



“Sonata Software Limited Q3 FY19 Results Conference Call”

February 08, 2019



MANAGEMENT: MR. SRIKAR REDDY – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER
MR. PRASANNA OKE – CHIEF FINANCIAL OFFICER
MR. VIKAS GURUGUNTI – CHIEF OPERATING OFFICER
MR. PVS N RAJU – CHIEF DELIVERY OFFICER
MR. R SATHYANARAYANA – VICE PRESIDENT - FINANCE & ACCOUNTS
MR. KUNDAN LAL – COMPANY SECRETARY AND COMPLIANCE OFFICER
MR. SUJIT MOHANTY – HEAD (INDIA BUSINESS)
MR. RANGA PURANIK – CHIEF GROWTH OFFICER



*Sonata Software Limited
February 08, 2019*

Moderator: Ladies and gentlemen, good day. And welcome to the Sonata Software Limited Q3 FY19 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Srikar Reddy – Managing Director & CEO, Sonata Software Limited. Thank you and over to you, Mr. Reddy.

Srikar Reddy: Thank you, Karuna. Good evening, and welcome to the Analyst Call post the Quarter Three Results, which we announced this afternoon. Our results are up on our website, so hopefully you all had a chance to look at it.

I have here today with me Prasanna, our CFO; Sathya, Head of Finance; Kundan, our Company Secretary and Compliance Officer. Apart from that, we have Vikas, who is our Chief Operating Officer; Raju, our Chief Delivery Officer; Ranga, Chief Growth Officer; and Sujit, who heads our India business. So, I will share a few quick qualitative highlights for the quarter before I hand the mic over to Prasanna to take you through a more detailed analysis of the financials for the quarter.

At a high level, I think the quarter continued to be good in terms of growth, both in top-line and EBITDA and profit after tax. As I have been saying in the past calls, it has been primarily driven by focus on our platformation led digital transformation strategy with our IP as a differentiator, and a strong alliance with Microsoft has continued to drive the growth momentum for us. We have seen growth, both with our strong existing clients, and also the last quarter has been extremely good in terms of some key clients wins we have had. So that has been good last quarter.

The other significant events of last quarter were we announced signing of a definitive agreement for acquisition of two key strategic investments. For us, one was Scalable Data Systems, which is an Australian-based technology company, focused on the Microsoft Dynamics 365 ecosystem. They have been in business for close to about 25 years, good reputation in the Australian market. They also have a platform called commodity trading and risk management, which runs on the Dynamic 365 platform, which is fairly, widely accepted and used globally in the consumer distribution businesses, which are based a lot upon buying where commodities are a key element of their supply chain.

For scalable transactions is closed so and the integration process is on. The second company where we have signed the agreement, Sopris transaction is still in the process of closure, so we will let you know once we complete the closure. But on a high level again, it is a line to our Dynamics 365 strategy. Sopris is in field services space, which I have been told is one of the fastest growing segments in the Dynamics 365 footprint of Microsoft. So, we believe that it completes full 365 capability. Obviously, the plan is to integrate these companies and leverage their capabilities globally and build these competencies in Sonata so that we can scale up the good competencies these two companies have.

Overall, I think our deal pipeline continues to look better, which I think as I alluded to in my last call, so that looks good.

So that is a high level summary qualitatively of last quarter's performance. I will hand over the mic to Prasanna to take you through the more detailed analysis of the financials.

Prasanna Oke:

Thanks, Srikar. Our results have been posted on our corporate website about a couple of hours back. Let me give you some key highlights of Q3 2019. On a Consolidated basis for the quarter ended December 31, our revenues stood at Rs. 844 crores, that is a growth of about 42% quarter-on-quarter and a growth of 10% year-on-year. Our PAT stood at Rs. 64 crores, a sequential growth of 3% quarter-on-quarter and a growth of 30% on a year-on-year basis. ROCE on a consolidated basis was 36%.

