



“Sonata Software Limited Q2 FY-19 Earnings Conference Call”

November 05, 2018



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Moderator: Ladies and gentlemen, good day and welcome to Sonata Software Limited Second Quarter Results Update 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 ‘*’ and then ‘0’ on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Srikar Reddy – CEO & Managing Director, Sonata Software. Thank you and over to you sir.

Srikar Reddy: Thank you. Good afternoon everybody and welcome to the analyst call post the announcement of our quarter two results on the 2nd of November. The results are on the website and the analysis.

Up here today with me actually is a larger audience physically, a lot of more of my colleagues are here with me physically today apart from Prasanna whom you all know the CFO; Sathya, the Head of Finance and Kundan, our Company Secretary. We have Vikas who is the Chief Operating Officer normally based out of Houston in US; Raju, our Chief Delivery Officer; Ranga Puranik, Chief Growth Officer usually based out of the Bay Area and Sujit Mohanty, Head of our subsidiary SITL. So a quick qualitative analysis on the performance of Q2.

On the international services business, we grew about 3% on dollar terms and about 4% at constant currency. I think our margins have been a little better normal, some of it obviously driven by the exchange movement in foreign currency. We did our first phase of our pay revisions last quarter. So the results factor in the revisions we make in compensation last quarter and we continue to see a very steady uptake in our India business from a margin perspective and absolute gross margin perspective, so that continues to grow at the rate at which we had said it will grow at. So qualitatively, we have seen both growth in some of our larger existing clients. We have also added some fairly marquee names as clients last quarter. Europe has been relatively growing faster than the rest of the other geographies. So that has been, I would say, the highlight.

Our focus on Platformation continues to drive access to clients, reposition ourselves as digital transformation partners in our client space and new client space. Our alliance with Microsoft has gone up a notch last quarter. I think we have just made an announcement of us being inducted into what Microsoft calls its Inner Circle members for dynamic focus which has been both organic and inorganic in the dynamic space has now brought us to be one of the Inner Circle members which is about 30-40 partners worldwide, I guess we maybe one or two of Indian partners who are in that list, so that has been a good sign and we continue to leverage the alliance for accessing new clients. So that has been a very high level summary analysis of performance last quarter. I will hand it over to Prasanna to give you the details and analysis of the financials and then we will take some questions if you have. Thank you.

Prasanna Oke: Thanks, Srikar. To everyone, welcome to the earnings call. As you are aware, the results were declared on the 2nd of November, Friday and both the investor deck and results have been on our corporate site since then if you would have had a chance to look at it.

Here are some few key highlights. We will set off with the consolidated numbers. Our revenue stood at 593 crores with a PAT of 62.2 crores that is a sequential growth of about 8% and growth of 37% on a year-on-year basis. ROC stood at 35% and RoNW at 36%. Moving onto our two separate segments, so we will start off with the international IT services segment. Revenues of 275.3 crores, a sequential growth quarter over quarter of about 7% and year-on-year growth of 17%. These revenues are about 46% of consolidated revenues. The revenues in dollar terms stood at 39.1 million during the quarter. There is a sequential growth of 3.3%. Trying to break it up INR, revenue growth of 7% and USD growth in constant currency of 4%. One of the majors that we have been talking about revenues on the digital component that is at 35%. IP led revenues which we have been looking at for the last 5 quarters now currently stands at 18% of our revenues, so that is the uptake from the 16.3% last quarter. EBITDA overall at 26.7%, sequential growth of 10%. We added about 10 to 11 new clients. They came from across North America, Europe and Asia.

So moving onto our domestic products and services, PAT continued to grow, PAT at about 11 crores, Q-on-Q growth of 6% and year-on-year growth of 31%. This contributed about 18% of our consolidated PAT. ROC and RoNW both at about 25%-26%. So this is in short some of our financial numbers. Our investor deck is already there with you. It has more details on this. So I will hand it back to Tanvi and then she can take on any other questions, you can do the questions which you may have.

Moderator: We will now begin the question and answer session. We have the first question from the line of Harith Shah from Reliance Securities. Please go ahead.

