



Sonata Software Limited Conference Call FY2010 (Q4)

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CORPORATE PARTICIPANTS

B. Ramaswamy, President & Managing Director

P Srikar Reddy, EVP & COO

Venkatraman N, Head -- Strategic Finance and Risk Management

Sathyanarayana R, Head – Finance & Accounts

Praveen Kumar D, Company Secretary

PRESENTATION

Swati – Moderator

Good Morning, ladies and gentlemen. I am Swati, the moderator for this conference. Welcome to the conference call of Sonata Software Limited. Mr. B. Ramaswamy will be your call leader today. For the duration of the presentation, all participant lines will be in the listen-only mode. After the presentation, the question and answer session will be conducted for the participants in the conference. Now, I hand over the floor to Mr. B. Ramaswamy. Thank you and over to you, Mr. Ramaswamy.

B. Ramaswamy – President & Managing Director – Sonata Software Limited

Thank you, Swati. Good Morning everyone, a warm welcome to the earnings call of Sonata. I have with me Srikar Reddy, who is the Director and COO, Venkat, who is the head of Risk Management and Strategy, Sathya, who is the Head of Finance, and Praveen, who is the Company Secretary. I will begin with an overview of the results for the quarter ended March 31, 2010 and hand it over to Venkat to take you through the financials for the quarter as well as the year.

As far as the consolidated business of Sonata is concerned, we look at it in three slices. One is the international service, which is basically Sonata's standalone with Sonata Software Limited plus Sonata North America, Sonata GmbH and Sonata Europe, all put together. The second slice is Sonata Information Technology Limited, which is a 100% subsidiary and focuses on the domestic market and the third is the JV, where we have a 50.1 stake in TUI InfoTec. So these are the three distinct businesses, which when combined give you a picture of the consolidated group. Let me begin with the international services. During the quarter January-March, we had a volume growth of 7% sequentially and about 8% year-on-year in terms of the US Dollar. In terms of the Indian Rupee, it was 3% sequentially and about 7% year-on-year. In terms of

geographies that contributed to this revenue, there was a very significant improvement or growth in the US market. In Q4, 49% of the revenues were contributed by the US geography, 43% by Europe and 8% by the Middle East, as compared to the same quarter last year wherein 51% came from Europe, 44% came from US and 5% from the Middle East. So there is a distinction compared to the previous year and even in terms of the overall year for the entire financial year, US contributed 46% as compared to 39% in the previous year. Europe came down from 59% to 48% and the Middle East improved from 2% to 7%. In terms of the offshore percentage, it remained pretty flat at 73% and the top 10 clients contributed to about 76% of the revenue. In terms of verticals, the Travel vertical, which happens to be one of our key focus area, has contributed about 40% to our revenues. Independent Software Vendors or ISVs contributed about 33%, while the enterprise segment contributed about 27% to our revenues. Our utilization during this quarter improved by about 3percentage points to 74% and the net addition in terms of manpower was about 119. As far as the quarter goes, one distinctive feature was that we had very deep engagement with each of our customers in terms of the budget and the outlook for the year, and it was very gratifying that there is very clear visibility for the next planning horizon which is 12 months. Since for most of them, it is January-December, there is no runaway growth in this budget though there is visibility. In some cases, there is a marginal decline and all in all, I think we have a fairly good idea in terms of what they are trying to do. One thing is becoming very clear, that they are trying to get more from their spend which is either a static budget or a slightly or marginally reduced budget. They want to get more and in terms of their asks, they want to see how are we able to relate that to some outcome or the output-based business models and what is the risk that we are sharing with them in terms of what is our skin in the game. So these are the kind of discussions that we are having and since most of them are long-term customers, it is easy for us to fashion business models which suit each one of them and we have been able to successfully do it for some of the major clients. Having said that, I think the key challenge that we are facing, going forward, is the currency fluctuation; not only going forward but during the quarter as well. Venkat will cover the impact of the currency volatility that we witnessed in the last three months in the results of the March quarter. Going forward, we continue to have the same concern, especially for European currencies, including the Sterling Pound as well as Euro. We have requirement for aggressive addition of manpower, not really in terms of large numbers from campuses but for beefing up some of the services and solution areas as well as the verticals. For about 18 months, the job environment was benign and we were able to have very good additions laterally in these areas. Going forward, we see that that is becoming little tight and we expect significant challenges out there. The other is the salary cost and expectation. Another significant area of concern is Europe, where we had dependence and still have about 40% dependence. So Europe as an economy, the impact on our customer budgets and new customer additions are areas of concern and



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challenges. Having said that, I will hand it over to Venkat now to take you through the financials, and come back for question and answers.

