



“Sonata Software Limited Q2 FY17 Results Conference Call”

November 03, 2016



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*Sonata Software Limited
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Moderator:

Good Day, Ladies and gentlemen, and Welcome to the Q2 FY17 Results Conference Call of Sonata Software Limited. 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 phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Srikar Reddy – Managing Director and Chief Executive Officer, Sonata Software Limited. Thank you and over to you, Mr. Reddy.

Srikar Reddy:

Thank you, Margret. Good morning everybody, and welcome to the Analyst Call post the announcements of our Q2 Results yesterday. I am actually speaking from Hyderabad and my colleagues are in Bangalore, that is Prasanna Oke who is our CFO and Raju who is Chief Delivery Officer, Omprakash who is our Head of Digital and Vertical and Sujit Mohanty who runs TISG business or what you may all know as the SITL subsidiary, apart from Sathyanarayana Head of Finance and Accounts and Kundan Lal who has just joined as a Company Secretary in the Board Meeting yesterday. The investor presentation is already uploaded on our website. And I am assuming most of you have had an opportunity to have a look at it. While I leave that later to Prasanna in terms of taking you through the financials.

At a very high level, I think the quarter has seen us especially on our international IT services side do a decent growth in top-line. Though there is an element of SI revenue in that of \$1 million, so even if you factor that in and if you factor the steep drop in the Pound, so at constant currency, we have had a very decent growth in top-line and in our TISG or SITL business there has been a drop in the top-line, but as I have told many times, that business is really managed based on the gross margins. And I think on an absolute gross margin business we have seen growth in that operation. And this has been driven by both a growth in our existing customers and more importantly I think growth which has come from the customers we have recently acquired. So, that has been the good sign last quarter that the customers we have recently acquired have started to scale up and these customers have been acquired, as I have mentioned many times, based on our IP led strategy going into these accounts with the IP we have created, which I did allude to last time in terms of the IP we have for retail distribution, mobility and travel industry.

The other thing which I had mentioned in my previous call was the finalization of the restructuring of the I.B.I.S. business which we had acquired. And we are happy to announce that we have completed the restructuring of that business and we believe that that business has turned around. And as I have said that we will start seeing a breakeven in Q3 and growth going forward and we think we are on track of that in terms of the I.B.I.S. business starting to deliver to the bottom-line from Q4 onwards.

So, overall there has been, as I said a significant qualitative improvement. The investments which we have made and which I have mentioned both in terms of the IP development and the sales and marketing investments which we have made recently in terms of hiring of new people, I believe are starting to pay results in terms of the pipeline which we have been able to generate.

The other strong positive sign last quarter has been our increased traction with the two of our strategic partners. We are today a lot more aligned with them globally across many geographies and they see a lot of value in the IP we have created for us to drive their technology revenues and their own game plan of becoming digital transformation partners to their clients across the technology stack and our own IP which will help them position their technology, because everybody is now looking at consumption of their technology through IP. As I had mentioned last time, we have a couple of our products on what is called the AppSource of Microsoft and we are looking at moving more products on to these kinds of platforms so that the sale of the platform will drive the sale of our platform.

So, in summary I think we believe that story of being a digital platform partner in the transformation journey of our client, we are starting to pay out and we will continue to see the progress we have made. Though, as I said the margins have got affected both in terms of the FOREX impact and the increase in cost in terms of both investments and the compensation increases we have done. But I believe, going forward the top-line growth should take care of that.

So, I will end my conversation at this point and come back later on to answer questions you may have and hand over the mike to Prasanna, our CFO.

Prasanna Oke:

Thank you, Srikar. And a good afternoon to all of you. As you are aware, our results have been posted on the corporate website yesterday afternoon. A few key highlights of the current quarter that have happened. We will start with the consolidated results for Q2 FY16-17. Our revenues stood at Rs. 522.5 crores, this is a 31% year-on-year growth and a de-growth of about 23% as compared to the last quarter. EBITDA of Rs. 59 crores, the sequential increase of 1%. And PAT stood at Rs. 37.8 crores, sequential growth of 3% and a year-on-year decrease of about 4%. ROC stands at about 22% for the consolidated business as a whole.

On the international IT services business, which is one of our two components of our business, Q2 FY16-17 we recorded the highest quarterly revenues. Revenues stood at Rs. 209 crores with a sequential growth, as compared to last quarter of 7%, year-on-year growth of 23%. This segment contributed about 40% of our consolidated revenues. Revenues in USD stood at \$31.2 million during the quarter with a sequential growth of 7%, year-on-year growth of about 20%. One of the ways that we measure our revenues is a components of digital, which stands at 31% of our revenues coming from digital component. EBITDA is at Rs. 45.5 crores, sequential growth of 3% and year-on-year de-growth of 1%. Whereas our rupee realization is at about USD 69, EURO 77.68, GBP 104.95. PAT stood at Rs. 29.6 crores, sequential growth of 6% and year-on-year de-growth of 4%, PAT from international IT services business contributed 78% of the consolidated PAT. We added five new customers during the quarter, few of them came in from the US, one came in from Asia and two from Europe. Overall, we had growth in our clients, as you can see from the revenue increase.