Harith Shah: Sir, I had a query from a service line perspective, the infra management business for the last couple of quarters there has been a little more on the subdued side, couple of quarters of revenue decline. So if you could give some color on exactly what is happening in that space, you know the trends, any impact from digital disruption, how are things shaping up on that front?

Srikar Reddy: At a high level, as you know, it is an industry trend, there is a shift from on-prem to cloud. So good news is that I think the large percentage of our infra now revenues are from cloud rather than from on-prem kind of stuff. So that shift will continue to take place in the industry. I think it is nothing new to me and it is an inevitable shift which is going to be happening and how that finally falls out in terms of what are the service components of this shift. Obviously for new players like us, it is a bigger opportunity in terms of the market.

Harith Shah: So basically, you are trying to say that maybe in the near-term that a subdued growth could continue on the IMS side?

Srikar Reddy: It is a function of the movement to the cloud and most of our clients we are seeing just embarked on it. So as they do more of it, we will see a higher percentage of that going forward. So at a very high-level, as you know our strategy, infrastructure is not a leading service for Sonata.

Infrastructure is for us across the other services. So that is the fundamental difference if you understood what I was trying to say.

Harith Shah: And one final thing. How is your progress in the analyst meet which you held earlier this year? You obviously communicated a lot about Platformation. So how is that progressing at the moment in terms of the client interest, be it current existing clients and the new clients and any interesting activities that you have seen on this front that could lead you to record improved revenue growth going forward also?

Srikar Reddy: Good, thank you for asking that question. I think since we last met with you, I think a lot of both interest and actions from our side both from existing clients, actually a lot of good has been with existing clients and marginally with completely new clients with Platformation as a leading service. So in the existing clients I think since we last met, we have seen a lot more traction in terms of conducting of workshops with the top management teams. I think I mentioned one or two and since then we have done another three or four more. So that is on the uptake in terms of being able to engage with the leadership teams of our clients. And even with the alliance partners, we are seeing quite a lot of interest of wanting to work with us to engage in their digital transformation initiatives. So that they also have a fairly unique value proposition when they talk about digital transformation. So to answer your question, in a nutshell we have seen lot more traction and interest on this and we said last time also that we will continue to report again this in a more detailed way as we go forward.

Moderator: Thank you. The next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain: Sir, our T&M is disproportionately high versus other, so is there a reason you guys prefer T&M versus others preferring fixed price contract?

Srikar Reddy: This is the nature of the business we do to start with. We do not have any preference. Obviously, if clients prefer fixed price, we do fixed price and if clients prefer T&M, we do T&M . It is not like we are not trying to convert T&M to fixed price or fixed price to T&M kind of stuff. So, we do not see that as a model to say that it is a kind of a value proposition. Finally, I think value comes from what service we deliver. For us, the pricing of that services is really the secondary aspect of how do we price the service whether T&M, fixed price, outcome based etc. So, our focus is still to be very heavily differentiated on the service we offer and the way we offer the service and what value we bring into our customers and how do we measure the value, our services deliver to our clients business . So, what I am saying is that it is not a focused activity to do T&M or FP. I would say our margins are pretty decent. So, actually my belief is that the focus shall be on the margins, whether it is T&M or fixed price.

Mohit Jain: Where are your IT services margins for this quarter if you adjust for the FOREX gains or other income?

