



Sonata Software Limited Conference Call FY2013 (Q1)

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CORPORATE PARTICIPANTS

P. Srikar Reddy

Managing Director & Chief Executive Officer

N. Venkatraman

Chief Financial Officer

Sathyanarayana R.

Head - Finance and Accounts

Swati Sengupta

Head – Corporate Marketing and Communications

Moderator

Ladies and gentlemen, good morning and welcome to the Sonata Software Limited Q1 FY2013 earnings conference call. Joining us on the call today from Sonata are Mr. Srikar Reddy – Managing Director & Chief Executive Officer and Mr. N.Venkatraman - Chief Financial Officer along with other members of the management. As a reminder for the duration of this conference all participant 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 this conference, please signal an operator by pressing “*” and then “0” on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Srikar Reddy. Thank you and over to you, Sir.

Srikar Reddy

Good morning everybody and welcome to the analyst call for the quarter ended June 30th, 2012. I have here with me Venkatraman, CFO, Sathyanarayana, Head of Finance and Swati Sengupta, Head of Corporate Communications.

Let me just step back and remind you of the conversation that we had about three or four months ago where I did take you through our immediate priorities and focus areas. I said that we are looking at four or five areas- one was that we will continue to focus on our existing clients as we believe that there is a lot of headroom there for growth. Secondly, we will continue to work



Sonata Software Limited Conference Call

strongly with our alliance partners as we go to market in some of our key market segments. Third, we will strengthen our sales operations in different geographies. Fourthly, we will continue to verticalize some of our offerings. We are in two verticals today - Outsourced Product Development and Travel & Tourism. We said that we will work with our clients to verticalize some of our offerings; and we will continue to invest in some of the technologies like Mobility, Cloud, Social media, BI & Data Analytics.

I am pleased to report to you that we have had a decent quarter. We have been able to execute on some of the strategies. The highlights for the quarter are: we have added 6 new clients last quarter, we have been able to expand our services with our existing clients and we have been able to add new services with most of our clients. We have forged new alliances with some of the technology areas that we are interested in like hybris, Salesforce and Amazon. We have also made an announcement about strengthening our sales team in the US. Over the last quarter and over the next few weeks, we will have five new senior sales members in the US geography. We have had a margin improvement which Venkat will cover in detail - basically coming out of improved billing rates, improved utilization and higher revenues. We have had confirmed go-to-market (GTMs) in some of the geographies especially with Microsoft and SAP. We continue to have a stronger pipeline now as compared to where we started off. We have done a couple of internal things which were launched: a new brand identity program and a strong leadership development program. We have had increased coverage from analysts like Forrester and Zinnov. Zinnov has rated us in the leader quadrant in couple of service areas and in Outsourced Product Development space.

Going forward, our focus would be to continue to strengthen our sales team. We are going to strengthen our sales team in Europe. Hopefully, we will have 3 or 4 people on board over the next few weeks. We are trying to expand our geographic presence. We are looking at increasing our presence and opening up our offices in Singapore and Australia where we have a few clients. Hopefully by the next few quarters we should have some announcement in this space. We will continue to invest in the development of our leadership. I will now hand over to Venkat who will take you through the detailed financials for the quarter. Thank you.



Sonata Software Limited Conference Call

N. Venkatraman

Good morning to everybody. Thank you, Srikar. The results of the investor presentation have been uploaded on our website last Friday and I hope all of you had a quick chance to look at it. Our business as detailed by Srikar is essentially made up of 3 identifiable segments and we have been continuously focusing on presenting our financial results on a segmental basis. We have actually changed the format of our press release this time to give you a lot more information on the segments we operate in. The segments are: International IT services - the software services business, Domestic products and services essentially our India business where we do both services and products, and third is our joint-venture with TUI InfoTec in Germany. As you will recollect, I had signed off on a positive note in my last quarter's communication. I am very glad to tell you that our results are in line and we have shown a significant improvement during this quarter.