Domestic products and services, the second part of our business, For Q2 FY16-17, revenues stood at Rs. 317.4 crores, a year-on-year growth of 37% which contributed about 60% of the consolidated revenues. EBITDA stood at Rs. 14.2 crores, year-on-year flattish. And PAT stood at Rs. 8.2 crores, this contributed about 22% on a consolidated PAT. Post the result declaration yesterday, the interim dividends were also announced in the results yesterday of Rs. 3.5 per share, translating to 350% dividend.

This was the financial summary. I will now hand it back to Srikar.

- Srikar Reddy:** Thank you, Prasanna. So, Margret, possibly you can throw it open for questions.
- Moderator:** Sure, thank you very much. We will now begin with the question-and-answer session. Our first question is from the line of Madhu Babu from Centrum Broking. Please go ahead.
- Madhu Babu:** Sir, could you clarify about the SI revenue for the quarter, the \$1 million, what is it?
- Srikar Reddy:** Invoice we made about \$1 million, so that is made at a very low margin of about 7%, so it is a part of a deal we do with the customer. So if you remove that, maybe we will continue to do that going forward and we will inform that to you. But if you remove that, which has not been there before kind of stuff and then factor in at 20% - 25% drop in terms of the Pound, compared to previous quarter we took at 1.5 and I think last quarter at 1.3, then I see at a Constant currency growth, I think we still see the same growth of whatever we have projected kind of stuff.
- Madhu Babu:** Okay, this is \$1 million, exact nature if you can detail on that.
- Srikar Reddy:** Hardware included.
- Madhu Babu:** And second, you said OPD is showing strong growth last two quarters and we talked about our platforms enabling on that. Could you give more detail about this OPD growth?
- Srikar Reddy:** Sorry, the question is what is driving the OPD growth h?
- Madhu Babu:** Yes, last two quarters I think it was kind of 9% and in this quarter it is 10% quarter-on-quarter growth.
- Srikar Reddy:** Right. So we are offering, one is obviously our cloud engineering services which is based on the Azure. And what our message is that, because we have created now a lot of IP and bought IP, whether it is Rezopia or **AX or**ASCS, the fact that we have created this IP on the cloud is a solid proof that we have the engineering methodology and process to deliver scalable **IP products** that is one main driving force. The second is also that some of the horizontal IP which we have acquired, like the Mobility or even Rezopia, we are willing to offer on what we call a white labeled or a source code licensing model so people do not have to recreate again from scratch. So that is having growth, although that has not really started yielding huge revenues but we see that becoming interesting to those people that we are not only just providing services but

actually are able to come with a set of readymade tools and components which they could use in delivering their solutions.

Madhu Babu: And just one last question from my side, the new clients we said that they are seeing a strong pickup, could you talk about visit from the APAC and Australia which are these clients and which are the sub-verticals where we are getting these new clients from?

Srikar Reddy: Verticals are both in the retail distribution and travel and ISV , so it has been across the board. They were all started with a fairly small deal size, I think one or two quarters back about almost just like \$40,000 - \$50,000 kind of stuff. So the deal sizes have become bigger now in terms of almost like \$0.5 million, not that they are all being filled now but to be executed over the next six to 12 months. So that has been the encouraging sign that the clients who we acquired have now started to grow.

Madhu Babu: And any guidance on the second half, is it going to be a good growth or any weakness?

Srikar Reddy: Guidance, as I said that we do not give quantitative guidance, we can only give a qualitative guidance which I did give saying that we have turned around I.B.I.S. and so that will not have the drag and hopefully will have a positive impact. And I think yes, I mean on a constant currency we should continue to see the growth we have had. And I think we do not see any adverse impact further on the margins, because most of the cost increases have been done kind of stuff.

Moderator: Thank you. Our next question is from the line of Chetan Wadia from JHP Securities. Please go ahead.

Chetan Wadia: Sir, my question is on these IT industry leaders have either the revised guidance for FY17 downwards or painted a gloomy picture for 2017 or maybe to that extent for 2018? So what is Sonata's assessment of the overall situation and where does this stand compared to its peers? And is our quarterly run-rate on the revenue growth sustainable for 2017 as well as 2018?

Srikar Reddy: Okay, I think this has been what I have been saying for quite some time now. I am not saying it for the first time that we had a little different strategy, we are no more and never were in the purely commodity space. We were in the specialized services space and now we are driving to digital and IP led kind of stuff. So, at a high level from our visibility we see a lot more opportunities. Now it's the question for us to win or lose it. I do not think our problem is that we are not seeing opportunities and pipeline, where we are participating where the services are required kind of stuff. So, it is really our own ability to tell a good story and win the deal kind of stuff. So that is what we see for ourselves, we do not see a lack of opportunity in the kind of things that we are offering.

Chetan Wadia: Then quarterly run-rate that will grow that our traditional right now is very much sustainable?

Srikar Reddy: It is sustainable, absolutely. As I said it is not for a lack of opportunity or pipeline or interest kind of stuff, as I said it is on the basis of us being able to convert this opportunity into growth.

