



# “Sonata Software Limited Q2 FY16 Earnings Conference Call”

**November 03, 2015**



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**Moderator:** Ladies and gentlemen good day and welcome to the Sonata Software Limited Q2 FY16 Results 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, please signal an operator by pressing “\*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now would now like to hand the conference over to Mr. Srikar Reddy. Thank you and over to you, sir.

**Srikar Reddy:** Yes, thank you Karuna, good morning, everybody and welcome back to the Analyst Conference Call post the announcement of our quarter two results FY16. Today I am in Delhi because I had a meeting and my team is in Bangalore so, the team in Bangalore is Prasanna our CFO, Satya Head of Finance and Priya – the Company Secretary. I thought that before go into the more detailed analysis of the results from Prasanna for the quarter we will set the tone in terms of how do we see the results and also explain to you at very high level about acquisition which we announced about a week ago and going forward how do we look at these things that are playing together kind of stuff.

On a high level I think our results for the quarter are in line with what we have been saying so far, though we had a flat quarter in terms of dollar revenues I think we have had a good growth in operating margin in terms of both EBITDA and PAT. And in the Domestic business though we have seen a drop in revenue I have always been saying that there the focus is on the absolute gross margin and so that we have stayed consistent with in terms of the growth there. I think more importantly what we are happy about is that we are really now executing and seeing some of the results of the execution we have talked about almost about 12 months to 15 months when we talked about but we are going to move towards in IP led services strategy and that is we have now executed upon in terms of for the acquisition of Rezopia and then Halosys the mobility platform now the I.B.I.S. the Dynamics Partner based out of U.S. with a strong distribution IP. So this in line with what we have been talking about in terms of moving towards the digital transformation of our client’s businesses and our strategy is that do that through a combination of IP Consulting and Specialized Services and our earlier strategy was really based on specialized services around Dynamics AX and Mobility and Cloud Engineering and we are going to add the IP led services on top as we address the digital transformation issues for our client’s going forward. So I think that was more I would say key point I was trying to make was that we are well on our way in terms of executing the strategy we have been speaking about and our plans are obviously now going forward is to how do you put all these together and then give an integrated holistic value proposition to our clients in all the verticals we are operating on. I am sure all of you a lot of questions and I will answer then once Prasanna take you through our financial. I will just handover the micro phone to Prasanna to take you through the financial analysis for the quarter and we would come back to questions which you may have.

**Prasanna Oke:** Thanks Srikar, good afternoon to all of you. Our results have been posted on our corporate website since yesterday as you are aware. Nevertheless let me provide some key highlights what we achieved in Q2 FY15 - 16. We have been able to sustain the growth performance on the key metrics and targets that we had set for our self. You might have seen the Press Release and

Investor Presentation which is posted in our website wherein we have bettered all of our previous records on majority of the matrices in this quarter as well.

Based on the assessment of the financial performance of the company, the board approved an interim dividend of Rs.3.5 per share which will be considered in meeting of the board to be held on November 6, 2015.

Now I will draw your attention to the details of financial performance. We gave our performance in three parts one is consolidated, second is the international IT services and third is the domestic product and services. Key highlights for Q2 FY15 - 16 for consolidated. We have achieved a highest EBITDA and PAT in this quarter. The overall revenues stood at Rs.398 crore. Yes, we have de-growth of 17% sequential and 2% on year on year basis. There is reduction in revenues on account of some of the orders in the domestic products business which has not come through. However we did manage to keep the EBITDA and margins in line.

Overall EBITDA on a consolidated basis Rs.59 crores, sequential growth of 5% and 32% on year on year basis. PAT at Rs.39 crores, sequential growth of 3% and 26% year on year. Total cash and cash equivalents stands at approximately Rs.212 crores. ROCE is 30%, RONW is 33%.