Moving in to our two specific segments, that is our International IT Services segment. The revenues were at Rs. 284 crores, sequential growth of 3%, year-on-year growth of 18%. On a constant currency basis, we grew at about 5%. Revenues from the digital component stood at 35%. One of the items that we track regularly and have been reporting for the last six to eight quarters is our IP-led revenues, they have increased to about 19.1% of our services revenues. Overall, PAT, Rs. 52.1 crore, year-on-year growth of 30%. This contributed about 80% of our overall consolidated PAT. We added nine new customers during the quarter, spread across all the three geos, five came in from the US, two from Europe and two from Asia.

Looking at the Domestic Products & Services, that is our India business, Revenues stood at Rs. 563.2 crores, contributed about 66% of our revenues. EBITDA at Rs. 19.5 crores, and year-on-year growth of 26%. PAT stood at about Rs. 12 crores, 2% of the revenues, year-on-year growth of 31% and contributed about 20% of our consolidated PAT.

As Srikar mentioned, we announced two definitive agreements during the last quarter. Cash and cash equivalents stood at about Rs. 320 crores for the period ended December 31, net of all the borrowings. DSOs averaging about 40 to 42 across our both lines of businesses. Our headcount stands at about 3,967. We grew by about 131 headcounts in this quarter.

These are the key highlights. Karuna, I will hand it back to you, and we can take the questions.

Moderator:

Thank you very much. Ladies & gentlemen, we will now begin the question-and-answer session. The first question is from the line of Bharat Shah from Reliance Securities. Please go ahead.

Harit Shah:

Sir, one thing I noticed, your rupee revenue growth was actually lower than your dollar revenue growth in this particular quarter for your ITS business. That is, despite the rupee kind of seeing a slight depreciation in the quarter against the dollar. So, what would be the reason for that, if you can just give some elaboration on that?

Srikar Reddy:

Yes. I think I will ask Sathya for him to answer the question. But my guess is that I think the dollar was a little lower last quarter, but they will answer for it.

R. Sathyanarayana:

Yes. Closing dollar rate moved from \$72.5 to \$69.9, as well as the GBP from 94.5 to GBP 88.8 and Euro from 83.9 to 80.2.

Prasanna Oke:

So, Harit, this was few of the currency impact at this time.

Srikar Reddy: Yes. The other way around, actually these currencies went the other way, not upwards.

Harit Shah: And actually, so I think rates that you were giving more or less at the end of period. So, I know generally from a revenue perspective it tends to realize over the period of quarter, right, so generally if you look at the average quarterly, it was higher.

Srikar Reddy: Yes, we will give you the average rate.

Harit Shah: Yes. So, the average was actually higher, that is what I am saying, the rupee depreciated slightly against the dollar on the average rate. So that is why I was asking.

Srikar Reddy: Correct, Harit. Yes, my guess is the average rate is lower, but we give it to you.

Harit Shah: Because is it that you get a lot of, a greater portion of your revenue at the end of the period.

Srikar Reddy: Yes, it can become upon timing of the invoice, yes.

Harit Shah: Okay, I will assume it is that. I think missed the constant currency figure, if you would give that again, is it 5%, I think?

Prasanna Oke: Yes, constant currency grew at 5%.

Harit Shah: And that was in a sequential terms, right?

Prasanna Oke: In sequential terms, yes.

Harit Shah: And we have the year-on-year figure on basis in constant currency, how much growth did you achieve?

Prasanna Oke: You are talking of the dollar figure on a sequential basis?

Srikar Reddy: No, year-on-year.

Harit Shah: Constant currency year-on-year, dollar vis-à-vis we have, of course.

Prasanna Oke: Harit, I will come back to you on this.

Moderator: Thank you. The next question is from the line of Madhu Babu from Centrum Broking. Please go ahead.

Madhu Babu: So just on the margins, I think adjusted margins have almost touched 27% - 28%, because if you exclude that FOREX loss which you had. So, what led to this kind of strong margin expansion? And was there any IP-led revenues, license revenues which directly flowed in?

