



“Sonata Software Limited Q3 FY14 Earnings Conference Call”

February 10, 2014



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Moderator

Ladies and gentlemen good day and welcome to the Third Quarter Earnings Conference call of Sonata Software Limited. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your Touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. P. Srikar Reddy. Thank you and over to you, Mr. Reddy.

P Srikar Reddy

Good morning everybody and welcome to the Analysts call following our quarter three results of financial year 14 which we announced on Saturday. And here with me Venkatraman Narayanan our CFO; R. Sathyanarayana who is the Head of Finance & Accounts; Priya, our Company Secretary; and Arun Sriram – Head of Marketing. I think based on the results which you might have now had some time to go through and the analysts data we have put on to our website you should notice that I think we have made fairly significant movement forward on different financial parameters like Profit After Tax, EBITDA, Margins etcetera which I think Venkat will cover in greater detail when he speak to you after I do my bit.

And you might have also noticed that there is continuous momentum to our growth over the last six to seven quarters especially last three quarters as the first three quarters of this financial year I think have shown fairly significant growth in terms of our profits and EBITDA. I think the reasons as was in the past and I will continue the same thing really has been our focus on execution. We have set the course in terms of our strategy of focusing on select verticals, specialized horizontal services, working with select technology partners, investing in strategic sound management, marketing and branding, investing in talents, investing and ensuring that we have a globally scalable world class delivery organization. I think these are as I said have been the key cornerstones of our strategy and continue to be so as we go forward.

Also mentioned in the last couple of calls the investments we have already made especially in sales and marketing globally is expanding our footprints I think which we were all well aware of. Going forward as I said our focus remains to be the same. Our immediate strategies are really gets more focused on organized go to market approach. I think we do believe that we now have a very solid go to market plan there is a team in place and the key thing is now to execute on that as we go forward. And I believe the success of that will start showing up in the results as we go forward. The focus is also to look at the M&A which is aligned to our growth strategy, invest deeper in our vertical capability; invest in talent; invest in branding. We are also going to invest in nearshore development centers you are going to hear some announcements from us in terms of what we are going to do both in the US and Europe as we announced setting up of these development centers.

And I think one more key thing. Last quarter I think has been the traction in the Retail sector and a couple of good major marquee brand names which were acquired as clients in the last quarter. So net-net to sum-up I think we do believe we have had a good year so far and we do believe that the commitment of the team and the focus we have shown so far will continue to stand as in



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good stead as we go forward. And yeah, thank you all for your support and I now handover the mike to Venkat to take this with details of the financial highlights for the quarter and then more than happy to take any questions you may have at the end of it. Thank you.

Venkatraman Narayanan Thank you Srikar. Good morning to all of you. I think the previous quarter we have the investor presentation up on our websites taking quite a bit of feedback from many of you who have taken the time and effort to reach out to us or changes we have been consistently improving putting new metrics and we would be delighted to hear more from you and if you want anymore metric we will surely evaluate them and have them posted as part of the investor presentation, so that we have one place where we could cover all the metrics and the numbers that you would typically look for.

Taking over from Srikar overall the financials have been very good for this quarter so it has been a very good quarter and our revenue growth in our IT services business or rather let me start by saying that I think all in all we have two segments of our business one is the product business and the other is the IT services business. Both have different rhythms so what we look at metrics separately for each of them and we try to report to the extent possible we divide the metrics amongst the two segments and try to highlight them to our investors and to the analysts community.

So I am going to take the first segment which is the IT services we refer to that by International IT Services in our press release in our presentation. That is essentially the IT export business where substantial numbers of people of the company are engaged in. The revenue growth in that business was 8% in dollar terms. That was a number which we have not put out there so I thought will be a key for you people to realize that we have really done volume growth and the growth in our revenues of 41% for the nine months ended as it is not coming solely from the foreign currency fluctuation.