- Prasanna Oke:** IT services Mohit on EBITDA basis, we touched about 26.7%. You strip it out the other income and the FOREX, we are at 22.4%. We are at 22.5, 23 excluding FOREX and other income.
- Mohit Jain:** And sir just one thing on the cash flow. If you could walk us through the first half cash generated?
- Sathyanarayana R:** As in closing we have about 360 crores cash available. This is after the final dividend that we have paid.
- Mohit Jain:** Sir, how much would be the first half cash flow operations?
- Sathyanarayana R:** Cash from operations will be about 130 crores.
- Prasanna Oke:** So Mohit, it is like we were about 520 and what we see now is about 360, so there has been one of the large deals that we typically get for the quarter and then we collect the money from that. So that money did not get collected before 30th September and that is the reason that you see this 100 crores kind of a gap. We pay dividends and we did not get the 100. So that is the difference between 520 and 360 that you see.
- Mohit Jain:** Understood sir. In first half number, you said it is 130 crores, is it?
- Sathyanarayana R:** Yes.
- Moderator:** Thank you. The next question is from the line of Amit Chandra from HDFC Securities. Please go ahead.
- Amit Chandra:** Sir, my question is regarding the IITS margins. So like if we adjust the other income, so if you just the complete step up the other income from the EBITDA, then there is a fall of around 236 basis points in our EBITDA margin that is despite the currency benefits and the higher utilization we have and also offshoring has been pretty steep this quarter. So it is only the wage hike that has impacted or is there something else like pricing, now the pricing pressure is also there like some other read through is there.
- Prasanna Oke:** That is why we have talked Amit, we have adjusted also for the salary hikes in this. So stripping it off the product gains and other income, we are at 22.4% and that is including the salary hikes which has taken place in Q2 of this year.
- Amit Chandra:** So like going ahead, 22-23 range is what you are looking for or it can go up with higher proportion of IP led revenues?
- Prasanna Oke:** Definitely, our IP led revenues and the value that we add while we do not give a guidance back yet, that are expected to add value, but we believe at this point of time that 22-23 has most of our costs baked in. So that is where we are.

Amit Chandra: And sir like we have seen very strong growth in the travel vertical, so this is largely led by the large client or it is like addition of some new clients there and what is happening there in travel vertical if you explain that?

Srikar Reddy: A lot of it has been led by growth in the large clients from some interesting new clients in that space. It is a mix of both. We have I think gone about 2 or 3 new clients who are looking extremely promising in that vertical in terms of growth and these are fairly big names they all are in Europe and some are in Asia. So that has been the question, it has been driven by both the growth in the large client and some very interesting large new clients we have acquired in Europe.

Amit Chandra: And sir like in the vertical mix if you see that the others component has come off sharply in this quarter. Can you please elaborate on what exactly led to this decline or?

Prasanna Oke: The focus remains on our key verticals. So, others what you are saying, as the percentage will decrease but that is because our focus is on the 3, 4 verticals and if we were to keep that at the same percentage, that will focus on the other verticals too.

Amit Chandra: But in revenue terms also sir, it has declined at 12%, revenue in absolute revenue terms, it declined this quarter, so that's why I was just?

Srikar Reddy: As we said, others are not focused for us. We are not going after and getting other clients. These are clients we get because of relationships and other things and not a goal structure, goal market, IP-led, Platformation-led, vertical-led, alliance-led etc., which are focused on our 4 verticals; travel, retail, distribution and ISVs. The others are really what we had, legacy and where we get based on relationships, alliance-led and so on and so forth. So, it is not very close. We don't say that we want to get X amount of other business. It is not something we plan for, it is what we get. What we plan for is our vertically-led growth.

Amit Chandra: And sir lastly on the IP-led revenue, so we have seen pretty good growth in the IP-led portfolio since the last 6, 7 quarters since we have started reporting. So, considering the current run rate, the IP led portfolio revenue is around 28 million, so what scope you can let you see in that portfolio, saying that we have 6 IPs, so can it be 50 to 60 million portfolio like in the next 2 to 3 years?

Srikar Reddy: That's what we said. I think IP-led; it is not licenses we get on the IP, so you all know what it means. It is where a client we get because of our IP and then we do services with them. It is not licenses of IP and that will be less than 5% which I have told you long back, so absolutely that has been our strategy which has been the 3-point strategy which is Platformation-led, IP-led and alliance-led. So IP is a very very strong differentiator for us to go and get new clients and I would be very disappointed if you don't get to this number of 50, 60 million in 2 to 3 years.

Amit Chandra: So sir, of the 6 IPs you have, which are the top IPs?