Srikar Reddy: I think it's a mix of all the three, Madhu, more IP, higher premium services and then better utilization of, I think, our billability improved last quarter. So, it's a mix of at least three factors.

Madhu Babu: Because almost 800 basis points improvement on a quarter-on-quarter basis.



Sonata Software Limited
February 08, 2019

Srikar Reddy: Correct. So, I do not know whether my team has got a more granular analysis of the contribution of what these three levers have contributed to the margins. They will share it. But at a high level, I know that these three things have driven the higher margins last quarter, yes.

Madhu Babu: Okay. And second, sir, on the travel vertical, our largest client yesterday posted results and there was a huge fall in that stock price. I mean, they are cutting their outlook. So, any impact for us from our large client in travel, I mean?

Srikar Reddy: No, not really. I mean, I believe these are all good things because that means margin pressures is like to do more with less, right? We are not seeing any cut on projects. So, our current dialogue is actually how we can do more margins. And some of it is actually coming from some cost pressures. So right now, it is all to the good, Madhu.

Madhu Babu: Yes. Sir, directionally how should we see margins? Because, the way I am calculating it, the margin expansion has been very strong in terms of momentum.

Srikar Reddy: I think one of the levers is gone. I think utilization has come to really like a break-point. So, that is done and dusted. The utilization lever is done.

Madhu Babu: Yes. But when you sell a license or platform, the IP revenue...

Srikar Reddy: That is why I said the other levers are the ones which are more IP led and the service component and then onsite/offshore mix would be the other three levers, which would drive further margins. But I think I have always been saying that 22, 23 is a good number for us to be working with. But yes, so I think as you know we have these levers with us. So obviously, it is based upon the revenue mix, and that will define the percentage margin. But overall, I think, yes, we are in the premium business.

Madhu Babu: Okay. And just one more thing, going into next year, I mean, it is too early but considering the calendar year has started, so how do we see the momentum in terms of your key verticals?

Srikar Reddy: Sorry. What is the question, Madhu? I did not get it.

Madhu Babu: Going into next year, I mean, CY19, so how do we see the momentum within our top.

Srikar Reddy: Overall, I think things are good, stable. So that is where we are currently as we look at our next year. I think there is a lot more to be optimistic about than to be pessimistic about. That is the current mood we have in the organization.

Moderator: Thank you. The next question is from the line of Shekar Mundra, an Individual Investor. Please go ahead.

Shekar Mundra: Just wanted to understand, are these margins sustainable for the international services?

Srikar Reddy: That is what I was just telling Madhu, that there are three or four levers. We have been generally talking about 22 to 24 is where we can be, want to be, etc. So yes, and then there is revenue mix in terms of

much more of IP led get into our mix. So, there are various factors. So, I think, as I was just telling him, the overall nature of our businesses is more of higher-end and premium kind of business. So, margins will be a little hither.

Shekhar Mundra: Don't you see more competition coming in because of these kind of margins?

Srikar Reddy: No. That is where we feel we are differentiated because of our IP. Our focus on certain technologies and tools have been the criticality. We are in those tools for our partner and the dominance we have established in certain areas based upon these kind of stuff. So, obviously, there is enough competition, it is not that there is no competition in the business we do today, but in general, the business we do today, the pricing is a little bit higher than the traditional business. So, it is not about that there is less competition, but it is the nature of our business.

Shekhar Mundra: And I just wanted to know your concentration, revenue concentration from your top 5 clients and the top 10 clients?

Prasanna Oke: Yes. From our top 5 clients it is about 60%. From our top 10 is about 69% to 70%.

Shekhar Mundra: Top 5, 60%, is that right?

Prasanna Oke: 59% - 60%.

Shekhar Mundra: All right. So, I just wanted to understand this International IT Services business, because I am a layman, I don't understand IT that well. So, can you give me like flavor of the business? Like is it a recurring business, or are there contracts for like a fixed-year contracts?