- Chetan Wadia:** And sir, are we to assume that in the few quarters or maybe a year ago that you had given a doubling of dollar revenue every four years. So based on the current scenario are you revising that or still maintaining that?
- Srikar Reddy:** That is the plan, I mean, that is what we see as an opportunity and that is what we want to achieve.
- Chetan Wadia:** And last one from my side, what will be the sustainable EBITDA margins based on the current business model and with IPs also coming in for the international business and for the domestic business for FY17 to FY18?
- Srikar Reddy:** EBITDA should be about 20% - 21% once I.B.I.S. turns around, because that is actually dragging it up a little bit right now kind of stuff. And as I said, domestic business let's just focus on gross margin rather than EBITDA because that is a very wrong thing. And percentage of profits as a percentage of gross margin will show healthy growth sign in the domestic business also.
- Chetan Wadia:** Sir, can you give a range?
- Srikar Reddy:** Range, I mean, we should be making about 40% as EBITDA of gross margin, if we make a gross margin of let's say Rs. 15 crores then we should make Rs. 6 crores as profit.
- Moderator:** Thank you. Our next question is from the line of Dhiraj Dave from Samvad Financial Services. Please go ahead.
- Dhiraj Dave:** Sir, one question I have is basically increase in the attrition rate, in fact if we refer to slide 25, we find that the Q2 2016 which was the highest basically employee attrition at 21%, this time it has gone up to 23%. Any specific reason why we have such increase or is it normal?
- Srikar Reddy:** It has been a blip which we have taken note of. And I think that is the time where we had done the comp increase. So normally we see that when that happens and then there is, actually when you do it there is actually an attrition because sometimes the expectations are not met and there can be huge demand for that skill in the market. So a lot of factors can come in and increase it. But yes, we have taken note of that and that is definitely not the way we want to be, we are very sure we will be back to wherever we are which is a little lower than industry norm.
- Dhiraj Dave:** The second question is, when I look at slide 28 when you are giving a breakup of digital and other businesses, segment wise, competency wise breakup, if I add up for Q2 the numbers which we call as digital that is ecommerce, BI, Mobility, Cloud and Rezopia, I think the addition does not come to 31%. So if I look at Q2 for example, BI which is I see green color is slight 9% and ecommerce is 6%, and then mobility 5%, totaling 20%, so are we missing something or...?
- Srikar Reddy:** Can I ask Prasanna and Sathya to answer this question?

Prasanna Oke: So, Dhiraj, we will be trying to look at the component of revenues from Digital and then you look at all the projects which are there, largely they comprise of, as you said BI, ecommerce, Mobility, Cloud, Rezopia. However, there are certain projects which are embedded inside the ADM and testing also, which have component of Digital revenues, so we had that up. This gives the realistic picture and that's what we have been measuring across the last four, five quarters.

Dhiraj Dave: So then, what it would be let us say in Q2 2016, because just to get an idea, what I understand is that this should be a high growth area, if I am wrong please correct me. So what would be comparable figure, because in fact if you look at Q2 for this specific we see decline, 21% becoming 20%.

Prasanna Oke: So what we have done, and if you really look at the investor presentation that we have given from the last three, four quarters, we started off measuring this about four quarters back, we said about 24% - 25% out of our total service revenues

Dhiraj Dave: And basically if you look at the EBITDA margin from domestic and international business, we kind of see stagnancy which I understand there is a headwind in the sector as well but actually if you look at the company, even as compared to with the peer group they have shown a significant amount of growth in last, let us say till FY16. But at least if I look at say five quarters numbers, kind of EBITDA or at net level, actually EBITDA is remaining kind of stable at Rs. 14 crores to Rs. 15 crores from domestic business and somewhere around Rs. 45 crores to Rs. 47 crores with highest being Rs. 49 crores in Q3 FY16. So, as we see some stagnancy, do we see kind of, yes I do understand we have acquired some business and we are looking at turning around. But is it like what we should expect or you have some other plans to see growth shortly?

Srikar Reddy: Let me answer that question. So, as I said at the beginning itself in my call, the investments which we have made and which we have said last time around also that we will present it when we have not, so it shows that there is steep increase in non-direct investments, as I said both in IP development and sales and marketing, apart from compensation increases and other things, apart from some losses which have come from the acquisition from I.B.I.S. kind of stuff. So if we see, actually our gross margins we have actually increased almost by about Rs. 8 crores this quarter and the same in the domestic business, if we take off the one-time other income kind of stuff. So if we measure the gross margin with direct operational margin, that is there is a growth. But the non-operational cost which has gone up and we believe as I said, those investments should yield results and that will take up the absolute margin upwards.

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

Mohit Jain: Hi Sir, first is on this \$1 million deal that you mentioned, so is it like we should exclude while doing the estimates?

Srikar Reddy: Yes, you can actually. I did not want to say that, you can and you can get a different margin, absolutely.

