



Sonata Software Limited Conference Call

Sonata Software Limited Conference Call FY2013 (Q3)

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CORPORATE PARTICIPANTS

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Chief Financial Officer

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Ms. Priya Jaswani

Company Secretary

Moderator

Ladies and gentlemen, good day, and welcome to the Sonata Software Third Quarter Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call please signal an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Srikar Reddy. Thank you and over to you Sir.

Srikar Reddy

Thank you very much and welcome to the analysts call for the presentation and discussion on our Quarter 3 results which we announced yesterday. I have here with me Venkatraman Narayanan – our CFO, Sathyanarayana – Head of Finance and Accounts; Priya – Company Secretary, and Swati Sengupta – Head of Marketing.

To just step back and really take you through what we said over the last couple of quarters and we continue to say as we go forward the theme will not change much at all. Basically we are saying that our strategic focus is on 6 or 7 items and there is a sharp focus on our existing clients. How do we improve our account management, how do we do a better delivery, how do

we set up what we call our customer specific Centers of Excellence and how do we cross sell and up sell the new technology services which we are coming out with. So the focus will continue to be there.

The second initiative was to really strengthen our sales engine and we have covered that over the last few quarters, wherein we have actually put together the sales team and then we said that the next step was to really get a very formal structured go to market approach to access markets of key interest to us, both from a vertical perspective and a technology perspective.

The third was on how we can get more verticals into our business focus. As you know we were being continued to operate in two verticals with the Travel and Tourism and Outsourced Product Development business. The next aspect of our strategy was to focus on how close we work with our alliances. We have strong alliances with global partners in India and we said that how we can take them with the rest of the global markets and how do we go to the market with them. And then there was investment in new technologies, which is what most of the industry is talking about- like Social Media, Mobility, Analytics, Cloud, and Big Data. The next focus is on overall progress in improving the talent in the organization and getting in sharper business processes into the organization for bid management and go-to-market, product management, and all other associated customer facing activities. So as I said that thing continues to remain constant. We continue to execute on these strategies to give you a quick short update on each of these, our focus on our existing clients have yielded us good results. We are seeing some significant growth from our existing clients and some of them have remained flat because of market conditions.

On the new sales front, as I told you last time, we put forward this plan of making an effective sales team and how do you go to market more effectively. We see a much healthier pipeline than what we had seen over a couple of quarters back. We continue to build on these pipelines and get new clients. We have had about 12 new clients this year because of the efforts on new business. Now we need focus heavily on the way we access new clients, our market messaging and positioning, and value proposition to our potential customers. We continue to work on reaching out to our potential clients with better messaging, which is a continuous activity and then we will see the results of these activities as we go forward.

On our alliances front, we have had good traction with our Microsoft alliance globally. We have very strong alliances now in the Asia Pacific and the US markets. We have started making some inroads in Europe, especially UK with a hybrid setup of very strong alliance in Europe. We are now trying to see how we can take that to other geographies with hybrid alliances where we focused on our travel and tourism verticals and then we are looking at one or two more alliances. I think we will make a few announcements over the next few weeks in terms of our alliances with TIBCO, which is a social networking platform and Oracle Exalytics for their analytics and big data kind of solutions. So we will make those announcements in the next couple of weeks and then we will leverage these alliances for our growth as we go forward. On verticals we have started seeding into the organization a few more verticals which are Retail and Consumer Packaged Goods. So we have to put a lot more together in terms of the assets and target markets and what are the solutions and what are partnerships we need to build there. But we have started seeding these two new verticals into the organization and we will start executing on this as we go forward. On new technologies, we have had a fairly decent sized Mobility practice built over the last 9 to 12 months. Other areas where we are focusing as I said are Big Data, Analytics, Social, and Cloud. On Social, we will announce partnership with TIBCO, a corporate social networking platform and that should be our entry strategy into offering solutions around social network into corporations. We will also put capability into other areas, like Big Data and Analytics. On Cloud, we have a fairly decent story on the Microsoft Azure Platform. We have got a few wins and then we are working closely to see how we can take that solution to the rest of the world.