So we have had revenue growth in US Dollar terms of 8% which is 32% year-over-year. In INR it was 7% and that was a 52% growth year-over-year. We have added three new customers during the quarter and few of them are the verticals that we focus on so it is very important. The EBITDA number we are at 20% which is a significant expansion from the 16% that we reported last quarter and 14% in the same quarter last year. So I remember one question somebody asked as to when we would touch a number like 19% and Srikar had answered that it would take us really four quarters to do that we seemed to be ahead of that target by two quarters right now.

Revenue from the top ten customers we were at about 79% in the quarter before last. The last quarter we have brought it down to 74% and right now we are at 73% so like Srikar mentioned it is slowly showing up the broad basing of our customer bases which is showing up on our customer concentration itself. Utilization has been at a stable 83% and billability is at an internal number that we track is at a high of 77% and essentially it shows up on the delivery metrics that we were putting out there. The rupee realization has been better and as you have all been told in the past we used to have hedges which went in to six quarters in to the future. For the last four



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quarters we have consistently unwound those positions and right now we are only hedged essentially for two quarters that is all that we hedged. It is showing up on the realization rates that we are getting as you see in the presentation.

The other missing feature is Europe has shown a significant uptake in terms of the geography concentration it has gone up from 33% compared to 27% and 28% in the earlier quarter. Headcount has been stable we are at about 2,476. ROCE which is another metrics that we have started reporting which is about 22% for the business of the international services. As far as the product business is concerned I have been saying this in the earlier analysts calls as well we do not really focus on top line it was essentially the margin and the profitability that is the focus in that business and as you will see the EBITDA in that business is Rs. 8 crores which is at 3% of our revenues and this has shown an improvement from the earlier quarters of 2%.

The revenue de-growth is essentially on account of the lumpiness in the business because we get certain orders which are in line with the quarter end of the principle which is why I keep repeating that we should not be too focused on revenues though you have some in the quarter and then it reflects as minus in the next and vice versa. ROC and RONW in this business is 20% and 30% respectively this is the key focus for us like in earlier quarters I have been mentioning we focus on Return on Capital employed, Return on networth receivables working capital management in this business. For most part of the quarter or for the year this business work on a kind of negative working capital so to that extent our ROC and RONW are at a healthy numbers.

Consolidated PAT growth has been 20%. It was 150% on a year-over-year basis. Year ended the quarter with a healthy cash and equivalence of about Rs. 195 crores. EPS stood at Rs. 5.15 for the nine month period ended which is in sharp comparison to the loss of Rs. 3.33 in the earlier period. We have made a significant progress in the tax issues as you know that reflects in that we have got refund from Government and we have not added to any new issues and it is also kind of a relief for us that now the issues that we have used to face on an individual basis are now largely industry issues and they are getting a lot more attention and all the attentions that they deserve.

On the M&A efforts like Srikar said it is an area of focus we are looking at companies in the areas of Travel. Microsoft Ax and they will continue to be the area of focus and the goes that we are looking for are Europe and US. That said we have been a little slow it is not that there are worth any lack of effort on that part. The base going forward has been such the real challenge will be to ensure that we keep growing at the same pace and we will keep the same momentum going forward in to the next quarters and the years going forward. Thank you and I will now turn it over to you for questions.

Moderator

Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. Anyone who wishes to ask a question may press * and 1 on their Touchtone telephone. The first question is from the line of Shweta Seth from Stewart & Mackertich. Please go ahead.