- Mohit Jain:** And even for the revenue growth trajectory because this is...
- Srikar Reddy:** Yes, you should, unless it becomes a steady thing that the clients want us to do that as part of a deal kind of stuff, it had become one-off so let us see whether it becomes a standard thing. But yes, but we will be transparent in informing you.
- Mohit Jain:** Second is on the IT services margins which you mentioned should be around 20% - 22% which I am assuming ex-FOREX gains and other income. So in this if you could help me understand the levers that are available, apart from I.B.I.S. turnaround, because your utilization is flat for like last four five quarters. Is there a way to improve pricing? And I notice that your onsite proportion is also going up, which may put some pressure on the margin side, so are there any other levers that you have apart from...?
- Srikar Reddy:** There are some levers like because of the Visa issue we hire expensive local contractors till the Visas open in October. And then people are ready to travel after that. So there is some expected movement there, when the resources who obtain Visa from India go and replace those expensive contractors onsite, so that is one lever there. The second lever as you said is the I.B.I.S. turnaround, I think our billable utilization has actually gone up. If you see the number of people we added from last quarter to this quarter and if you do a constant currency kind of stuff, there is very huge uptick in terms of billable utilization, because for 40 people we have almost delivered at a constant currency a extra \$1.5 million of revenue kind of stuff. So there has been an uptick there kind of stuff. So, I think these are the three or four levers available apart from there could be an opportunity to go and renegotiate billing rate, especially because of the Brexit and Pound, but let's see what we can achieve from that. Otherwise it is only going to be a top-line kind of a growth. I mean, the basic overhead cost is not going to go up in the same proportion.
- Mohit Jain:** Okay. Second is on Rezopia, so when you say this white labeled service, will this be part of Rezopia in your breakup or will it be part of ADM?
- Srikar Reddy:** We are signing the contract directly, we may not be signing it through Rezopia.
- Mohit Jain:** So it will come in ADM in your breakup, is it?
- Srikar Reddy:** It will come in digital I guess.
- Mohit Jain:** And one for Prasanna, Prasanna what should we assume for tax rate in this particular year and next year?
- Sathyanarayana R:** Tax rate basically for domestic services is about 34%, for international overall it comes to about 30%.
- Moderator:** Thank you. Our next question is from the line of Vipul Shah from Sumangal Investments. Please go ahead.

- Vipul Shah:** Hi good afternoon Sir, your revenue has gone up from \$26 million in quarter two 2016 to \$31.2 million, your onsite ratio has gone up also sharply, that you gave the reason, non-availability of Visa. So, in spite of almost 20% increase in dollar revenue why margins have come down? Can you breakup the FOREX part, specifically how much we have lost due to FOREX or is there any pricing pressure? And Rezopia revenue also has come down from 5% to 3% I suppose sequentially Q1 to Q2, so any specific reason?
- Srikar Reddy:** I will just explain, one is the SI I just spoke about, even if you take that out kind of thing. The increase in investments on both sales, presales, IP development has reduced margins, apart from the I.B.I.S. which has been at a negative margin, forget about the positive margin which has been backed as the absolute margin for the company.
- Vipul Shah:** Sorry to interrupt sir, but can you quantify both, how much we have lost due to both these factors?
- Srikar Reddy:** I cannot give you this thing, I can ask either Prasanna or Sathya to answer that question in terms of a quick breakup of the math.
- Sathyanarayana R:** On the Brexit impact, in terms of revenue Rs. 4.2 crores has got an impact in the revenues front. And on the IBIS I think we had about Rs. 1.6 crores negative in current quarter.
- Prasanna Oke:** So, Vipul in a way to look at answering your question, when you say \$26 million to \$31.2 million and onsite has also changed, a part of it is definitely the growth, a part has been negatively impacted because of the currencies. The third is that the onsite, offshore revenue mix also changed because I.B.I.S. was onsite largely driven revenues. We did not have the kind of margins that we are talking about.
- Vipul Shah:** And why Rezopia has come down sir?
- Srikar Reddy:** I think that is the odd looking, Rezopia from a company perspective or somewhere we have put that, because Rezopia...
- Vipul Shah:** I am referring to your slide 28 wherein you have given quarter one 2017 you have given Rezopia 5%, yellow line, and quarter two it is 3%. So if I am not getting anything correct so please explain.
- Prasanna Oke:** So this is the revenue by competency that you are trying to look at, right Vipul?
- Vipul Shah:** I am not getting you, sorry.
- Prasanna Oke:** Vipul, you are trying to say on slide 27 where we have given a revenue by competency and we will try to look at component of digital?
- Vipul Shah:** ok, yes.

- Prasanna Oke:** So, see what is also happening is that we are using the Rezopia as a platform, now any of these acquisitions which is a platform gives us revenues in multiple ways which includes revenue which is coming to Sonata by itself and not only from Rezopia.
- Srikar Reddy:** No, the question is have you reclassified the Rezopia revenues and put them in some other bucket, that is his question.
- Vipul Shah:** Yes, that is my exact question.
- Srikar Reddy:** So as the revenues are growing up, in presentation it shows its growing down, so have you taken the Rezopia revenues and put it in some other bucket?
- Vipul Shah:** Yes, so has it been put into some other head or bucket?
- Srikar Reddy:** Correct, because I know for sure the revenues have gone up.
- Prasanna Oke:** Revenues have gone up, there is a little bit of reclassification which has happened. So there are two components, a little bit of classification happened. Again again, what is also happening is that the overall revenues have gone up so Vipul, we can actually give a little bit more clarity on this at reclassification.
- Vipul Shah:** So, I did not hear your answer to first question clearly, Rs. 4.2 crores you said you lost due to Pound right and Rs. 1.6 crores due to I.B.I.S.?
- Srikar Reddy:** That is right. There has been a Rs. 6 crores increase in compensation.
- Moderator:** Thank you. Our next question is from the line of Harit Shah from Reliance Securities. Please go ahead.
- Harit Shah:** Sir, I just wanted to clarify. So this quarter did I.B.I.S. see some specific growth on the revenue side or was it still flattish and you are expecting it to grow from next quarter?
- Srikar Reddy:** This quarter we will see a revenue growth and that is what we will deliver, the breakeven, and then next quarter also revenue growth kind of stuff.
- Harit Shah:** So this quarter is basically a third quarter, right?
- Srikar Reddy:** Fourth quarter, Q3 is what I have said when we will breakeven in I.B.I.S..
- Harit Shah:** Yes, so the revenue growth will come in from the third quarter or from the fourth quarter, that is what I am trying to figure out.
- Srikar Reddy:** There will be a revenue growth, I mean, we are at about \$1 million - \$1.2 million or whatever it is, so there will be a revenue growth of at least some number.
- Harit Shah:** Yes, so this quarter it was flattish basically, in the second quarter right?