Now going to the first segment, the largest piece in terms of profitability and growth is the international IT services. Revenues have grown 23% on a sequential basis and absolute growth has been Rs.15 crores. Our earnings before interest, depreciation, tax and amortization have also shown a significant growth and they are at Rs.10.26 crores and PAT is at about Rs.5.87 crores. Revenues at Rs. 81 crores is one of the highest we have seen in this business ever. It has been the highest as far as this segment is concerned and we have had a certain upside, thanks to FOREX (I will cover that later). We have added 6 new customers - again one of the highest in a quarter. Traction and revenue growth from our existing customers have also contributed significantly to this revenue growth. As Srikar said, our pipeline in this business has never looked better. And on the operating metrics, we have improved our utilization significantly with a healthy 79%. We have managed our costs well. We have consolidated our facilities. We are planning for more space in the Technology Park that we are placed and we have contained the cost.

FOREX fluctuation does play through in and we have hedged a substantial part of our foreign currency and that will also have a role to play going forward. We have hedged for an average rate of 50 to a Dollar and thus the gains that some of our peers are going to get at 55 for their open position, will not be seen by us. We will have to cover that shortfall to our revenue growth.



Sonata Software Limited Conference Call

The day sales outstanding in this business has improved and is at 64 days, and that is, if you adjust for a mistaken wire transfer we had during the quarter. We ended the quarter with solid cash balance of Rs.136 crores in the business and thus we are on a firm footing going forward. The result of Q1 has been very good and in fact has set expectation from all of us in Q2.

Coming to the domestic products and services, revenues of Rs.204 crores has shown a growth of 48%. EBITDA at Rs.1.75 crores and PAT at Rs.90 lakhs also is a very positive growth. As the numbers are high, I am not giving it to you on percentage terms. In this business, we are very focused on profitability which has shown a significant improvement over the previous quarter. We have achieved this in the product business through our continued realignment of the product lines that we deal with and through better channel programs that we are participating with our principals. On the services side we have wound down certain loss-making projects and we are also now focusing on certain key go to market offerings and we will be focusing on developing both our customer base and our capability base. Positive changes in the tax environment during the quarter effective from July 1st will help us significantly grow this business in the coming quarter. Essentially tax on multiple levels of transactions or TDS on sale of software in India has been removed by the Finance Ministry. Day sales outstanding which was a very key matrix for our India product business stood at 53 against 49 last quarter. The increase is primarily because we closed two significant deals at the quarter end. Getting back to international services, business expectations in Q2 are quite high.

When we come to TUI InfoTec, the third segment which is our joint venture, revenues at Rs. 119 crores has shown a growth of 4%. EBITDA before exceptional items worth at Rs. 4.5 crores and PAT has shown a growth as well. As I had mentioned on our previous call, TUI InfoTec has put in place a voluntary retirement scheme for its employees. Earlier this scheme was only open to a few of the employees. During the quarter the company opened it to a larger group of employees and as per German Accounting and Law Provisions, we have to make accounting provisions for the same. Thus we made a non-cash provision of Rs.43 crores at the entity level. Upside to savings on account of this VRS will help us significantly turn around the profitability with the joint venture as we go forward. We have considered 50% of this restructuring cost as an exceptional item in our financials. The



**Sonata Software Limited
Conference Call**

company TUI InfoTec has got a reasonable amount of cash and they are on a good footing as far as meeting their costs or meeting their expenses are concerned. With that I come to the end of my speech and I will turn it over to the Moderator.

Moderator Thank you very much, Sir. 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. Participants are also requested to use only hand set while asking a question. Anyone who has a question at this time may press '*' and '1'. We have the first question from the line of Chetan Wadia from JHP Securities, please go ahead.

Chetan Wadia My first question is on the provision within the TUI InfoTec. To how many employees is it open now and how many have accepted? What is the potential provision that could be made in the books if the remaining eligible employees accept the VRS?

Srikar Reddy I think it is open to about 120 people and this time about 75-80 people have accepted it. So we are looking at another 40 people.

Chetan Wadia How much of that provision would they accept, let us say, in Q2?

Srikar Reddy It will be proportionate. I cannot give the math right now. It is Rs.43 crores for about 75 people; so 40 people, whatever the math is.

N. Venkatraman It has got a linkage to the salary that they draw but roughly yes, it would be in the range of about two-thirds.

Chetan Wadia Two-third of the current provision?

Srikar Reddy Right.

Chetan Wadia Ok, I take that. Second question is on the contingent liability which we have shown in the last quarter's results. What are the management views on the taxation contingent liabilities reported in the results and how hopeful is the management in resolving the issue? What is the basis of those hopes and in how much time frame?