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- Shweta Seth** My first question would be on margins we have seen a significant uptake. I understand that it would be because of the operational efficiencies and investments you have made earlier that would be kicking in. But would it be anything special you would like to mention for such a sudden uptake?
- P Srikar Reddy** I think it has been a gradual uptake in the margin as you see the trend. I think it has been mainly two factors. Obviously there is better realization on the dollar and then our focus on utilization, better negotiation of rate. I think some of our services started to move more value added and more upwards in terms of the kind of services we are offering. So I think it is a combination of various factors which have helped in the uptake in the margins.
- Shweta Seth** Do you feel this sort of momentum would be sustained going forward?
- P Srikar Reddy** Momentum in what, sorry?
- Shweta Seth** Momentum in margins would we see these sort of uptake in margins going forward?
- P Srikar Reddy** The levers which we have which we could operate on I think now it is really going to be more probably little bit from the dollar and the most of it has really now come from what we can call if we can get better realization for our services. So I think yeah, more or less there or there about. It is going to be it require solid amount of stuff to know starting the needle forward.
- Shweta Seth** My next question would be on your hedging thing. Can you just give me the number for outstanding hedging and rate at which it is fetched?
- Sathyanarayana R** We have coverage of about 63% for the US Dollars in the next two quarters and the rate at which we have covered is Rs.57 to 58
- Shweta Seth** My next question would be on your immigration bill effect. Sir, recently we had an announcement that even L1 visas would be under scanner in the US. So sir, how would it affect our business going forward and the I mean the amount of employment what set of we are looking at local employment or we would be hiring I mean how much employees locally and opening of near-shore centers and all?
- P Srikar Reddy** Yeah, I just mentioned it in my opening address that we are looking at expanding our near-shore centers and you soon hear some announcements on that. So I think one needs to take all this whatever our rules and regulations in our stride and then move on because obviously it is the same level playing field for everybody. So we need to plan around it and move on so definitely the near shore model is quite key now for us to address some of these issues.
- Shweta Seth** In the near term you are planning to open a new center as such is it anything on the table because we have opened some two centers recently, right?
- P Srikar Reddy** You may hear something about it in the next couple of months.



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- Shweta Seth** Where would it would be and which geography?
- P Srikar Reddy** It starts with in the US.
- Shweta Seth** I would like to have an outlook on your Retail and CPG vertical I mean what sort of investments have been made there and also I mean your Cloud and Mobility business and all which is one of clients you have added in Mobility in this quarter, right?
- P Srikar Reddy** You are asking me the shrink our, what we do over in 12 months period it is a 5 minutes answer I will try to do my best.
- Shweta Seth** Just wanted to have an outlook I mean what sort of approach you are?
- P Srikar Reddy** I think end of the day as I said I think one is that we are narrow segmenting these verticals so even in the verticals we do sub segmentation based on our specialized services which we have and then set on these partners we work with. So that is really first level selection of kind of companies we will target and address. And obviously then it has been like what everybody target in terms of building these domain capability, building solution accelerator, working with our technology partners to deliver solutions to joint go to market built brand and all that kind of stuff. So there are whole lot of stuff and not a rocket science it is obviously I mean it is just steady focused and get things done.
- Moderator** Thank you. The next question is from the line of Chetan Wadia from JHP Securities. Please go ahead.
- Chetan Wadia** The continuation of the previous question I think my question is with respect to the how much progress has been made in developing the technical capability in the area of Cloud computing, data Mobility and social media? So where do we stand today and what is our scalability in terms of doing business in these verticals?
- P Srikar Reddy** Yeah Chetan, it is a continuous process in terms of the scaling up these technical capability here I mean it is both lateral and then training people from within it and as I said it is like Mobility is like it is fairly broad based. I can give you a quick two minutes lecture on Mobility. Mobility we break up in to three parts. One is what you call designing responsive web applications; two is to design mobile applications in these platforms and then the third is just developing applications within the standard platforms like IOS and Android and so on and so forth. So we are looking at all the three areas we have got no select partnerships in each of these areas in terms of niche technology providers in these. With thes capabilities, we have service offerings which acquire Mobility center of excellence and Mobility factories; we are buildings, solutions framework for our verticals. So it is a whole lot of stuff and we are doing all that.



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Chetan Wadia My question is on the international business perse. We are seeing more growth in there in the last nine months in the international side. So what kind of do you plan to add more people in that area will the headcount would remain the same more or less at this level?

P Srikar Reddy So are you saying is our focus more on the international side is that the question?

Chetan Wadia Yeah.

P Srikar Reddy Sure we have got focused on both businesses and we believe both the businesses are great businesses. Obviously the domestic business is not a people intensive business and we are trying to transform that business by adding new lines of business in terms of more higher value-added products. I did forget to mention in my address that we have started two new lines there called Cloud Licensing and Engineered Systems and Appliances. So we personally believe it is a great business. I do not think hundreds of people will drive the business but I think from the brand we have market access, market reach, etc., is really leverage us and grow the business. Obviously yeah, International Services business is more people intensive business so as we grow we would obviously need more and more people.