- Srikar Reddy:** It was a little flat or even down. So, Q3 there will be revenue growth and that will what drive the breakeven.
- Harit Shah:** And just another thing, your wage hike impact was, I think I may have missed that figure, you had some impact from wage hikes in this quarter also, is that correct?
- Srikar Reddy:** Actually, yes every quarter there are certain people who come up for review and kind of stuff, the big wage hike was in April I think which was about Rs. 4 crores or whatever. Otherwise its been about Rs. 1 crores every quarter on top of it.
- Harit Shah:** So this quarter was about Rs. 1 crores or whereabouts?
- Srikar Reddy:** Yes.
- Harit Shah:** And finally, what is the approximate time period of your repayment of the debt which you have taken out for I.B.I.S. and going forward if you do see some interesting acquisitions, would you be maybe open to take on some more debt?
- Srikar Reddy:** I will let Sathya answer the first question, and then I will answer the second question.
- Sathyanarayana R.:** The repayment of the debt taken for acquisition is over a three year period starting from next year onwards, quarterly.
- Harit Shah:** Okay , so starting FY18 basically?
- Sathyanarayana R.:** Yes.
- Srikar Reddy:** And to answer your second question, I think the whole things is that it's not that we did not have internal cash, it is just that it was more attractive to borrow at a very low financial cost level and that is why we borrowed it. And if that is the situation in future, we will do that also.
- Moderator:** Thank you. Our next question is from the line of Chetan Badia from JHP Securities. Please go ahead.
- Chetan Badia:** Sir my question is on the, what are the key initiatives that Sonata is undertaking within retail, travel and ISV which will enable it to cater larger size deals in years to come?
- Srikar Reddy:** I think I might say that we have built IP for retail, we have got IP for travel and then for ISV we have got horizontal as we call the white labeled product kind of stuff. Now that is going to be our competitive differentiator and that will be our competitive differentiator which we believe can also get large deals.
- Chetan Badia:** And sir, the number of million dollar clients have more or less remained the same for the last three quarters, so how many of the existing other clients do you think will cross that mark in second half of FY17 or maybe in FY18?

- Srikar Reddy:** I feel that we should have two more to be added to this list in the second half.
- Chetan Badia:** And sir, third question on digital revenue, of the 31% digital revenue how much is coming from the domestic market?
- Srikar Reddy:** We do not count the TISG license sales in the digital revenues.
- Chetan Badia:** So how much would it come from the companies in India?
- Prasanna Oke:** Chetan, these are the international revenues, so if you look on Slide #27, I mean these are metrics for the international business, so this is all the revenue bases are coming from outside India.
- Chetan Badia:** And sir, then in that case what potential do you see for the digital revenues in the domestic markets?
- Srikar Reddy:** Not too much, we are looking at, currently I think our services business purely in India maybe less than 2% or 3%. And as I said, unless we drive the lot through IP only, otherwise the market is not that attractive in terms of purely service led kind of stuff for margins. So, I think we have to just see how to leverage our IT better to see whether they can be hosted models and things like that to drive digital growth in India. It cannot be the model we follow on IP led services model like we do abroad.
- Chetan Badia:** And finally one question for Prasanna, the consolidated trade receivables are at 484 instead of 354 as of March, so how should we interpret this number?
- Prasanna Oke:** Chetan, so our AR has gone up a little bit, it has hence been collected already but so often it happens that we are trying to look at quarter end and couple of large collections slip over into both 31st or 30th of the month, so that has what has happened. It is largely to do with the domestic business that we have, TISG business, couple of large deals and that has hence been collected already. But it slipped over to the next quarter.
- Moderator:** Thank you. Our next question is from the line of Visarg Vakharia from Lucky Investment Managers. Please go ahead.
- Visarg Vakharia:** Sir, at the cost of being a little repetitive, what is the constant currency growth ex of the I.B.I.S. revenue in this quarter?
- Srikar Reddy:** Constant currency growth ex of I.B.I.S. and ex of SI, right?
- Visarg Vakharia:** Yes sir.
- Srikar Reddy:** It would be about 6%.
- Visarg Vakharia:** And what is the absolute number that we have invested in this IP development which you have mentioned, which is why the margins are lower?