Our product business continues to do well. You can see that in the results, which Venkat will cover that in greater detail, but we see a significant traction there, and an increase in both the margin and EBITDA in that business. So overall as we see it, I think you see some of these strategies, which we have put in place and which we continue to stay focused on are starting to yield some results. Some have worked much quicker than expected, some are taking a little bit more time, but we are very clear that this is our way forward plan and we will continue to invest and grow on it. We do think that based on the results we obtained so far, that we are on the right track and as we intensify our efforts in all these areas, we would start seeing the results of

these actions as we go forward. With that I will stop at this point in time and hand it over to Venkat to take you through a more detailed financial presentation of the quarterly results and year to day results so far and then we will open the floor for questions after that. Thank you very much.

Venkatraman N.

Thank you Srikar. The results have been on our website since last evening and we have also released our detailed press release. I will now try to take you through the results for this quarter very quickly. Speaking from a financial perspective, this has been a good quarter because after three quarters of losses on a consolidated basis, even though they were based on non cash entries or adjustments for our joint venture, we have returned to profits. So it is very good news for us and like Srikar mentioned it is primarily because of the focus that we have put into business and also trying to set right certain aspects of the business segment that we have in place. Post divestiture of our German joint venture, we are now essentially only in two segments, which are: International Services - that is IT exports and our Domestic Products in domestic business. So the first segment as you all know and as we have been repeating, is essentially the export of IT services from India to other parts of the world, and the second segment is the domestic products where we are distributing products in India.

Coming to our results, I will go over the consolidated numbers first and then move on to the segments. Consolidated numbers, revenues have actually grown 5% on a sequential basis and on a year-on-year basis it has been a de-growth of 4%, but as I have been telling in the past calls, this is essentially because of our products business in India where we have focused more on bottom-line and return on capital employed done on revenues. We had an EBITDA of 17.5 crores on a consolidated basis which is a 16% growth quarter-on-quarter and 256% growth on year-on-year basis. We will have to go down to each segment to see the exact reason for it. On the PAT it has been again a successful quarter, with significant progress. I am not talking of number and percentages because they are quite large.

On the international services front, that is the first segment of our business, this business contributes to about 21% of our total revenue but it is contributing about 70% of our EBITDA and PAT, so it is a significant part of the business as you can see. Revenue for this quarter was 84 crores and this has shown a sequential growth of 2% and 21% on a year-over-year basis. In

constant currency of US dollars we have shown a growth of 4% on a sequential basis and 14% on a year-over-year basis, so volume growth is also there and it is essentially because of the traction that we are slowly building up in markets of Americas and Europe. EBITDA in the international IT services business stands at about 12.2 crores which is a 9% sequential growth and a 75% year-over-year basis. PAT was 6.1 crores which is a 21% growth on a sequential basis and 96% on a year-over-year basis. We end the quarter with 140 crores of cash in the international services business and that is one of the highest that we have had in the quarters today.

As regards to our operating matrix, our utilization for the quarter stood at 78%. We have a couple of more percentage points that we can do, which is a lever that is available to us. Day sales outstanding in the IT services business has been a healthy 59 days compared to 71 in the last quarter, that has been because of consistent focus on that front. We had a closing headcount of 2288 employees compared to 2252, which are about 36 more than the last quarter.

Coming to the second segment of our business which is the domestic products and services, revenue for the quarter was 312 crores which is a sequential growth of 7% and domestic services revenue was about 9.5 crores which is a sequential growth of 2% and a year-over-year growth of 25%. EBITDA for the quarter in this business segment was 7.1 crores representing a growth of 25% and 450% on a year-over-year basis. Here in this business as Srikar was mentioning, essentially we have improved profitability substantially and that has been on account of focus that we have been putting into customers and the business lines that we deal with. It had been a tough one year prior, but all the fruits of that difficult one year were things that have been put back on track is now bearing fruit. PAT for the quarter was 2.5 crores representing a growth of 166% on a year-on-year basis and sequentially we had shown de-growth because we have started providing for taxes. Day sales outstanding is the critical matrix in this business because essentially we are talking about return on capital employment, return on net worth, being target in our domestic products and services business, day sales outstanding was at healthy 39 and our ROCE was about 22% and our RONW (Return on Net Worth) was about 25%. So as it can be seen, the numbers are beginning to speak even though it is early days, but from a

financial perspective it is beginning to show with the results of what has been happening in the last three quarters. I will turn it over to the operator for questions.