Chetan Wadia Lastly, on the domestic product side can you be more like some specific information in terms of kind of what are the key initiatives that you may have taken in the last six months and where do you think like what kind of quarterly run rate of revenue that we are seeing in the domestic business? Can that be continued for another four, six quarters there can be some improvement can be seen on that as well?

P Srikar Reddy As Venkat mentioned the focus on the domestic business is not revenue per margin. And we do believe that there is headroom to grow in the domestic market and as I said some of the new initiatives we have taken over the last two, three quarters hopefully will start yielding results and start showing up in our numbers in the next few quarters. So our focus there is margins so I think the revenue added that can go an aberration based on one of the large contract with sometimes a lower margin and that can change some of the stuff. But the focus there is really two things, one in margin and two is the capital we employ in the business and I think that capital we employ in the business is almost close to zero kind of stuff. So I think these are the two things which one needs to get and that is why I believe they are great businesses.

Moderator Thank you. The next question is from the line of Jatin Meswani who is an investor. Please go ahead.

Jatin Meswani My question is two questions. One is can you provide me the actual growth for International Services in a dollar or whatever Pound term because if I see currently while there is a growth in revenue but there are two parameters I believe that is driving. One is there is a significant change in the realization rate close to 20% increase in the realization and second is there is a utilization is improved. So probably that is helping the margins. So just want to understand revenue in a



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dollar term. That is my first question. And second is the growth in Europe is significant want to understand is it beyond TUI or still we have any engagement with TUI?

P Srikar Reddy Jatin, your first question revenue growth was about 8% on quarter-on-quarter basis in dollar terms constant currency and 32% year-over-year.

Jatin Meswani And second question was related to the Europe business was it still driven by TUI or there are some additional clients?

P Srikar Reddy TUI continues to be a client of ours. I think you know that we have mentioned it as far as the arrangements we had when we sold the joint venture. We had an agreement saying we will continue to be a strategic vendor for them. So they continue to be a strategic point for us. And we have seen some fairly significant traction in that market with couple of other strategic clients and as I mentioned we have acquired couple of fairly marquee names in the Retail sector in Europe over the last quarter.

Moderator The next question is from the line of Rajesh Kothari from AlfAccurate Advisors. Please go ahead.

Rajesh Kothari My question is basically two questions. One is what is the FOREX loss or gain in the current quarter?

Sathyanarayana R Current quarter on a consolidated basis we have a loss of Rs. 4 crores.

Rajesh Kothari And for nine months?

Sathyanarayana R Nine months it is Rs. 0.54 crores.

Rajesh Kothari My second question is basically with reference to your strategy since now on international business we have already kind of around 20% margin how do you see the growth as well as the margin outlook from here on? Do you think that we can further improve the profitability over next one to two years or do you think that this 20% is the optimum margin?

P Srikar Reddy I thought I did answer that question. I think most of the levers are really exhausted I think so. I think we are near about in terms of the percentage of margin drive and to bring the growth is now be driven by really top-line growth.

Rajesh Kothari And to achieve that the higher top line growth do you think that there might be significant investments in marketing and sales and distribution what we need to make to further penetrate either the existing customers or to get the new clients?

P Srikar Reddy Sure I think we have been mentioning it in all our past about 7 or 8 quarterly call we have expanded our onsite sales and the account management team by almost an absolute number of about 10 people that is this almost about another 300% to 400% more than what we had more



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than about 8 quarters ago. We have made significant investments and we did not mentioned we hired Ankush Patel who was the Vice President of Infosys he has come in on board as our Head of Sales – US; Rajeev Rege who was with Infosys and Accenture. We have opened our office in Australia three months ago. We have opened our office in Singapore expanding in other geographies. So whole lot of I think possibly for the last eight quarters and for our size we spent a huge amount of money in sales, marketing. Arun I think who has just come on board as Head of Marketing. Arun who was with Hindustan Uni Lever and he is an IIT & IIMB graduate with about 20 years of experience. And then the big you see a lot of initiatives in branding, Digital Media, Social all that kind of stuff. We have participated in lot of events, sponsored a lot of stuff and we have been specialized in our focus areas and all that. We will spend money but we will spend it very carefully and we look for leverage in terms of what we get for the money we spend. So to answer your question made a lot investment. We will continue to make a lot of investments. Obviously it will have to do our size but I think given our size we will be relatively little bit more than that in terms of competitors.