- Srikar Reddy:** I can quickly give you, you want....
- Visarg Vakharia:** Rough estimate sir.
- Srikar Reddy:** Yes, I can just quickly give you, I think we are doing about close to Rs. 20 crores per year which was about Rs. 14 crores and then much lower before that.
- Visarg Vakharia:** So this Rs. 20 crores is a sustainable number which will be even next year or will this go down again?
- Srikar Reddy:** No, it will not go down, I do not think it will not go up either.
- Visarg Vakharia:** And sir you mentioned that there is a Rs. 8 crores increase in gross margins, what has driven that gross margin increase?
- Srikar Reddy:** Revenues.
- Visarg Vakharia:** Is that higher quality revenue, the billing rates and...?
- Srikar Reddy:** I think it will remain the same, higher revenue, higher margin, lower number of people. I told you know, 40 people and \$1.5 million of extra revenues.
- Moderator:** Thank you. Our next question is from the line of Rohit Balakrishnan from Rare Enterprises. Please go ahead.
- Rohit Balakrishnan:** Sir, just want to understand few things. Sir, on your domestic business I think there has been sharp increase in the DSOs, so what is the reason for that?
- Srikar Reddy:** One single transaction of Rs. 126 crores, which is normally been collected before the end of the quarter, but we did not. So we have already collected it. You see that number today, it will be very different.
- Rohit Balakrishnan:** So, if you can just help me with, you have been guiding that the margins will sort of trend lower over the last couple of quarters, you have been saying that. So has there been a change in your stance?
- Srikar Reddy:** Its about 25 and we have said it will trend down to at about 20 - 21, we will be there.
- Rohit Balakrishnan:** So we will maintain these margins?
- Srikar Reddy:** Correct.
- Rohit Balakrishnan:** So, however, I heard you talking about I.B.I.S. getting to breakeven in this quarter and perhaps ...
- Srikar Reddy:** Going to the bottom-line going forward, yes.

- Rohit Balakrishnan:** So how do you view that in terms of, wouldn't that expand margins from here?
- Srikar Reddy:** Not a significant number right, I.B.I.S. is only \$1.5 million of revenue. It is not like a big number is what I am saying.
- Rohit Balakrishnan:** And sir, there was this announcement that you had some partnership in IoT, so if you can...
- Srikar Reddy:** Okay, that is basically the Halosys platform we bought, it is a mobility platform. So a lot of people are interested in partnering with us. So ARIS has an IoT platform and mobile devices are considered as an IoT device, they do not have mobility IoT platform. So they want to combine both and offer it and we want to combine both and offer it. So that is a very high level kind of a thing. Similarly, I have signed up with Zebra technologies again, they supply a lot of retail hardware and they want to supply the Halosys platform along with their devices kind of stuff. So there are some interesting, we have also signed up with net suite with BFN, made for net suite mobile platform. But these are all partnerships we have signed, let's see what they bring to us.
- Rohit Balakrishnan:** And across the board most of the companies are talking about pricing pressure and hence pressure on margins. You have maintained that there is nothing like that that you were saying, do you still maintain that or...?
- Srikar Reddy:** I think so because our mix has been a little different for some time now, services mix. So, I do not see that pressure today kind of stuff on our existing business. We may do, I don't know, larger deals going forward at a little lower margin that could overall impact, but our current business, I do not see any threat on margins.
- Rohit Balakrishnan:** And just on your million dollar clients, so how was that in this quarter, has there been any increase?
- Srikar Reddy:** No, the numbers have remained flat like somebody said 20 or whatever it is. But we can look at adding two more to that list in the next quarter. That means the current guys will become million dollar clients.
- Rohit Balakrishnan:** So you see visibility within...?
- Srikar Reddy:** Yes, a couple of them.
- Rohit Balakrishnan:** And typically what has been, how do we typically start with the million dollar type of customers...
- Srikar Reddy:** No, we do not, that is what I was saying. As I said, most of them, four - five of them have all started with one, two, three quarters back with about \$50,000 kind of stuff with some kind of a consulting assignment, performance improvement or architectural assessment, very specific area where we think we are good at. And that leads to the underlying thing then being given to us as a Phase-II, underlying thing is actually the larger piece of work. That is what we are seeing, yes.

- Rohit Balakrishnan:** And just two more questions. So, one, you mentioned that you do not see any immediate margin pressure in the current kind of work that you are doing and you also mentioned that that is slightly different from what the other folks are doing. So, if you can elaborate.
- Srikar Reddy:** Not what other folks are doing, in the revenue mix, I am saying our mix is much better that is what I am saying.
- Rohit Balakrishnan:** So if you can elaborate what exactly do you mean there.
- Srikar Reddy:** See, our underlying is like AX Services, Hybris Services, Azure development kind of stuff, even our platform based testing, platform based development revenues kind of stuff. They are all, I would say they are not normal, they are not commodity services, let me put it that way.
- Rohit Balakrishnan:** And what was your IP led revenue in this quarter?
- Srikar Reddy:** I think it was about Rs. 23 crores or Rs. 24 crores.
- Rohit Balakrishnan:** And what was it last quarter?
- Srikar Reddy:** It must have been Rs. 21 crores I think.
- Rohit Balakrishnan:** And sir, if you take a two to three year view, you have said your aspiration on your revenue, you talk a bit about the margins as well, how do you see that?
- Srikar Reddy:** Margins should be around where we are kind of stuff, I do not see that changing downwards at least.
- Rohit Balakrishnan:** And any aspiration towards increasing that, obviously we all want to increase margins but...?
- Srikar Reddy:** Let us see, I do not know I mean.
- Rohit Balakrishnan:** Do you think that you are doing specifically or anything that we see that could perhaps increase?
- Srikar Reddy:** The way I see now this business is also about investments, not just say, I will just and don't invest kind of stuff, and expect to continuously make margins, my feeling is that, those days are over. So you need to invest, what you invest is up to you but you need to invest and you need to continuously invest, I do not think you can not invest kind of stuff. So that is the way I read it, so should take it back and put some back in to the business to grow.
- Moderator:** Thank you. Our next question is from the line of Gaurav Lohiya from E&R Advisors. Please go ahead.
- Gaurav Lohiya:** Sir, sorry for keep pressing on the margin side, but when you say that your EBITDA margin, the IT services EBITDA margin would remain at around 20% - 22% kind of level, are you looking at this core EBITDA margin where I exclude other income and your FOREX gain? I see that you have seen some 1.6% kind of QoQ expansion in EBITDA margins, so I just wanted to