Looking at our International IT services business again here we recorded the highest revenues and PAT in this quarter. The revenues were at Rs.171 crores with a Q-on-Q growth of 3% and year-on-year growth of 15%. This contributed about 43% to our consolidated revenues. Revenues in US dollar is 26 million during the quarter just about flattish or 1% growth Q-on-Q and year-on-year of 7%. Revenue growth in constant currency terms Q-on-Q is 1% year-on-year 12%. Our revenue from the digital part of the business is 28% up from the 26% that we had in the last quarter. Overall EBITDA is Rs.45.3 crores with a Q-on-Q growth of 7% and a year-on-year growth of 27%.

During this quarter there is a FOREX gain of Rs.3.3 crores compared to the gain of Rs.5.6 crores in Q1 on account of lower realized gain. Rupee realization rate what we got for this quarter USD at Rs.65.65, Euro at Rs.80 and GBP at Rs.104.3.

Overall PAT for International IT services stood at Rs.31 crores with a quarter-on-quarter growth of 4% and year-on-year growth of 22%. This has contributed close to 79% of the consolidated PAT. We added 8 new customers during the quarter average DSOs for the quarter is 50 days and quarter end DSOs is 58 days.

Looking at second parts of our business domestic products and services number for Q2 FY15 - 16 revenues at Rs.232 crores, EBITDA at Rs.14.2 crores, PAT at Rs.8.4 crores with Q-on-Q flattish and year-on-year growth of 46%. The DSOs quarterly average of 52 days and a quarter end DSO of 101. The increase in the quarter in DSOs is on account of the few large orders that we get typically at the end of a quarter and the collections which we realize very soon after the

quarter ends. In this business line we received interest on IT refunds of Rs.0.96 crores. This is our results for Q2 FY15 - 16. And we can open it up for questions now.

**Moderator:** Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Harit Shah from HDFC Securities. Please go ahead.

**Harit Shah:** Sir, I have a question on your Domestic Business. So this quarter we saw some of your orders did not come through because of that your revenue was lower. You mentioned that the DSO was higher because of higher order receive towards the end of the quarter so, would that then imply therefore that you will see a recovery in growth in the second quarter in this particular business is that the correct way to look at it?

**Srikar Reddy:** Sure. Yes, I will ask Prasanna to answer that question on the DSO. Yes, we expect the top-line to grow but as I have always been saying that this business is all about the absolute gross margin and sometimes the top-line is purely a function of very large deal but at much lower margin so, I would continue to ask everybody to just look at this business as an absolute margin business and not as a percentage margin business. But having said that I think, yes, because things have shifted, we definitely can look forward to a better kind of top-line next quarter. Did you have a DSO or you had just revenue question?

**Harit Shah:** No, sir this was basically the revenue question. Secondly, what are the main drivers of higher EBITDA margin in this quarter or in this particular business because we...

**Srikar Reddy:** That is what I said, sometimes certain transaction based on the kind of underlying product the principal's give us a higher margin or rebates what they call. Because they want to promote those products, so to that extent what happens is we can get higher margin. But on a consistent basis I think we should take that, whatever I mentioned, 5-5.5% increase the norm kind of stuff. I mean there can be some variations but one should not read too much into it that this business has now become an 8% margin business. I do not think that is happening. So that is why I said we continue to look at the absolute gross margin is I think Rs.60 crores or whatever I mean that is the kind of number which we need to focus upon and grow that basically.

**Harit Shah:** Sure, sir. I mean within this business are you seeing any specific traction in any particular area, I mean your cloud security, these are obviously growth area so is that what is driving growth for you right now?

**Srikar Reddy:** Yes. We are seeing lot more of Cloud is driving growth because a lot of companies are moving there licensing models to the Cloud because that is the huge driver. Security is something we are planning to start as a separate line of business so we should do that next quarter but that will take time to build the large momentum. But definitely Cloud is a large growth driver for most of the principles we deal with.