Rajesh Kothari

So basically for the higher growth compared to what the industry right now and looking at our small size of the business what kind of growth you think over next two and half and three years you would like to target?

P Srikar Reddy

You know we don't give forward-looking statements but we keep saying that we believe the big headroom, a lot of opportunity to grow. We also believe that we can do better than the industry average but that is what we can say at this stage.

Moderator

Thank you. The next question is from the line of Shweta Seth from Stewart & Mackertich. Please go ahead.

Shweta Seth

Just two data points. How much of your revenues would be from the SEZ currently around one-third if I am not wrong?

Sathyanarayana R

About 35%.

Shweta Seth

Any outlook on your tax rate going forward?

Venkatraman N

Our current average tax rate is at about 26% to 27% so given the way the benefits of the SEZs are slowly being vanishing as per the direct tax benefits are concerned I think we should be thereabout in that area itself. We are 26-27% may be 1% reduction is what we are looking at because as we go forward almost all our expansion and the developments are our offshore capabilities will be inside SEZ. On a weighted basis yeah, we are expecting it to bring it down by a percentage point as we grow.

Moderator

The next question is from the line of Deepak Agarwal from Impetus Advisors. Please go ahead.



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- Deepak Agarwal** As we increase our presence on the near shore and also whatever we do to take care of the US immigration bill impact that will compress our margins or will we be able to raise prices enough to take care of that?
- P Srikar Reddy** Okay it is a follow on question. I do not think it will affect our margins actually we have got it a lot more organized. Here I think what is happening is because of the let us say the little uncertain way the visas have been processed, what is happening is at sometimes there are we have to hire people locally at a lot higher competition because of lateness to their hiring. So if we plan for it I do believe that our average onsite cost will not increase significantly.
- Deepak Agarwal** Our total employee have seen a lot of volatility off late like September quarter it went up by Rs. 8 crores sequentially this quarter it is down some Rs. 4 crores to Rs. 5 crores. What is happening there?
- Venkatraman N** That is based on the provisions for the incentives and the provisions for the variable pay that happens. Because based on our quarter's performance we have announced certain additional variable pay which happens after results. So that is something which gets factored in.
- Deepak Agarwal** That is every quarter?
- Venkatraman N** Yeah, our variable pay for the employees other than the senior management is on a quarterly basis. And the other aspect is also the impact of the foreign currency on our onsite pay. For example what will be converted as Rs. 60 one quarter gets converted to Rs. 62 on another quarter and the same for GBP which is we have quite a large onsite persons in UK there is a huge amount of variable. So these two are the main things of which impact the numbers when I reported in rupees.
- Deepak Agarwal** My last question is on the net FOREX loss of Rs. 4 crores can you give further breakup on this what has given rise to this?
- Venkatraman N** There are two elements to this one is the restatements and the other is the realized. The realized plus mark-to-market comes to about Rs. 4 crores and the restatement this time we are at about zero.
- Moderator** Thank you. The next question is from the line of Ravi Menon from Centrum Broking. Please go ahead.
- Ravi Menon** Just wanted a couple of fair points if you can, what do you think about the outlook for next year especially Australia and New Zealand and your customers in the UK. And secondly which areas do you see momentum in your international business?
- P Srikar Reddy** Yeah, I think Australia we have just opened Ravi about three months ago. Obviously we will take it as investment and as you know with most of it sometimes to do with managing our current



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client base and then use that leverage in go-to-market. We have taken an investment and we do believe that we will start to see the serious benefits out of that in the next possibly 12 to 18 months in the Australia and New Zealand. Europe continues to be focused. We see good traction. I think now we are focused three or four verticals Travel & Tourism, Retail, Consumer, and Packaged Goods. We mentioned about the services we focused on. So I think in general I feel our outlook is that we do see let us say a good opportunity for our services and the verticals we operate and the way we are able to communicate our value to our clients. So obviously we need to execute well and all that kind of stuff. But I think overall we do see the opportunity continues to exist.