- Srikar Reddy:** Most of the IPs which are doing well are first of all our dynamic-led IPs which is the Brick & Click, the Kartopia and the modern distribution, Rezopia from the channel perspective and Halosys. The one which has still not got very strong traction in the market is the rapid DevOps, CloudOps platform. So that is still in the phase of getting some traction. So otherwise each of them obviously serve a different purpose in the client's value footprint and yes, I mean, so that continues to be as I said our differentiation growth in clients and with our alliance partners to say why we should work together to access clients in the market because of the IP we have in the industry which are they are interesting in already.
- Amit Chandra:** And sir what about this one, Brick & Click IP in the retail that you had, you mentioned that it is like very strong IP and it is like the acceptance in the market is also very good Brick & Click?
- Srikar Reddy:** Yes.
- Prasanna Oke:** Obviously, we will try to get some more details on it as we get the IP and each of the IPs to certain threshold kind of a level.
- Moderator:** Thank you. The next question is from the line of Vipul Shah, Individual Investor. Please go ahead.
- Vipul Shah:** Can you share IBIS, Halosys turnover and EBITDA for the quarter and Rezopia?
- Srikar Reddy:** IBIS, we should share as we have mentioned in the past, Halosys and Rezopia are not operating entities anymore although they exist as companies, the business gets done through Sonata 100%. We can share IBIS which is a truly operating entity. The business which is done for Rezopia and Halosys are completely operating through the Sonata entities today. So, they are not separate, although they exist as entities, there is no business it gets done through that. We can share IBIS level.
- Vipul Shah:** Can you give the IBIS turnover and EBITDA for the quarter?
- Prasanna Oke:** So, we did about between \$2.2M to \$2.3 million in IBIS and EBITDA was about 18%.
- Moderator:** Thank you. We have a follow up question from the line of Harith Shah from Reliance Securities. Please go ahead.
- Harith Shah:** Sir, we are just coming back to the question, what is the other segment of your verticals. So, I get the point of your focus being on OPD, retail and travel, but even so other still accounts about sixth of your revenue. So, it is still quite substantial. So just wanted to get a sense of what exactly does it totally consist of? Can you give some idea of the sub verticals where?
- Srikar Reddy:** We will have healthcare companies, insurance companies, some financial services companies, I guess that is the mix.

Harith Shah: So, this is basically, I think it is fair to say that this is not going to be any specific area of focus for you in future now?

Srikar Reddy: These are, as I said, based on relationships the CxOs. They get back to us or sometimes even the top management says that we know you guys and I think you are very good technologically, we would like to work with you, so we do that. So, it is not really IP-led or solution-led, it is not like very heavily competitive good market scenarios can start, so there is still a lot of that based on the goodwill and the fact that we have existed as a company now for more than 31 years. We have that goodwill out in the market and that can still continue to happen hopefully in the same proportion.

Harith Shah: One last thing. I think I missed one figure, I think you had mentioned IBIS revenue and EBITDA margin, if you could repeat that once?

Prasanna Oke: Yes, IBIS revenue is about \$ 2.2 to 2.3 million and EBITDA margin of about 18%,

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

Madhu Babu: Sir, last year we had a very good swing quarter where we had 8% of quarter-on-quarter growth, so this year can we expect any such number in the second half?

Prasanna Oke: Madhu, we are not giving the guidance, so we will see in the second half but as Srikar talked about we are getting good tractions from the discussions we are having on the Platformation clients on the verticals, IPs, so we just have to wait and watch for the next 6 months.

Madhu Babu: And second sir, I think we have recently released a press release saying that we are more into the Microsoft Inner Circle for the dynamics, so how significant that will be as a relationship with Microsoft?

Srikar Reddy: It is very significant as I told you that like, we are the cream of the cream. We are like 1% of the partners globally, which is like 1% of 4000 partners globally. So, we are one out of 30-40 and I said one out of 2 probably from India and actually, may be one only. Other is an acquisition which an Indian company made. So, that is why we are very-very prestigious and it gives you access to market if you say access to the leadership of Microsoft, you figure in their list of premium partners, we are doing well for them. And this is selected based on customer adds, IP you have ability to deliver value, successful delivery of projects, that is all metrics which they use before they choose these partners. So it is very prestigious. I don't think there have been many companies in the past in this list in the dynamic space and as I said, we have made the investments long back. We see a huge amount of traction in the market. Microsoft is doing extremely well. They have had the first \$1 billion last quarter for Dynamics, first time ever. So they are growing at 50% to 60% in the Dynamic business so it is delivered.