N. Venkatraman – Head -- Strategic Finance and Risk Management – Sonata Software Limited

Thank you, Mr. Ramaswamy. This is Venkat here and I will take you through our financials, which have been on our website for the past week or so. So it should have given you some time to go through them. I will cover the results of the quarter and the year that ended on March 31, 2010. On an overall basis, we are pleased with our performance during the quarter and the year that just ended. Such results coming after a tough year definitely points out a resilient business model. Prior to starting out on the financials, I will take you briefly through the structure that Mr. Ramaswamy covered. The first aspect of our business is international services, which is essentially the software exports business of our company. The second business line is the domestic products and services, which we carry through our 100% subsidiary called Sonata Information Technology Limited -- SITL for short, and the third business line is the joint venture with TUI AG, which is based out of Germany. It is a 50:1 joint venture between Sonata and TUI AG. Now talking about our consolidated financials, our consolidated PAT for the year was Rs. 80 Crores compared to Rs. 77 Crores the previous year, which shows a growth of about 4%. Our consolidated PAT has actually shown a CAGR of 38% over the last six years. The consolidated PAT for the quarter was Rs. 18.8 Crores as against Rs. 17.2 Crores, showing a year-over-year growth of 9%. On a sequential basis, the PAT has shown a drop of Rs. 3.2 Crores, which was primarily on account of the exchange rate fluctuations, which Mr. Ramaswamy briefly covered and which I will also cover as we go through each of the business unit. The second aspect is also a drop in profits of TUI, which will also be covered as I go through TUI InfoTec trading. Consolidated EBITA for the quarter was Rs. 39.9 Crores compared to Rs. 36 Crores for the same quarter of the last year, showing an 11% growth year-over-year. Coming to revenues, consolidated revenues were Rs. 1,380 Crores compared to Rs. 1,595 Crores in the last year and as we go through each of the business line, this drop will also become clear. We reported a consolidated EPS of 7.6 as of March 31, 2010 and this is a 4% year-on-year basis. Coming to our return on net worth and capital employed, both stood at 25% for the year and for the quarter, it was 22% and 21% respectively. Coming to the cash and cash equivalents, we ended the year with Rs. 107 Crores on a consolidated basis, out of which Rs. 24 Crores are with our joint venture TUI InfoTec. The consolidated manpower was 2,801. Now, I will take you through the highlights of our first business line that is international services. International services contribute 22% to our consolidated revenue and 73% to our PAT, so they play a significant role as you can see from a corporate perspective. Revenues in this business for the quarter were Rs. 71 Crores versus Rs. 66.5 Crores a year ago,

which is a growth of 7% and on a sequential basis, quarter-over-quarter, we have grown 3% in terms of INR. PAT was Rs. 13.7 Crores, which showed a year-over-year growth of 8% and sequentially we have shown a drop, which again primarily is on account of exchange rate fluctuations. The sequential drop is on account of the unfavorable moments in the GBP, Euro and US Dollar versus the Indian Rupee. Our cap flows are hedged with forward cover contracts but what really hit us was the exchange loss that arose on account of consolidation of our subsidiaries and year-end rates. When we consolidate our subsidiaries, we use our year-end rate and that loss had to be factored. The second aspect was restatement of debtors and cash balance. We hold a sizable amount of cash in our subsidiaries in Sonata Europe, which when we consolidated, also impacted us. Finally, due to lower value of Rupee, we got lower amount of money for the same business that we did the last quarter. This has also hit us quite badly just as it hit the entire industry. So all of it put together, the impact is about Rs. 6 Crores for this quarter. Part of this loss is reversible because, for example, when the debtors are realized, they would come at the cash flow hedge rates and so, part of them will get reversed to P&L. Our international service business has a consolidated cash balance of Rs. 50 Crores and the main area of focus from a finance perspective this quarter or Q1 of 2010-2011 would be BSO -- Base Sales Outstanding, which is TPA. We added six clients from the business and our employee utilization has been about 74%. We closed the quarter with 2,205 people, which is a net addition of 119 people over the previous quarter. Now, I will cover the domestic products and services business, which we carry out through our 100% subsidiary Sonata Information Technologies Limited. For the quarter, this business contributed 35% to our consolidated revenue and 14% to our PAT. Revenues in this business for the quarter were Rs. 111 Crores versus Rs. 160 Crores a year ago. We have been explaining this constant decline in sales on year-over-year basis through our focus, because our focus in this business has been to increase the revenue quality and be careful on our credit control mechanisms. We do not want to extend undue credit to the customers and get stuck. Sequentially, revenues have remained almost flat, which actually vindicates the same position that we talked about for revenue management. PAT was Rs. 2.67 Crores versus Rs. 1.93 Crores in the previous year, showing a growth of 38%. So even though we had higher revenues the last year, we had lower profits than those of the current quarter. Sequential growth in PAT was 6%. EBITDA, which is a very strong determinant of this business, was Rs. 4.17 Crores, showing a growth of 2% on a sequential basis and 13% on a year-over-year basis. Our focus in the domestic business is to focus on services and the services business contributed Rs. 20 Crores to our domestic products and services business. This component has shown a year-over-year growth of 9%. We will be focusing on these areas in the coming year as well. This business is all about working on capital management and maintaining returns on capital employed. For the quarter, our main (ph) sales outstanding was at 61 days and our ROC and RONW were 23% and 29% respectively, which is