understand, you are saying that in Q3 and Q4 you will see lower cost due to contract employees being replaced by your offshore employees and all. And plus there are other levers as well, shouldn't you see expansion in EBITDA margins going forward instead of maintaining it at around 20% - 22% kind of level, or is it because of decline in other income and FOREX that you are expecting?

Srikar Reddy: No, that is what I am saying that while we take some of these actions, yes the FOREX, I am not too sure we will be okay I think and this other income is a variable thing kind of stuff. But yes, from our point of view, it is a rather safe estimate to stay at this rather than overstate it.

Gaurav Lohiya: But you think that you will be able to maintain Q2 kind of margins or there is a scope of further improvement from here onwards as well or...?

Srikar Reddy: Our belief is that let's stay at where we are kind of stuff, if we improve it we will all take it.

Gaurav Lohiya: And sir, we are seeing lots of traction in our new client side but when I see it our non-top 10 clients growth it is lower than the overall IT services business growth, it is at around 3.3%. So are we talking about the future forecast where we will see higher growth or am I missing something here?

Srikar Reddy: They are not in the top 10 clients, the clients I am mentioning are not in the top 10, right.

Gaurav Lohiya: Okay, they are still not under top 10 clients, you are saying that they are yet to be booked in revenues?

Srikar Reddy: I am talking about the people who are not even in the million dollars. So there is three grades right, there are top 10 then there are next million dollar clients and there are people who are not even million dollar clients, I am talking about the third lot.

Gaurav Lohiya: So when you say non-top 10 clients, it does not include all other clients, its million dollar clients you are talking about?

Srikar Reddy: That is right, correct.

Gaurav Lohiya: And will we see further changes in offshore and onsite proportion going forward or it will remain at same levels? Because I remember in the last quarter you said it will only be 1% or 2% here and there but I think there was a 3% change in this quarter. So I just wanted to figure out if there will be further changes in this proportion going forward as we move to digital and we see higher growth in digital side.

Srikar Reddy: I think one of the main reasons why onsite could go up is I.B.I.S. because it is a purely onsite business. Otherwise I do not see, I mean I will continue to maintain that, that is not what we are seeing there is a bigger shift onsite kind of stuff.

- Gaurav Lohiya:** And sir last question, on the domestic product business in the first half we have seen some 16% growth in EBITDA, so you think that you will be able to maintain this kind of growth or the margin expansion for the financial year or in the second half there will be some lower growth in domestic product?
- Srikar Reddy:** In EBITDA do not look at it its all I am saying in the domestic business, wrong metrics.
- Gaurav Lohiya:** EBITDA also is a wrong matrix?
- Srikar Reddy:** Yes, I said we have to measure it as a percentage of gross margin.
- Gaurav Lohiya:** So, do you expect gross margin to expand going forward?
- Srikar Reddy:** We will expand, yes.
- Gaurav Lohiya:** And as EBITDA's percentage of gross profit, even if they remain the same there will be some growth?
- Srikar Reddy:** There will be growth, correct. You are absolutely right.
- Moderator:** Thank you. Our next question is from the line of Amish Kanani from JM Financial. Please go ahead.
- Amish Kanani:** Sir, you said that there is no dearth of opportunity in the area where we operate. If you can give us some sense in terms of number of enquiries, funnel, in terms of either total or vertical wise how is it better vis-à-vis say last year this time or something like that, it would help us understand what is the underlying growth opportunity. You said it will depend on the win rates of course, we understand that, but if you can just at least tell us the pipeline or enquiry level stuff. You said, basically the idea was you highlighted that you want to be a turnkey partner for mid-sized \$500 million plus customer across these verticals. If you can give us some flavor of quantification in terms of number of clients that you are discussing or overall value of pipeline that you are discussing.
- Srikar Reddy:** I would love to give you the detailed quantitative information but because our system grosses up the total opportunity and I do not want to give you some huge number, it does not look very real kind of stuff so we have to classify further into what we call hot and immediate and then good jumps to win and that kind of stuff. So, I can say that at this point of time and we will try to give you a more qualitative and quantitative analysis next time onwards. So at a very gut feel level I would say that in terms of the number of enquiries what we call leads and then what we call leads to opportunities, these are the two metrics we track. And if we take the hot level, they have both gone up by 50%. But the third is, opportunities to deals metric.
- Amish Kanani:** So you are saying there is something called leads and then there is something called opportunity?
- Srikar Reddy:** Yes, correct.