N. Venkatraman Good question. In fact we have given a very detailed position of our contingent liabilities in our annual financial statement. So we have tried to



Sonata Software Limited Conference Call

explain each of the liability that adds up to the total number. We have positive orders in our favor in almost every case. The only issue is the Government sometimes goes and appeals, and sometimes does not go and appeal to the High Court or the Supreme Court, as the case may be. As it stands now most of the cases with respect to whether it is 10A or whether it is respect to tax deduction at source, we have won the cases at the lower level. One of the significant aspects of liability is the disallowance of payment for software under Section 40-A1. There, thanks to the amendment that has been made in the Finance Act of 2012 and also the changes that the Finance Minister wants to bring in the retrospective amendments that they have made in 2012, I think we are again on a strong footing. We have taken this issue up with the IT committee which has been formed by the Prime Minister to look at the tax issues of the industry. This has been a committee which was recently formed under the leadership of Mr. Rangachari and we are taking it up with them and we hope the outcome will be very positive. Presently as we stand today we do not have any demands. In fact we have got positive orders and we are pushing for refund of all the money that is stuck with the government and we are quite confident, in fact on all the items that we have listed in the contingent liability management list, feels are more than reasonably confident of a positive outcome. From a corporate governance and disclosure perspective, we have disclosed this in our financial statement.

Chetan Wadia So you believe in FY13 the amount of contingent liabilities in the books as reported should come down substantially?

Srikar Reddy Yes, it should come down substantially and we are taking all measures, not only the litigated steps but we are using soft power, we are having consolidated meetings with Government agencies, the Prime Minister's office and the Finance Minister's office, and we are going through NASSCOM. We are seeing quite a bit of positive outcomes through such steps.

Chetan Wadia Ok, I take that. What is the current head count?

N.Venkatraman Head count? We have actually published that in our financial statement. It is 2650 on a consolidated basis.

Chetan Wadia How many new joiners for the quarter?



Sonata Software Limited Conference Call

- Srikar Reddy** We have actually had a total decrease in the manpower between last quarters to this quarter - of about 75 – 80 people. As I said in the previous meeting, we have seen some excess capacity last year and that we are looking at ensuring that we are at the right capacity. So, that has decreased by about 75 – 80 people last quarter, net.
- N.Venkatraman** So that's been one reason for improvement in utilization and it has gone up to 79%. We honor every commitment that we have made to the campuses or to the new joiners. And this is not any forced attrition; we have basically just not filled up attrition
- Chetan Wadia** Ok, I take that.
- My next question is that you said in the initial remarks Rs.136 Crores. Was it only for international operations or for consolidated?
- N.Venkatraman** Only for International IT Services.
- Chetan Wadia** How much is for the domestic and TUI?
- N.Venkatraman** Domestic it is about Rs.17 Crores and TUI Infotec it is about Rs.31 Crores.
- Chetan Wadia** How much is the short term loan (domestic)?
- N.Venkatraman** Short term loan is about Rs.30 Crores.
- Chetan Wadia** Short term loan is mainly for what purpose?
- N.Venkatraman** That is for the mismatch between our debtors and creditors. We work on a negative working capital most of the time but sometimes, it is the timing issue. Also if you realize, there is Rs.120 Crores of our money lying with the Government that is tax recoverable. So we are trying to get that back and once that happens the domestic business will actually be cash surplus hopefully.
- Chetan Wadia** What is the exchange rate impact on the revenue for the quarter?
- N.Venkatraman** Our realization or conversion rate if you take for dollar would be 55.65 and if you take that forward we are at about 50, our average rate including open position would be 51.5 or 52.