- Moderator:** Thank you. The next question is from the line of Sunil Jain from Nirmal Bang. Please go ahead.
- Sunil Jain:** My question relates to more of how much new business we own in this particular quarter?
- Srikar Reddy:** Customers we have signed last quarter and we gave our business last quarter, right?
- Prasanna Oke:** The last two quarters that we signed.
- Srikar Reddy:** So, these are customer signed over the last two quarters, from this beginning, is \$2 million.
- Sunil Jain:** And how was it in previous quarter?
- Prasanna Oke:** We typically take in from the beginning of the year. This actually builds up when we get into Q3 and Q4 when we realized that the clients are brought to a larger size. Last year, I think it should have been about 5-5.5%. We can get back to the exact numbers, but that is the new business that we started in April and that is what we consumed during the year.
- Sunil Jain:** This is related to European region, can you throw some light, how is the business panning out over there, you see some comparatively better growth over there?
- Srikar Reddy:** Yes, I think we have grown relatively better in numbers, 25% growth I guess in Europe on the first half is the correct number. So, as I said driven by both growths in our existing clients, growth in clients we acquired last year and some good new marquee clients this year which we have acquired. The markets we are operating are in UK, Nordics and Switzerland. These are the three places where we are operating, and we are seeing good traction.
- Sunil Jain:** And how is the pipeline looking for this particularly IP-led revenue? How is the pipeline for this for next second half?
- Srikar Reddy:** Generally, I think I would say the pipeline is looking very good, we have to convert it but I would say that it has never looked this healthier in terms of both existing and new. In terms of pipeline kind of opportunities, we are in good shape. Obviously, we have to convert it and grow it, but overall pipeline growth has been very healthy.
- Moderator:** Thank you. We have a follow-up question from the line of Vipul Shah, Individual Investor. Please go ahead.
- Vipul Shah:** Sir, I missed your figures you gave for other income and FOREX gain for this quarter?
- Prasanna Oke:** As we said, our overall EBITDA is about 26.7% and stripping it off with FOREX and other income is 22.4%. So roughly about 2.3% is FOREX and 2.1% is other income. That brings a drop from 26.7% to 22.4%.
- Vipul Shah:** And what is the fresh order intake in this quarter?

Srikar Reddy: Our fresh order intake as we said, we measure it starting from beginning of the year, so the number of new clients that we got and the revenues which have come from them is about \$2.0 million.

Moderator: Thank you. The next question is from the line of Devang Bhatt from ICICI Securities. Please go ahead.

Devang Bhatt: Sir, I just wanted to know on the margin front, what were the headwinds and tailwinds in the IT services?

Prasanna Oke: Overall, we kept on growing. If you look, there is a small change in the onsite-offshore mix. The headwinds came in from the cross currency effects and also I would like to say that headwinds is a part of normal operations, but in the hindsight that we took care of this time. There is some investment that we made in the management in overseas, so these were a little bit of cost upside and positive was obviously the FOREX and as we talked about the utilization increase.

Devang Bhatt: Can you break it up in BPS terms, I mean how it moved from margin to margin from Q-o-Q basis?

Prasanna Oke: Sure, if we look across the last 3 quarters, EBITDA without other income and without FOREX has actually moved from 18% in Q2 FY18 to 21.1%, 20.9%, 23.5% and roughly about 22.4% this time. That is what we have been seeing as a growth, that is what we are saying that on an overall basis, if you look at the EBITDA year on year basis in absolute terms or percentage terms, it was 39.4%.

Devang Bhatt: Do you hedge more of your revenues, so will there be higher FOREX gain in the next second half?

Prasanna Oke: Second half, actually we had expected where we talked about it in beginning of the year that our covers in the range of 69 to 70, obviously that is not going to benefit us considering the INR versus dollar hedges that we have got. Obviously, we had benefits on account of the revenue translations, but the benefits that we would have seen would be more likely towards H1 of next year.

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Srikar Reddy for closing comments.

Srikar Reddy: Thank you all very much for joining and highly interactive participation. Thank you very much for your support all this while. Wishing you and your families very happy prosperous Diwali and look forward to interacting with you in the future. Thank you all again.

Moderator: Thank you. On behalf of Sonata Software Limited, we conclude this conference. Thank you for joining us and you may now disconnect your lines.