Moderator Thank you, ladies and gentlemen, we will now begin with the question and answer session. We have the first question from the line of Pooja Swamy, from San Capitals. Please go ahead.

Sudhakar Hi this is Sudhakar. You highlighted a couple of points, which you said will drive growth, so my question is what kind of growth are you are expecting over the next two to three years and when will these measures fructify into higher growth for you?

Srikar Reddy Sudhakar, we don't give quantitative forward looking statements. I think I did mention in the couple of calls back also that we will start, or we will expect to start seeing the results of our work starting financial year Q2, next year, that is what our expectation is, that some of these actions we are taking will start reflecting in say more customers and opening up more logos and opening up more service lines, and so on and so forth, so that is the kind of matrix we look at and we are tracking, but beyond that we don't make forward looking quantitative statements.

Sudhakar No Srikar I understand that you guys don't give guidance, but aspirationally what do you aspire, right now you are around 60 million in terms of IT services, do you aspire to become 100 millions over the next two to three years or do you think that is too high for you guys?

Srikar Reddy Aspirationally, I think we are looking at about a 100-million company over the next two to three years.

Sudhakar What do you think will drive that?

Srikar Reddy I think there are a whole lot of things as I said which matter, like - one is our product market focus, in terms of how do we sharpen our product market focus, what do we take to market, and what is our value proposition to the market. What is the role end-to-end process in terms of accessing new clients, building pipelines, getting our value proposition right, getting proper account management processes in place, getting new technology acquisition,

getting better talent, a whole lot of things we need to put in place. We need to execute flawlessly, as we see, I think there is a big opportunity for us in the market and we have to execute really flawlessly for us to get where we want to get, and I do believe we have the talent and the management bandwidth to actually execute on this.

Sudhakar Secondly on the margins, this quarter we have seen an improvement in the margins, around 14% at an operating level. Do you think this margin is sustainable or you can improve on it?

Venkatraman N. Yes, Sudhakar, I think we can surely persist to maintain it, that is there, to improve upon it will be our constant trial and we did have a bit of ups and downs in foreign currency. Hopefully going into the next year we should see a little bit more of stability on that front.

Sudhakar My third question is on your cash balance. You had around 170 crores of cash, how do you plan to utilize it?

Venkatraman N. 140 crores, net off borrowings, because as you know, in our domestic business we have timing issues so we get paid and we worked on a negative working capital many times, so that is why I did not use the 172 crores, when I am talking to analysts, I rather stick to 140 crores, which really you can call as our disposable cash balance. What we are trying to do is focus on acquisitions, that is something that we are looking at and we pay a reasonable and decent dividend as you have known from our dividend distribution history as well.

Sudhakar Do you guys have any stated dividend policy?

Srikar Reddy There is no stated dividend policy, but there is something which says up to about 40 to 50% of our consolidated profit.

Moderator Our next question is from the line of Chetan Wadia from JHP Securities. Please go ahead.

Chetan Wadia What is your reading in terms of talking to the client in terms of their IT spending for 2013? With your clients of course, since you have been talking about getting the best out of the existing clients, what are they saying in terms of their spending for 2013?

Srikar Reddy

The way we see our customers, customers look at it that way, look at them, the IT spend in two ways, One, is what they call, run the business, that is keep the lights on kind of stuff. The other one is - change the business, so how do I put an information technology to improve the way I do business. So we definitely are seeing a trend where there is a huge pressure on companies to cut down and run the business and start moving it into newer areas or newer technology areas, or change the business. So we don't see significantly higher spends by our clients on IT, but we are going to see significantly a change in the way they are going to spend the money and our belief is that whatever we are trying to invest in and we are trying to go market or go to our clients with, we see that the trend is towards spending more on what we think we have to offer than a very traditionally ERPs, Maintenance, or Application Maintenance, and so on and so forth so there is no growth there. So, that is an overall trend we are seeing Chetan.

Chetan Vadia

So you think the category of the revenues that you are getting from the existing clients that might change but in terms of the revenue increase per se from the existing clients, there might be slightly an improvement on that front.