Sonata Software Limited Conference Call

- Chetan Wadia** I just asked this question in a different way, after 27%, 19% year on year growth, 27% quarter on quarter, how is that 27% consoles the exchange rate?
- N.Venkatraman** We are talking about the Rs.15Crores quarter on quarter increase, Out of which the exchange rate would amount to \$1 Million, that's say about Rs.5 Crores. Rs.10 Crores is volume growth.
- Chetan Wadia** The number of pledged shares is coming down both sequential and year on year. Now there are 3 questions:
- 1) Which promoter has pledged the share? 2) What was the purpose? 3) Within how many quarters it is likely to be cleared?
- N.Venkatraman** Right now the pledged encumbered share as per our disclosure is about 26.61% and we don't have any insight to when they are likely to clear it.
- Chetan Wadia** Which promoter has pledged the share, if you can share that?
- N.Venkatraman** This is Bhupati Investments and Finance.
- Chetan Wadia** My last question. How does FY13 look like to you in all the three business segments in terms of revenue and profitability?
- Srikar Reddy** We really don't make forward looking statements.
- Chetan Wadia** Qualitatively compared with FY12?
- Srikar Reddy** Qualitatively like I said the last time, without making any quantitative commitments that we are looking at an improved quarter and I believe that we have actually delivered on that. So looking forward like I said, we have improved our efficiency with our existing clients and I do believe that the investment we are making with expanding our geographic footprint and sales footprint will start yielding results slowly over the next couple of quarters. Unless there is something extremely untoward that will happen which we do not believe will, I think overall we are looking at a fairly positive next few quarters in terms of both top-line and bottom-line.



Sonata Software Limited Conference Call

- Moderator** Our next question is from Sudhakar Prabhu of Span Capital. Please go ahead.
- Sudhakar Prabhu** My question is that on the six clients which you added to this quarter. If you could give us the colour of these clients, when can we scale up?
- Srikar Reddy** Good question. Mainly in the three segments, one is in the OPD space, the other is in the Travel and Tourism Space and third, we are working with large SI partners, international majors, who don't have certain horizontal capability. We have been selected as the chosen partner for doing that business. So on the OPD front, I would say that the scaling up would not be very rapid. On the Travel and Tourism clients, I will say that the scaling up will take place and on the SI as we will both jointly go to the market with the clients, we will see that the going will be fairly quickly but not immediately but over the next couple of quarters.
- Sudhakar Prabhu** Over the last 2-3 quarters, we have been taking couple of steps towards improving the business and when do we see all these fructifying? May be in the next 2-3 quarters or one year down the line? When do you see big growth coming for the company?
- Srikar Reddy** The things which will yield up results immediately will be our existing client base. The big step might be possibly for Q1 next year. But I think we have seen incremental growth which depicts new clients and that is really from whatever we have done in the past and the contacts we have had. It is not the new people who have started kicking in or the new initiatives that we are taking. So all this I think will start really showing up in our numbers Q1 next year. Otherwise the current situation is looking fairly healthy and I think that should take care of our growth objectives for this year.
- Sudhakar Prabhu** If you could comment on your margins, we compare it with the last year margins are almost half this quarter, 12 ½% versus 23% in your international business. So do you see this improving over a period of time? What kind of steady state margin are you targeting?
- Srikar Reddy** I don't know what numbers you are referring to?
- Sudhakar Prabhu** I am referring to the EBITA margin in the international business, compared to last year it was almost 23%. So there is a big drop in your margins?



Sonata Software Limited Conference Call

- Srikar Reddy** It is about 13% this quarter. It is not for the year last year but for Q1 of the last year. But if you compare with the previous few quarters I think we have actually shown a growth in the margins.
- Sudhakar Prabhu** What kind of steady state margins are you targeting for your business?
- Srikar Reddy** If it is a number, it is roughly about 15%.
- Sudhakar Prabhu** So you think 15% would be good enough for you?
- Srikar Reddy** Not good enough. That is as far as we can work towards and achieve. We could have been substantially higher if we had an open position on our forward position but given that, we know certain things. That's why we are being a little cautious on a 15%. Like I said we are making investments as you understand which will not yield us immediate results.
- Sudhakar Prabhu** I am not talking about immediate growth, I am saying one year down the line?
- Srikar Reddy** For Q1, Q2 next year, we should be looking at 18-20%.
- Sudhakar Prabhu** Lastly on the cash position you have Rs.135 crores of cash in your books. How do you plan to utilize it? Why don't you go for buyback or something?
- Srikar Reddy** Buyback? I don't know. We are looking at some inorganic strategy. So hopefully, we should do something by the end of the year and that is how we currently feel is the best way to utilize the cash we have.
- Moderator** As there are no further questions from the participants I would now like to hand the floor over to Mr. Reddy for closing comments.
- Srikar Reddy** Thank you all again for joining the conference. We really look forward to having our next meeting.
- Moderator** Thank you very much gentlemen of the management. On behalf of Sonata Software Limited that concludes this conference call.