Prasanna Oke: Okay. So, see our businesses is split into two parts what we have been reporting for a long time. So, we have got a business, which is domestic business, which is more of India-focused, is into reselling, where we contribute about close to two-thirds of our revenues and a fifth of our profitability. The other part of the business is a classical IT services and solutions business that we do across a footprint which stretches from Americas to Europe to Asia to Australia now. And we are focused on four verticals: retail, travel, ISVs and distribution. And yes, these are projects implementations that we are doing for our clients. So, the profile of these two businesses is quite different, and that is the reason why we report them separately.

Moderator: Thank you. The next question is from the line of Vipul Shah from Sumangal Investments. Please go ahead.

Vipul Shah: What is the FOREX gain or loss in this quarter?

R. Sathyanarayana: On forex, we had an overall loss of Rs. 6.4 crores.

Vipul Shah: So that is in other expenses or it is netted out of other income?

R. Sathyanarayana: It is netted off in other income.



Sonata Software Limited
February 08, 2019

- Prasanna Oke:** So, EBITDA includes this. And what we do is that we give the EBITDA, including the other income and FOREX. So, if you strip it off and you add back the FOREX losses that we have, our EBITDA actually was at 28%.
- Vipul Shah:** Okay. And sir can you give the operational performance of IBIS or turnover and EBITDA for this quarter?
- Prasanna Oke:** Yes. So, a few of our IBIS projects, we did not do the kind of revenues that we expected. Secondly, we are also impacted by the holiday season in the US. Our IBIS EBITDA is close to about 7%.
- Vipul Shah:** What was the revenue, sir, in this quarter?
- Prasanna Oke:** Revenue was about \$1.2 million.
- Vipul Shah:** \$1.2 million?
- Prasanna Oke:** Yes.
- Vipul Shah:** And what was the same figure last quarter?
- Prasanna Oke:** It was about \$1.8 million to \$1.9 million.
- Vipul Shah:** Okay. And lastly, can you comment about margins from your IP business which is roughly 19% of revenues. So, it must be carrying a different trail, means very high margin as compared to others.
- Srikar Reddy:** No, I think I should explain. When we say the IP business it is not license business, we call it IP led services. So, these are customers we acquire because of our IP, and then services around IP. Our IP licensing business will be less than 5% of our revenues. So, it is not licensing business. If it is licensing business, then it is almost 100% margin. So, it's IP led services business, so it still will tend to be higher than the normal business, but it is not what we call typically IP business. So, I just wanted to clarify that to you.
- Vipul Shah:** So pure IP is 5%?
- Srikar Reddy:** Less than 5%.
- Vipul Shah:** Less than that. And rest is the business which you acquired due to your IP?
- Srikar Reddy:** All around the IP. With IP, it becomes a differentiator, we then provide integration etc.,
- Vipul Shah:** But it's a service business only, right?
- Srikar Reddy:** It is a service business, so you have to put people that we have to do work.
- Vipul Shah:** And it carries a little more margin than the normal services business.



Sonata Software Limited
February 08, 2019

Srikar Reddy: Because it is like only we can do that work, nobody can do, because it is our IP.

Moderator: Thank you. The next question is from the line of Harit Shah from Reliance Securities. Please go ahead.

Harit Shah: I just want an understanding about IBIS. So obviously this quarter you had about \$1.2 million or so revenue, about a year back it was almost double this revenue. So, if you could just give some perspective on what are the kind of developments? What are the headwinds affecting that business? Because for quite some time it has not been growing too much, so if you could give some understanding, that would be helpful.