- Harit Shah:** Yes, sure. My third question is to your International business. From a vertical perspective your OPD business has been declining for the last three quarters - four quarters in a row now. So if you will give some color on exactly what headwinds are you facing in that business that will be helpful?
- Srikar Reddy:** Sorry, I did not hear that question. What is the exact question?
- Harit Shah:** Yes, so my question was relating to your International IT business. Within that from a vertical perspective your OPD business has been a lot of headwind for the last three quarters - four quarters now so any if you will give some color on what...
- Srikar Reddy:** Yes, we did experience that we had a challenge, I think I have mentioned it a couple of quarters ago, with one of the clients in the OPD. So, that is what I think is the reason for decrease in the OPD business. But because it is a large kind of client the growth by the other client is not able to make up for it. But otherwise as a growth kind of engine we are seeing the same a level of growth as what we have been seeing and across all the three or four verticals we operate.
- Harit Shah:** Sure. And my last question, so now we have seen a couple of flattish quarter as far as your IT business is concerned in USD term. So can we expect this now to improve on quarter-to-quarter value?
- Srikar Reddy:** Yes, that is what we have said. We expect that to now improve. We think that we have now got a steadier platform.
- Harit Shah:** Sure, sir. There will not be any impact of this allows and shutdowns and thing like that in the third quarter generally...
- Srikar Reddy:** Seems to be an industry veteran, yes, and I think we are managing that.
- Moderator:** Thank you. Next question is from the line of Madhu Babu from Centrum. Please go ahead.
- Madhu Babu:** Sir, could you talk about the recent acquisition how much it will add to revenues and when it is going to be consolidated?
- Srikar Reddy:** Consolidation will happen when the actual deal closes which is about I guess two weeks from now. The company revenues are about annual revenues are about \$12 million so, once we consolidate, whatever it be, remaining part of the revenue will get added into our consolidated revenue.
- Madhu Babu:** Okay. Sir and the top account which was weak in the OPD side, which is weak for two quarters - three quarters, so has that stabilized and from here only...
- Srikar Reddy:** That is what we have factored that in by growth from other accounts that is what I said.

- Madhu Babu:** Okay. And just one more thing the onsite has been increasing in terms of revenue by delivery center onsite, so, onsite is driving growth so any but still again margins were good this quarter so, outlook on the margins on this...
- Srikar Reddy:** Margins I think again I mean be more saying that the margin I think this quarter it is almost 26% kind of stuff is a little high, I would say that is not a very sustainable kind of situation on the long-term basis at 20%. So we will get growth to absolute growth kind of stuff.
- Madhu Babu:** Okay, sir. And lastly, I think Q3 and Q4 definitely going to be much better and coming back to kind of 3% to 4% kind of quarter-on-quarter.
- Srikar Reddy:** Yes, that is what we expect.
- Madhu Babu:** Yes, 3% to 4% kind of quarter-on-quarter.
- Moderator:** Thank you. Next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.
- Mohit Jain:** Just to follow-up on the OPD side last time when we discussed in the Q1 call you talked about this industry level growth being possible for IT Services. My expectation decline was a little sharper than what one would expect. So now we grow on a sequential basis. Do you think that 10% to 12% is something you can do on IT Services in FY16?
- Srikar Reddy:** Yes, that is what we said I think last year we did \$ 98 mn and I mentioned even if you want to do 10% we have to come to \$ 106-107 mn that is possible.
- Mohit Jain:** \$ 106-107 mn looks doable to you?
- Srikar Reddy:** Yes, we are already at a run rate of \$ 104 or 104.5 mn, yes.
- Mohit Jain:** Yes, so the decline is mostly factored in Q2 numbers already?
- Srikar Reddy:** Yes.
- Mohit Jain:** Second thing is you did not talk about the margins of the acquired business.
- Srikar Reddy:** Yes, margins it is a purely U.S. business the margins are obviously are a lot lower currently. There is about 6% to 8%, we expect that to over a period of time to go up to 10% to 12%.
- Mohit Jain:** That is through offshoring only?
- Srikar Reddy:** Yes, some other services and whole lot of other things unusual stuff cross-selling, up-selling having more stuff moving some other stuff offshore taking the IP to other geographies all that kind of stuff but it will take a little bit of time to get to be on higher margin within 12 months.