- Amish Kanani:** And depending on the conversion, but at least your leads and opportunities are 50% more for the hot kind of deal that you think is winnable?
- Srikar Reddy:** Absolutely right.
- Moderator:** Thank you. Our next question is from the line of Vipul Shah from Sumangal Investments. Please go ahead.
- Vipul Shah:** My question has been answered. But just one thing I missed, what was the salary increase this quarter sir?
- Srikar Reddy:** About Rs. 1.30 crores or something like that.
- Moderator:** Thank you. Our next question is from the line of Kaustav Bubna from SKS Capital & Research. Please go ahead.
- Kaustav Bubna:** Last time we discussed, you guys do not segregate revenues, EBITDA, PAT based on services and products, should I expect you guys to do that in the future to improve transparency?
- Srikar Reddy:** Okay, because I have just shared a number called IP led revenue, so we want to say IP led revenue is what is the margin on it, we will present that.
- Moderator:** Thank you. Our next question is from the line of Rohit Balakrishnan from Rare Enterprises. Please go ahead.
- Rohit Balakrishnan:** So, what is the gross margin that we have in our IT services business?
- Prasanna Oke:** So, roughly the gross margin for us will be about 6% to 7%.
- Srikar Reddy:** Sorry, he is talking about the gross margin in the IT services business, not TISG Business
- Raju PVSN:** It is about 39%, Rohit.
- Rohit Balakrishnan:** And you have seen an increase in this quarter?
- Raju PVSN:** Yes, it moved up from 37% to 39%.
- Rohit Balakrishnan:** And, if you can just reiterate on what you had said in terms of the deals which you think are fairly hot or whatever, can you just explain that again, sorry?
- Srikar Reddy:** I said, we measure it on three dimensions, one is the number of leads or enquiries. And two is leads and convert into opportunities, that means if we want to buy something, not from you but we want to buy. And three is that they want to buy from us, that is the third dimension. I was saying L and O have gone up by 50%.

Moderator: Thank you. Our next question is from the line of Prakash Bua, he is an Individual Investor. Please go ahead.

Prakash Bua: We have been seeing very flat results quarter-after-quarter for Sonata, I can say even year-after-year. I have a very precise question to ask to the management and Mr. Reddy, when the share price is going to cross the mark of Rs. 250 and a dividend of Rs. 15 per share per year, when it is going to happen? Because we do not know about technology but we want the results from the management. And we know that the industry is doing not so good, but what is the Sonata differential, Sonata has not shown any growth on the bourses, so are we going to give any bonus shares at all to the shareholders asking for the next three years. Please clarify.

Srikar Reddy: I think Mr. Bua, we have shared this information just now. So on the share price I cannot comment because I do not think we manage the share price, we only manage the...

Prakash Bua: No, sir one thing, I know that you do not manage the share price but you must be looking at the share price from the shareholders perspective and analyst perspective. So just fussing about the figures where growth is very minor growth, what do you think for the fate of the company and the industry? Will the industries will have better days in coming years, can you give us some industry perspective. And what is the Sonata differential in that. See, all are doing that, all are doing that is one thing, but what is your Sonata differential as you were mentioning in the industry, please.

Srikar Reddy: We have just shared Mr. Bua that the differential is our IP and our focus and that is what has made us different from the rest of whatever result you are seeing. And we believe that that is what should take us forward. So that is all I can share.

Prakash Bua: How much forward you expect, can you give some flavor or share or color or some idea?

Srikar Reddy: Planning for what we can do and what we can happen kind of stuff, we just shared all this information.

Prakash Bua: You think that it will be a very something this is very satisfying compared to the last three four quarters where going a little up, little down, little up, little down. But it has, has it seen been a slowdown, I do not say that Sonata in particular but industry in general. Do you think that Sonata will be able to make the head up above the water level, much above the water level?

Srikar Reddy: That is the intent Mr. Bua, that is what we have been telling you for a long time, right.

Prakash Bua: To you I will suggest, I mean you will appreciate with me, it is share price, share price has to cross the mark of at least Rs. 200, I think that will make the entire Sonata family happy, like management and shareholders together. And if that happens, that is a real growth I can say. Growth year-on-year, pockets and all, Rezopia and all talk is something which is academic I can say, for us it is academic, for you you are dealing with it. But for us its just a academic talk, if you give the result I think extended profit and all that, that is what we are waiting for. Would



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you comment on bonus share, so it is a management decision but what is your feel on the bonus shares?

Srikar Reddy: Sure. It's Board's decision and not of management.

Prakash Bua: But you are the people who will motivate the Board to give the bonus shares, you have to give us the confidence.

Srikar Reddy: You should put it in the AGM also in front of the Board.

Moderator: Thank you. Ladies and Gentlemen, that was our last question. I now hand the conference over to Mr. Srikar Reddy for closing comments.

Srikar Reddy: Thank you all very much. It has been a very exciting call and thanks for all the questions and some good words. So yes, look forward to seeing you all in the next call and thanks for all your support so far. Take care.

Moderator: Thank you. On behalf of Sonata Software Limited, that concludes this conference. Thank you for joining us and you may now disconnect your line.