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well ahead of the cost of capital deployed. For this business, we ended the quarter with a head count of 144 people compared to 148 in the previous quarter. Now I will cover the joint venture, which is TUI InfoTec joint venture in Germany. TUI InfoTec is a 50.1 JV with TUI AG of Germany and TUI InfoTec is a dominant service provider for both IT operations and services for the TUI group as a whole. TUI group incidentally reported €15.2 billion as revenues for the nine month that ended in December 2009. The 50.1 share in the JV was acquired by Sonata in 2006 for €18 million and we continue to have a great relationship with our joint venture partner. Our international services business, which I talked about earlier, actually does the offshore work for TUI InfoTec and these inter-segmental transfers have been eliminated in my numbers, which I have presented till now. As I have explained in earlier calls as well, the European travel markets were hard hit by the current slowdown and there are signs of recovery but now the ash problem has only compounded it. We hear that there are certain warnings, which have been issued by various travel agencies to the London Stock Exchange with respect to the impact that the volcanic ash has created, in terms of slower travel. On the financials front, TUI InfoTec has revenues of Rs. 152.26 Crores for the quarter. This was a drop of 7% on a year-over-year basis and 9% on a sequential basis. The drop was primarily on account of volume reduction or rather belt tightening by the TUI group of companies to weather the slowdown. Further, historically also our January, February, March quarter for TUI has been always the lowest of the four quarters, so PAT for the quarter was Rs. 5.12 Crores as compared to Rs. 5.36 Crores in the same quarter last year, which is a de-growth of 5%. The direct costs have remained almost constant vis-à-vis revenues. All other costs have also shown a drop as far as the joint venture is concerned. However, there are certain elements of fixed and limited costs, which actually contributed to this drop in profits on a year-over-year basis. Post minority interest, our share in profits from this JV was Rs. 2.40 Crores compared to Rs. 2.65 Crores in the same quarter last year. TUI InfoTec ended the quarter with a head count of 452 people compared to 472 in the previous quarter. With that, I have covered the operational financials. I will come to the dividend now. On the dividend aspect, our board has recommended an additional dividend of 80% over and above the interim dividend of 90%, which was declared and paid out earlier. So with the 80% dividend now, the total dividend would come to 170% of Rs. 1.70 per share. Thanks for hearing me out and we will now open this floor for questions.

Swati – Moderator

Thank you, Sir. We will now begin the question and answer interactive session for the participants connected to audio conference through Airtel. Participants who wish to ask questions may please press “*” “1” on their touchtone-enabled telephone keypad. On pressing “*” “1” participants will get a chance to present their questions on a first-in-line basis. To ask a question, please press “*” “1” now. The first

question comes from Mr. Raunak O from Parag Parikh Advisors, Mumbai. You may ask your question now, Mr. Raunak.