**Mohit Jain:** For our factoring purpose right now we should consider 6% to 8%?

**Srikar Reddy:** That is right.

**Mohit Jain:** And then it will only be a gradual improve from there on?

**Srikar Reddy:** Absolutely.

**Mohit Jain:** Any inorganic revenues included in this particular quarter in \$26 million IT Services?

**Srikar Reddy:** Not much because I told last time Halosys was fairly small maybe \$6,000 something that.

**Mohit Jain:** How much?

**Srikar Reddy:** I am not too sure. I will ask Prasanna to say but I think it is about. Prasanna you want to answer the question.

**Prasanna Oke:** Yes, Srikar I will take it. This was we did the acquisition of the Halosys only on 11th of September so, probably it's about close to 20 days very-very minor within 50K-60K or something what we got not more than that.

**Mohit Jain:** And the full benefit will come in the third quarter?

**Prasanna Oke:** Yes, the revenues will be accretive so we will get a benefit in this quarter again. As we previously mentioned, Halosys is looking more as a platform and not really counting large time or big time on the revenues coming in from this client.

**Mohit Jain:** Any seasonality expected in the fourth quarter from Halosys?

**Srikar Reddy:** Sorry, what is the question?

**Mohit Jain:** In the fourth quarter do you expect any lumpiness in revenue from Halosys?

**Srikar Reddy:** No, I think right now we have pipeline. But they are not like huge million dollar kind of license deals and anyway most of them are subscription based. So most of our platforms are not one time license kind of stuff they are all subscription based. So there will not be any lumpiness.

**Mohit Jain:** Understood. Last thing is on margins. You have said IT Services margins are not sustainable is there a range that you are looking at?

**Srikar Reddy:** I think about 22%-24%, Yes that is what is sustainable, Yes.

**Mohit Jain:** So we are 24.5%, if I remove the FOREX impact?

- Srikar Reddy:** Okay, I am including everything because I mean people sometimes ask with ForEx, without FOREX and if we do not do with the FOREX kind of stuff so, you take everything into account FOREX go through the bank. So, I think Yes about 22% to 24% is very sustainable.
- Mohit Jain:** Very sustainable. On the Domestic Business side this is another quarter of increase I think this is one of the highest margin that you have delivered 3.5% odd percent so what is the target going on? Earlier you use to talk about 3% to 4% margins?
- Srikar Reddy:** 5.5% is what I think we talked about I mean it is gross it was we changed that I mean I just mentioned that there is a very unusual kind of a quarter in terms of the product mix but I mean it is not do not read too much into it while I am saying we just have focus on the absolute gross margin and not at percentage margin and I have said that many times it is no capital employed in the business it is a high return on capital employed business so, what we look there is absolute gross margin.
- Mohit Jain:** So next quarter should be a little slower in terms of margin that is what you mean this was an exceptionally good quarter.
- Srikar Reddy:** I think so in terms of percentage margin, absolutely.
- Mohit Jain:** Yes, percentage margin. So we should maintain that range of 2.8% to 3.5%.
- Srikar Reddy:** Yes, we will be I mean whatever we have seen in the last eight quarters to ten quarters is norm this quarter is an exceptional.
- Mohit Jain:** So in the last eight to ten you have improved significantly so there is no average...
- Srikar Reddy:** This quarter has been unusual, yes that is what I was saying.
- Moderator:** Thank you. Next question is from the line of Chetan Wadia from JHP Securities. Please go ahead.
- Chetan Wadia:** Sir, on the domestic front you said it is more about the margin than the top line front. So, earlier you also touch upon some of the service that you are offering to your international client that maybe it will brought back to the domestic customers. So what kind of outlook do you have to those services in domestic market?
- Srikar Reddy:** Sorry, what was the question?
- Chetan Wadia:** Yes. The kind of services that you are providing for the international clients right now, what kind of outlook do you have for those services in the domestic market?
- Srikar Reddy:** When we say the international services the services we provide now also are figuring there I mean we are not I mean the services we provide on top of the product which we sell is really our