Srikar Reddy

All I am saying is that in the existing client space where we are not there, that is shrinking and where we think we have a strength, that is increasing, that is at a very high level description of the business.

Chetan Vadia

My second question is the geographical revenues breakup that you have provided for in the slide, the rest of the world contribution is supposed to be kind of doubling up in the last year and a half, so which key countries comprise of this rest of the world and what is the outlook for calendar 2013?

Srikar Reddy

The rest of the world really I think, Singapore is one and Qatar is the other, in both we have seen good traction over the last year.

Chetan Vadia

And what is the outlook, can you provide?

Srikar Reddy;

Outlook, I mean I just returned back from Qatar last week. I think the economy is doing tremendously well. They are still growing at 17 to 18%. As an economy they have a lot of money to spend. So obviously, we need to have the right partnership and strategy, it is not a very easy market to crack, but as a market it looks very, very promising. Singapore, we are going to

open our operations, I think we were to actually open our office this quarter, but I think it got shifted a little bit, so we will actually have a physical presence and all this we have done without a physical presence in Singapore and so we should have one, I think beginning April kind of stuff, so I do think that we see a lot more promise there.

Chetan Vadia

My next question is on the days sales outstanding. If you see on the domestic front, in the slide that you have given, in the third quarter, especially the day sales have come down significantly, and in the rest of three quarters, it would rise. So, what actually triggers this movement. Slide #7 on the day sales outstanding, consolidated, international, and domestic, my question is about the domestic front. If you see the third quarter of each of the years, the day sales outstanding would drop substantially and then for the rest of the three quarters it would go up. What actually drives this movement, if I can ask?

Venkatraman N.

We have got renewals which come on an annual basis in the business, so you have got large customers who come up for renewals on an annual basis, and the larger the customer, you have leverage to go collect in time or even earlier than time, is that much better, because of the large volume of the business that we are doing. It is a lot more focused. From a DSO perspective, we are at the customers' place and we collect it ahead of time.

Srikar Reddy

Basically these are two large deals which come up for renewal in this quarter and they are paying more or less in advance, so we keep the money with us for 50 to 60 days, so that can dramatically change the DSO.

Chetan Vadia

Sir, I heard it correctly, is it 170 crores of cash in the book?

Venkatraman N.

172 on a consolidated basis that is including our domestic, the working capital credit, the negative working capital that we just talked about.

Chetan Vadia

Any update on the IT refund case?

Srikar Reddy

IT refund, we had made some inroads, in fact last quarter we did get a refund of about 9 crores, and we are pursuing the balance, yes, we are quite confident on hopefully getting some of it.

- Moderator** The next question is from the line of Kavita Vempalli from Nirmal Bang Securities, please go ahead.
- Kavita Vempalli** Sir, you are reporting some 2000 plus employees on your international business, and revenues of 84 crores, so are these employees on-site?
- Srikar Reddy** I think on-site off-shore mix is 40% onsite and 60% offshore.
- Kavita Vempalli** These are the employees who are working on your international clients?
- Srikar Reddy** No, they are working for international clients about 70% or 80% of the people work from India and 20% of them work from our clients internationally.
- Kavita Vempalli** You said that you do not give guidance, but then which geographies or which of your service lines do you see the next level of growth would come?
- Srikar Reddy** I think we have given the geographical mix of our revenues in the report, yes. Overall, it more or less reflects the global trends. We see that the US has started turning around, Europe continues to be a little stressed, and we see potential in Asia Pacific and the Middle East, and in that there seems to be growth economies. But obviously the US is the largest market, even if there is a small percentage growth, there it can translate into big change in the top-line kind of stuff. So, I think the global trends will continue to drive the way we see growth coming from. We are not going to be very different from anybody else.
- Kavita Vempalli** The service lines which you operate in, which of them are gaining more traction.
- Srikar Reddy** As I told you there is a traditional service line, which is Application Development, Testing, Maintenance, ERP, and that kind of stuff but it will start showing and as I said, may be now, 12, 13 months from now, the newer technology areas is where we are seeing traction, as I said, Social, Mobile, Analytics, Big Data, and Cloud. So these will start, I think, there will be a bigger trend towards it, as we go forward.
- Kavita Vempalli** This kind of business, Big Data and the newer technologies, any contribution of these kind of new technologies to your current revenues.