Raunak O -- Parag Parikh Advisors – Mumbai

I just had a question about the contingent liability that you have mentioned. In the previous quarter, there were Rs. 2.5 Crores; now they have increased this to Rs. 225 Crores. So, any suggestion about them and how have they built up so big and how does the material lie and why weren't any provisions made for them?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

This predominantly pertains to the TDS on software products, which we import from principals like Microsoft. The department at the assessment level had contended that payment for import of software products is in the nature of royalty and hence, attracts TDS. We, as an industry, have always maintained software as a product and this view has been upheld by the Supreme Court decision in the case of TCS versus the State of Andhra Pradesh, wherein the honorable Court has held that that shrink wrapped package software is 'goods'. . In our cases, the ITAT, which is the Income-tax appellate tribunal, in a landmark judgment held the case on our favor and ruled that payment for shrink wrapped software is not royalty and thus, does not attract TDS. We were 13 people starting with Samsung, IBM, Sonata, Infosys, GE Wipro etc. . The income-tax department went in appeal to the High Court and about four months back, the Bangalore High Court, without dealing with the issue of whether the payment for imported shrink wrap software is royalty or not, held that any payments to foreign companies attracts TDS under section 195. Not deducting tax at source leads to a consequential issue. That is the amount on which the tax was supposed to have been deducted. It gets disallowed as expenditure when calculating your taxable income. Thus, effectively our entire purchases get disallowed as expenditure and effectively the entire sales proceeds of the Company is subject to tax. For example, if you import material for about Rs. 95 and sell it at Rs. 100 and then do not deduct tax on the Rs 95 which you pay the foreign vendor, the entire amount of 95 is not allowed as cost of goods sold against the sales of Rs 100. Thus effectively, you end up paying 30% tax on Rs 100. As you can see this is a major issue and this only impacts the industry but all companies importing and making any kind of payments to companies outside India. Now, all the companies which were involved in the case at the High Court of Karnataka have appealed to the Supreme Court and the Honorable Court has granted a stay on the demand of the department and posted our case for hearing on the 18th of August 18. This is not a new disclosure. We had disclosed these facts on the contingent liability in our Q3 results itself. So this is where it stands, Raunak.



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Raunak O -- Parag Parikh Advisors – Mumbai

According to the accounting, are not any provisions required to be made because this is a significant amount as compared to your net worth. 60% of the net worth is contingent liability, so is not an accounting provision required somewhere for this kind of liability?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

See, it depends on the facts of the case. While the Karnataka High Court judgment ruled in favour of the Income-tax authorities, three equivalent courts including in an advance ruling by the department itself, the Karnataka High Court Judgment. All these judgments have held that there is no TDS required for payment for import of software or in cases where the income of the foreign company is not taxable in India. Thus, when there is so much lack of clarity on the issue and particularly when the issue is yet to be settled, making a provision of Rs 200 Crores, reversing it later, etc., are not the right accounting practices. It is not something, which is going to be very appropriate from an investor's point of view. That is why, the board, in its wisdom, took a detailed view of this and said that we disclose the entire facts of the case. That is why it is called contingent liability.

Raunak O -- Parag Parikh Advisors – Mumbai

So otherwise, there is no certain probability involved to say that this might come in your favour, not come in our favour?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

No, we cannot say as it is being heard by the Supreme Court. Also, I want to add that there are two issues involved here. One is the payment of TDS and the other is the disallowance of expenditure. In the case of TDS, Microsoft, one of our principal vendors has paid tax on the entire amount of imports that we made from till 2004. From 2005 as a matter of abundant caution, we have been deducting tax under from payments being made for import of shrink wrapped software under protest and depositing the same with the government. Thus should the Supreme Court ruling be unfavorable, we do not have to pay the TDS on imports that we have made from Microsoft. There will be only an interest liability that we will be attracting. This has been made clear in the contingent liability note. On the disallowance of expenditure this is essentially a timing issue. Thus the year in which the TDS is remitted the entire amount of purchase will get allowed

as an expense. And you will get the tax benefit. So it is essentially a cash flow issue in so far as the 40(a)(i) disallowance is concerned. A possible demand on account of TDS net of what has already been paid is relatively smaller in value. Again, the disallowance is not permanent. It is only a cash flow issue, it will be disallowed in the year in which you also have not deducted tax, and will be allowed as an expense in the subsequent years and you will get tax relief.

Raunak O -- Parag Parikh Advisors – Mumbai

Also, from the volume growth side, we haven't really seen any volume growth this entire year, so any particular reason?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

Europe, we had a dependence of 59% as you saw last year and that did not grow. That is one of the principal reasons, though in the US, we have had a fairly good growth.