domestic and other services is just services and then it therefore more or less the similar kind of margin so, it is a services business and whether you do it in India or globally that is part of our services international services business.

**Chetan Wadia:** Okay. And sir, the kind of client addition that you are doing for the last three quarters to four quarters what is the outlook for the number of clients that you may possibly going to add in the second-half?

**Srikar Reddy:** Because you say that but I think this same trend will continue. It is very difficult to predict exact timing of deals to close so that is where you can lumpiness suddenly it will be 2 and suddenly it will be 8 kind of stuff. So I think the trend of new deal closures will be, I would say in the same kind of a pattern.

**Chetan Wadia:** Okay. And sir I know you do not give revenue guidance but at this point in time what kind of target you are working on like to achieve sales in the let us say in the next 3 to 5 years' time kind of?

**Srikar Reddy:** We did say that, we want to double them about in three years and that is what we continue to stay with.

**Chetan Wadia:** Double the revenue every three years and...

**Srikar Reddy:** Not every three years, in this year I mean.

**Chetan Wadia:** Okay. In terms of margin sir?

**Srikar Reddy:** We did say I think we can sustain 22% to 24% not this 26%-27%. I mean, I am just assuming, I do not want to get into with or without FOREX kind of stuff, but absolute margin kind of stuff.

**Moderator:** Thank you. Next question is from the line of Madhu Babu from Centrum. Please go ahead.

**Madhu Babu:** Sir, CPG Retail kind of has been showing good traction. Could you talk about the digital kind of engagements currently which we are doing and what would be the synergies from this recent acquisition in Microsoft Dynamics AX Practice?

**Srikar Reddy:** Yes, good question, whatever we are doing is all part of our overall digital side so, while this is and Dynamics AX itself as a platform because it is a very modern platform with now on the Cloud and other thing it is increasingly becoming a core part of people itself. But having said that I think this company which we acquired has got very core IP for the B2B distribution space. So now for Travel today we now with Rezopia, we have a full story in terms of how do we take people digital because Cloud based Travel platform kind of stuff. On Retail we are working on something on our own and with this we believe we have an end-to-end distribution B2B for what

we call a modern distributor. So I think it will be a core to our strategies of helping let us say distribution companies who are digital.

**Madhu Babu:** Okay. And secondly, on the attrition side which has been increasing last two quarters and what would be the outlook at net headcount addition?

**Srikar Reddy:** Attrition, I think about 18%-19%, I think that is where we are.

**Madhu Babu:** Sir just outlook on that and headcount addition, so it has been increasing right attrition last two quarters?

**Srikar Reddy:** It is about 18%-19% maybe I am not too sure 20%.

**Prasanna Oke:** Let me take that. So Madhu this time we have shown 21%. There has been a little bit of uptick in this quarter. Having said with all the technologies etc, I mean we expect it to remain in that range of 18% to 20% at this point of time. I mean we are not seeing that this uptick would continue on the same linear rate.

**Moderator:** Thank you. Next question is from the line of Prakash Buva, Individual Investor. Please go ahead.

**Prakash Buva:** Sir, can I know how many headcounts we have got added because of these three acquisitions and what is the new talents acquisitions done? And how many trainees we are going to add-on that is one and could you say something about the quality of the clients that we are having? Just number of clients is one part of it but what is the strength of the client, could you say something on that? Thank you.