Srikar Reddy: I think there are three things. One is, you should understand our IBIS business in a little different way. IBIS is a company we acquired, but then it had an IP also. So, all that stuff then goes through Sonata also. So, if you have, let's say, the dynamic business worldwide, which is what we bought the company for, then the revenues which accrued from the IBIS IP, then we will be showing that in the Sonata business. So, IBIS then happens to be the company which is using their brand, where we acquired certain customers and grow them. Having said that, the company was a purely project-oriented company, and our plan has been to convert those customers into more annuity customers kind of stuff. It has taken a little longer than what we thought it would take. And because of the seasonality, which Prasanna mentioned about, there has been a dip because if the project stops then there is no revenue for us. So, to reemphasize my point so that it is also valid for these two new acquisitions, please don't look at these numbers of these companies in isolation. You have to look at the numbers of these companies as a total business it creates for Sonata within the Microsoft ecosystem. And that is the only reason why we are making these acquisitions. So, a lot more revenues which will filter through the Sonata book than the acquired company book. So that is how we do the internal ROI justification. So, I just wanted to clarify these two points to you.

Harit Shah: Got that. Any figure, so the percentage of annuity revenue like for IBIS, just for prospective?

Srikar Reddy: Yes. Annuity revenue, as we speak today for IBIS is fairly small, it would not be more than about \$2 million. So, rest of it is project business.

Harit Shah: \$2 million annually, right?

Srikar Reddy: Yes, \$2 million annually. I mean, if you say what is the annuity for Sonata, I would say like its contract that are more or less done at the beginning of the year whereas if you take similar things that there is a need and there are services to be obtained for from customers, and there is a visibility of about \$2 million. So, the rest of it is you have to get the projects and execute it, and then convert them into more longer-term. So that is about \$2 million.

Harit Shah: Got that. What is the digital percentage revenue share, I think, last quarter was about 35%?

Prasanna Oke: Yes. We moved up from about 34% to 35%, roughly, and just to trying of round off.

Harit Shah: So, the 35% is that for this quarter?



Sonata Software Limited
February 08, 2019

- Prasanna Oke:** Yes, for this quarter. So, what we do is that we break up our entire revenue stack into various split projects. We look at what is connected to mobility, another takes cloud, and we stack that up. So that's about 35%.
- Harit Shah:** Got it. And one last question, your acquisitions, approximately, when will they be consolidated from? Will it be entirely from this quarter?
- Srikar Reddy:** See, they were a very marginal amount, I think, this quarter. So, I do not know how much it is, they can share with you. So, the Scalable will have a full quarter this quarter. The Sopris, the transaction has not been closed yet, hopefully we will close it by the end of February. So, we may have Sopris for about a month this quarter. So, we will have Scalable for the whole of this quarter and Sopris for about a month this quarter.
- Harit Shah:** Right. And for the third quarter, it was not too much of revenue, is it, from Scalable?
- Srikar Reddy:** Not much, yes.
- Moderator:** Thank you. We have one question which has just come up. Should we take that too?
- Srikar Reddy:** Yes. Let's take that as a last question, and then we will close it, yes.
- Moderator:** Yes. It is in the line of Akshay Ramnani from HDFC Securities. Please go ahead.
- Akshay Ramnani:** So just a question on the margins. So, we saw a 780 bps expansion in ITS margin. So, you pointed out two, three factors of higher utilization and better mix of services, IP led services. So, I was just going through the utilization trend. It is just 10 bps expansion in utilization, so is it more of the margin expansion is coming from the better mix or does it have any other aspect to that? So, does that expansion has any other aspect?
- Srikar Reddy:** Okay. So, I think there are two metrics here, Akshay. So, utilization is utilization, then we have a metric called billability. So, the billability percentage is higher, I guess we need to show that separately. But utilization is productivity measure and billability is the time that we charge to our clients. So that's higher.
- Moderator:** Thank you. I now hand the conference over to Mr. Reddy for his closing comments. Over to you, sir.
- Srikar Reddy:** Right, Thank you, Karuna. Thank you all, again, for joining the call, and thank you for your support. So, we look forward to seeing you in the next call. So, from me and the rest of the team here, we thank you all, again, for joining the call today.
- Moderator:** Thank you very much, sir. Ladies and gentlemen, on behalf of Sonata Software Limited, that concludes this conference call. Thank you for joining us. And you may now disconnect your lines.