uprising happened, then Tunisia happened, people in Saudi etc also postponed decisions; and then July, August are in any case not the months for initiating new business with Ramadan and so on. But we think now it is coming back to normal and we are finding increased traction in Africa, Philippines, even in Japan. I think it is not in the press release but this quarter we have picked up an order from Europe also.

Dhiraj:

This Rs. 117 crore of order as it stands today, it will be implemented over what period of time or what quarter?

Pramod:

Most of this order book, I cannot give you quarter-wise but I would say that leaving one large order from a European Bank, most of this order book would be completed within 12 months definitely.

Dhiraj:

Also we are witnessing some deterioration in the margins. On a y-o-y basis obviously it is down and maybe it was because of the salary cost, high cost, and DSO's marginally receivable cycle has been pushed up. Any comment on these two?

Pramod:

No, in fact margins, if you look at it, we have been doing actually very bad margins for two or three quarters; and this quarter we have again picked up on the margin front as such. If you look at on a quarter-on-quarter basis, there was fall in revenue in several quarters, and because of the fall in revenue, we could not absorb either the marketing cost or the development cost adequately. So, the margins were falling. In fact, margins for the entire FY 11 were at 11.27%.

Dhiraj:

Can this level of margins be sustained? Can we take that as a base assumption?

Pramod:

If you look at our numbers over the various years, our expenses have been under control since we actually looked at them very carefully in 2008-09, after the crisis. Since then the expenses have not shown any major increase. In fact, the salary cost also has not gone up to that extent. For a product company, if you look at FY 08, we had 25% EBITDA, FY 09 we had 15% ,in FY 10 we had 18.5 % and then we are at 12% now . There is no reason for us not to do better margins but, yes, we have to do more business for that.

Dhiraj:

So, one can assume this can be the base level margins from here on?

Pramod:

Well, that is what we strive for based on the business we do. Of course, if the top line falls off, then the marginal effect is higher.

Meenakshi:

We would like to thank everybody for joining us in this call and with this I would like to pass it on to Vishnu for his closing comment.

NUCLEUS SOFTWARE

Vishnu:

I would like to take this opportunity to thank you all for your interest in Nucleus and would like reiterate our commitment to deliver value to our customers and in turn to our investors. Thank you.