**Srikar Reddy:** I think Rezopia is now we had about the 50 to 60 people and Halosys we have about 15 people - 20 people.

**Prakash Buva:** And IBIS?

**Srikar Reddy:** IBIS will be about 50 people.

**Prakash Buva:** Okay. How many people will be adding at training level so that long-term manpower plans will be more balanced from the future growth point of view?

**Srikar Reddy:** I think we have added by about 100 now in the quarter, we are talking about Q3 and then we have a season in which we do that kind of stuff.

**Prakash Buva:** You see the fructification of our acquisition in the last quarter of the financial year 2016 or the start of the next year like first quarter? We will see the fructification of our acquisitions the results coming out of in terms of billing revenues and all that, in the last quarter or in the first quarter?

- Srikar Reddy:** Some of them are very strategic long-term platform base initiatives. We are not just acquiring companies to put it into our top-line kind of stuff. They are all very core IP base kind of stuff and that is whatever three years kind of stuff to actually do this hiring and buying company to...
- Prakash Buva:** Yes, what about the strength of the new clients that we have acquired, the eight clients and the trend may continue so we may add up another 8 clients to 10 clients and go to a total inventory of 90 clients at the end of the year. So how do you look at the quality and the billability of those clients because we have seen a lot of integration work now?
- Srikar Reddy:** And the quality is when we choose our clients is based on vertical that we are operating in and we are not sizing and you know opportunity to grow that kind of stuff so I think the key is that we entered there the step is how do we grow these clients?. So we have strategies in terms of growing these clients so of course all of them have potential but all of them are also competitive in their basic nature kind of stuff. Important thing to note is that there is larger client base for us to grow kind of stuff. We will grow I mean obviously north kind of stuff.
- Prakash Buva:** And the results will be seen by the last quarter mostly or more than that it will take?
- Srikar Reddy:** Beyond that we will take more time for them to structuring up. We talked about that we will grow other that now kind of stuff but these clients will take not all of them as I said have a potential to become million dollar clients kind of things.
- Prakash Buva:** Okay, they have a potential to become million dollar...
- Srikar Reddy:** Yes, you get in you need to do a pilot or you do a project and then obviously then the next step and these things can take three months to six months and then you can go after and do more things kind of stuff.
- Prakash Buva:** So, two three quarters more to see the result.
- Srikar Reddy:** Absolutely.
- Moderator:** Thank you. Next question is from the line of Nikunj Mehta from IIFL. Please go ahead.
- Nikunj Mehta:** Sir, could you just repeat the figure of IT refund we received during the quarter.
- Srikar Reddy:** I do not think we got any IT refund but I will ask Satya to answer that question.
- R. Sathyanarayana:** Yes, we have got about Rs.13 crores refund during the quarter, which includes interest of Rs.96 lakhs.
- Nikunj Mehta:** And how much of it still remains and how much of it still remains outstanding to be received?