- Srikar Reddy** No they are fairly miniscule at this point, maybe less than 5%.
- Kavita Vempalli** Secondly, what do you think would be the margin levers going forward? When do you think that you will get back to this earlier margin level of 11 to 12% EBITDA margins?
- Venkatraman N.** Our EBITDA margins are about 14% already, but the margin levers are essentially new technology business at a better rate, more of US business and Europe business, because APAC can be a little revenue lower in terms of pricing, so there is a pricing lever that you have. You have got large contracts within our own existing world coming up for renewals, the ability to quickly reprice them. These are the various things that we are looking at and foreign currency which I did mention we have been buffeted by wild fluctuations in the past. We have been taking forwards, and every quarter we have been hit by just about 4 to 5 crores of foreign currency fluctuations, so that comes in, we should be able to hopefully avoid or at least minimize the extend of forward covers. So these are things that we are doing right now and more importantly it is to do more of the new business and new technology areas and also ensure that we get more from our existing customers because the cost of sale in that is much lower. These are levers that we have got. Grow revenue growth, because we have our fixed overhead in place, a large part of the revenue growth should drop to our bottom-line.
- Kavita Vempalli** This new technology, which you are talking about, so you are going to mine the existing customers or you are going to hunt the new ones?
- Srikar Reddy** Both. We will use that to mine existing customers and they will become our access mechanism for getting new clients.
- Kavita Vempalli** So what is the approximate R&D cost, if you can quantify?
- Srikar Reddy** There is no R&D in our business, we don't capitalize this. There would be a certain percentage of the organization which would be about 5 to 7% who are just focused on learning new technologies, building concepts, solutions frameworks, and new models for growth and so on and so forth. We don't really have classical R&D, where we capitalize R&D and so on and so forth.

- Kavita Vempalli** 5 to 7% of the headcount, you are saying.
- Srikar Reddy** That is correct.
- Kavita Vempalli** So, for this new technologies, do you have any ready products or you have any ITs ready with you, what is the strategy exactly?
- Srikar Reddy** The strategy is, actually if you get expertise and strategy is to actually get partnership because for each of these technologies there are a lot of toolmakers, vendors, then who have the tools, so we have got to get partnerships, we have got to get expertise in these areas, and we have got to understand how we can apply these technologies to improve certain specific business processes of our clients of verticals, which are of interest to us and as we build that we will reap what we sow and harvest these things and if you want to call it IP I will call it IP, but some kind of solution framework, yes.
- Kavita Vempalli** In the current quarter what was the FOREX loss?
- Venkatraman N.** About 5.4 crores on account of forwards, which were restated, but we had a gain of about 4 crores and thereabouts, on restatement consolidation, because we hold money overseas, so consolidation so to that extent yes, the net FOREX loss was about 2 crores.
- Kavita Vempalli** That is included in the other income or the other expenses, above EBITDA.
- Venkatraman N.** It is in the expenses side.
- Kavita Vempalli** Above EBITDA. Could you give the same number in the previous quarters also? The net numbers should be fine.
- Venkatraman N.** It was 6.7 in Q2 and a 0.5 in Q3 last year if I am right.
- Moderator** The next question is from the line of Ananth Kumar from Way2Wealth Securities. Please go ahead.
- Ananth Kumar** Can you please comment on your hedging policy as well as your outstanding hedges and their average rate?



Sonata Software
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Venkatraman N. Currently what we do is we take hedges for one year period and the coverage % for the coming quarter will be higher, as we go down Q3-Q4, it would be lower. So we are looking at covering the 60 to 70% of our net receivables currently.

Ananth Kumar What are the outstanding hedges at the end of the quarter?

Venkatraman N. End of the quarter, what we have covered for the next quarter will be about 85% cover.

Moderator As we have no further questions, I would like to hand the floor back to the management for closing comments. Please go ahead Sir.

Srikar Reddy Well, thank you all very much for joining this call and the level of questions and wanting the deep understanding, wanting to know our business better is really great. So look forward to meeting you on our next Analysts Call and thank you for all your support so far and look forward to your continued support.

Moderator Thank you gentlemen of the management. Ladies and gentlemen on behalf of Sonata Software that concludes this conference call.