Raunak O -- Parag Parikh Advisors – Mumbai

Is it because of some marketing efforts from your side have not materialized or is it just the conditions out there are not suitable? What is the reason?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

It is the market condition itself, Raunak.

Raunak O -- Parag Parikh Advisors – Mumbai

You have seen a significant growth in the US in your geography. What did you do differently there?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

See, we do focus on ISVs, which we don't focus on in Europe. That is a very significant difference between the two geographies.

Raunak O -- Parag Parikh Advisors – Mumbai



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So it is the ISV lead volume that has given the US geography more prominence this quarter.

B. Ramaswamy – President & Managing Director – Sonata Software Limited

That is right.

Raunak O -- Parag Parikh Advisors – Mumbai

Also, there is a provision for doubtful debt that has almost doubled. So any particular reason for that? I mean, are the customers not able to pay now, since conditions have slightly improved?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

No, we did not across the Board, we had one or two customers where we had some kind of issues and that is not so much in this quarter. It was the previous quarter, when we had to agree for settlements, to agree for certain reductions that they were asking for and closed it out. So that was what was provided for in the last quarter.

Raunak O -- Parag Parikh Advisors – Mumbai

So do you expect it to come the next quarter or in how much time do you think it will come back to you?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

No, that is a provision; it is a formality that we have to write it off. We have to apply for the permission from the authorized dealer and then write it off.

Raunak O -- Parag Parikh Advisors – Mumbai

That is all from my side. Thank you very much.

B. Ramaswamy – President & Managing Director – Sonata Software Limited

Thank you.

Swati – Moderator

Thank you, Mr. Raunak. Participants who wish to ask questions may please press “*” and “1”. The next question comes from Mr. Roshan Jain from Way 2 Wealth Securities, Mumbai.

Alok Ranjan – Way 2 Wealth Securities – Mumbai

Hi, this is Alok Ranjan. I just wanted to know the growth prospect of the business for the coming year, like what efforts are we making and what kind of growth can we expect in the coming year?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

Hello, as you know we won't give the guidance but I can qualitatively tell you in terms of the efforts we are making. We are very clearly seeing buoyancy in the ISV business in the US. I mean ISVs are predominantly from the US, not so much from the Middle East or even Europe. In TTL, which predominantly is right now focused on Europe and the Middle East, we are trying to focus on building solution frameworks, especially for airline as well as tour operator business. These are the two micro verticals that we are focusing on and aggressive client additions that are planned for in these areas should see us through the kind of growth that we are planning for the next year and the third is the enterprise segment, which is showing a lot of promise because we are offering three or four solutions out there -- one is infrastructure management, second is ERP, third is BI and fourth is MOSS or the enterprise collaboration solution. So we are finding some kind of connections for specialized services like these in large companies, which already have income with offshore vendors and they choose us as specialty vendors because of these capabilities, that is for new client acquisitions. As far as the existing clients are concerned I would say that is something, which is looking very positive for us because we are seeing on the whole, though in certain cases there may be some reduction.

Alok Ranjan – Way 2 Wealth Securities – Mumbai

Can I get some idea about your hiring plans for the coming year?

B. Ramaswamy – President & Managing Director – Sonata Software Limited

We will be looking at slightly aggressive growth in terms of manpower the next year and also it will be coming selectively from lateral hires as well as freshers. As of today, we have cleared the entire backlog of all the



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campus recruitments that we had planned for, where there were delayed letters because of the situation that we had faced in the last 18 to 20 months. So all those kinds are in, whoever was available. Now we are looking for new additions during the campus placement season, plus I think our emphasis is also on lateral hires; that may not be in terms of huge numbers, but in terms of quality addition. That is where we are going to be focusing on in some of our service offerings and vertical domains.

Alok Ranjan – Way 2 Wealth Securities – Mumbai

Thank you.

Swati – Moderator

Thank you, Sir. Participants who wish to ask questions may please press “*” “1”. Participants are requested to please press “*” “1”. At this moment, there are no further questions from participants. I now hand over the floor back to Mr. B. Ramaswamy for the final remarks.

**B. Ramaswamy – President & Managing Director –
Sonata Software Limited**

Well, I have attempted to cover the so-called business landscape as much as required but if you have any further questions, you can always get in touch with Venkat or me and thank you for the participation and Good Day.

Swathi – Moderator

Ladies and gentlemen, this concludes the conference call. You may now disconnect your lines. Thank you for connecting to audio conference service from Airtel and have a pleasant day ahead.