Ravi Menon

What kind of deals are we are looking typically I mean you said like sub-\$5 million kind of annual run rates or what sort of contract sizes and annual run rates that we are targeting mostly?

P Srikar Reddy

I think at this stage our main strategy is what we call "land & expand" strategy. So we will to get in to straight large kind of opportunity hopefully we have something around it. Right now it is really land and then expand and really our focus is to drive any account we get in to through about \$2 to \$3 million in about 18 months' time net. But it is all strategic long term and we do not want to get in to short term single project kind of engagements that is not our plan. The strategy is not like we are picking up our targeted accounts. But at this stage our focus is not really just go and pick for large deals.

Ravi Menon

But then your chosen the new areas Mobility, Cloud and all that do you think that the nature of engagements it is short term by nature?

P Srikar Reddy

Not really because I think they are all moving to now centers of excellence and all investment. I think they can all start off initially with saying what can we for us and how much benefit and all that but they become like any other area whether it is Big Data or whatever it is once that becomes there it is like huge momentum keep on figuring out which business profit do they get up exit buy it and point of solutions to our kind of stuff. So I think it is the initial curve is what will take long time but after that I think it becomes fairly straight.

Ravi Menon

So you think that there is take off maintenance revenues going forward to from these kinds of engagements?

P Srikar Reddy

Absolutely.

Ravi Menon

On the India side of the business if you can give some color on what is your outlook there in general I mean are people are averse to spending or because we have heard commentary on those lines from the large companies who are system integration players in India?

P Srikar Reddy

A lot of big corporates are now being what for legal Software. I think as they grow they need to spend more so it is fairly simple straightforward kind of alignment to the growth in whatever their own employees and all that kind of stuff. So we will continue to see the growth in market



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and we will continue to see the growth especially things like Cloud and Appliances and Engineered Systems or finding what we call markets for new entrants we want to get in. I think we have been quite a great story in terms of for any technology provider want to access the Indian market and great track record the huge presence, huge brand, huge reach all that kind of stuff; understanding the market. So opportunity is there and then we have got some ideas. So as I said it is all about execution and I think we will continue to see some growth there.

Ravi Menon

And why do not you try cross selling more business services would you do that and be more of a system integrated player in India other than just a value-added reseller of Software?

P Srikar Reddy

Yeah, I mean interesting question. So that is something that we are exploring purely from the Software, Cloud, and Engineering System side. So let us see whether such an opportunity and such a value proposition make sense to us and we will be there.

Moderator

The next question is from the line of Anil Jain from Equi Passion Capital. Please go ahead.

Anil Jain

I just have two questions, first is what is the dollar revenue created for nine months ended 31st December and second is what is our hedging policy?

Venkatraman N

The dollar revenue was \$57.3 million.

Anil Jain

And what is the growth from previous years?

Venkatraman N

That was 8% on a sequential basis and 32% on a year-over-year basis for the quarter and nine months over nine months was about 28%.

Anil Jain

What about FOREX hedging policies?

Venkatraman N

Our hedging policy like I said in earlier to cover for two quarters which is the current and the next quarter so we have got hedges for Q4 and Q1. It earlier used to be for six quarters which has been brought down to two quarters right now.

Moderator

As there are no further questions I now hand the conference over to the management for their closing comments.

P Srikar Reddy

Thank you all for joining in and it is really great to see the interest we are able to generate. Thanks for all the great questions and thanks again for all your support for the last many quarters. We look forward to your continued support and look forward to seeing you after our I think this time it is going to be annual results sometimes in May. Thank you.

Moderator

Thank you very much members of the management. Ladies and gentlemen, on behalf of Sonata Software Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.