- R. Sathyanarayana:** Overall both the companies to put together Rs.25 crores, which will be based on the individual assessment of respective years, when the assessment happens.
- Moderator:** Thank you. Next question is from the line of Nisarg Vakharia from Lucky Investments. Please go ahead.
- Nisarg Vakharia:** When you said that the constant currency revenue growth we should expect in the range of 3% to 4%, I am assuming this is organic growth ex-acquisition, correct?
- Srikar Reddy:** That is right.
- Nisarg Vakharia:** We have been investors in your company over the last two years now. Over the first few quarters we have been very-very confident on achieving 20% to 25% constant currency growth which seems to obviously have slowed down over the last two quarters. We are still not very confident on achieving that. FY17 onwards have we taken the necessary initiatives to get that sort of growth back?
- Srikar Reddy:** I think everybody has initiative, nobody is wanting de-growth I mean growth is a factor of strategy execution and then what happens in the market kind of stuff. Obviously the whole management team is totally committed to grow the company at much higher than the industry growth rate. We believe, we have great platform to grow kind of stuff. So, obviously I think there is a huge commitment to grow the company absolutely.
- Nisarg Vakharia:** Okay. And sir, secondly when we mentioned that we should look at the domestic business purely as a return on capital employed, cash flow business, if you top-line wants to...
- Srikar Reddy:** I said look at it as gross margin business.
- Nisarg Vakharia:** Gross margin business.
- Srikar Reddy:** Not as a percentage of revenue margin business.
- Nisarg Vakharia:** Sure. So even if your revenues were to show an uptick in the next quarter, should we assume these gross margin as steady state, what we achieve annually?
- Srikar Reddy:** That is what I am saying. So, I think the gross margin will show a growth of 10%-15% I think that is what we should focus upon not on the variation to the percentage margins.
- Moderator:** Thank you. Next question is from the line of Vipul Shah from Sumangal Investments. Please go ahead.
- Vipul Shah:** Yes, my question is regarding the revenue productivity per software engineer what is the number and where do you see it inching up in say two years to three years' time?

- Srikar Reddy:** I do not have the number with me straight off, I will ask Prasanna to go ahead...
- Prasanna Oke:** So, Vipul when you look at the revenue productivity again we are investing significantly into of the IT development, in R&D. Roughly for our billable employees on offshore basis we realize about \$25 and the on-site is roughly about \$65.
- Vipul Shah:** \$65, okay. And where do you see it going in three years sir?
- Srikar Reddy:** Vipul, very difficult to say where it will go in three years' time having said that as we have been taking about, we are differentiating ourselves and the value add that we are doing so at the very least I would expect this to be in the same range and again it will depend on what we can realize in the client. But we feel that there could be an increase by at this point of time would be conservative and say consuming at this level.
- Moderator:** Thank you. Next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.
- Mohit Jain:** Just a follow-up on the IBIS side. What are the historical revenue trend? what kind of growth rate this company is exhibiting?
- Srikar Reddy:** Historical revenue growth for IBIS, it has been in business for long time and it changes it business model. So the Dynamics AX business have been let us say about seven years to eight years for them. I think they have been having about in that business they have and now they are in the CRM business. The IP is brand new they have just invested in the IP and then gone to market about a year ago. So I would say each of them have definitely the core AX for distribution companies in the IP businesses has been growing at about 10% to 15%.
- Mohit Jain:** Okay. And secondly is there any liability also that is coming along with it or the company is absolutely debt-free?
- Srikar Reddy:** This is absolutely debt-free.
- Moderator:** Thank you. Next question is from the line of Ashish Chopra from Motilal Oswal. Please go ahead.
- Ashish Chopra:** Just one question from my end for better understanding. So, Sonata has had a fairly strong Microsoft Dynamics AX Practice in the past and now you have this acquisition if you could just help me understand, what it adds over and above what you already had in terms of whether it helps you increase your reach in terms of specific niche capabilities or verticals or any region broadly...
- Srikar Reddy:** Excellent question, sorry we did not address it. Absolutely, our dynamic capability was really based on delivering more of tactical services around the dynamics platform with a lot of offshore component kind of stuff. What IBIS brings in is a completely onsite team of consultant and

project managers and sales team and analyst and so on and so forth. So a very strong on side component. Second is it brings very strong IP. So, together I think we would become a very strong value proposition for Microsoft when they are now looking partners, when they go for larger deals. IBIS's problem was that they did not have a balance sheet to participate in large AX deal so with new balance sheet we believe we are very strong kind of value proposition apart from the size of the teams we have about 400 resources kind of stuff. So the overall plan as I said I think some of you were there actually we said consolidate in areas where we are specialized and growing and then become some kind of a leader so it is part of that strategy.

**Ashish Chopra:** Okay, that is helpful and then just to clarify. So when you say a greater amount of onsite presence to the resources, would you be referring to greater consulting and/or the domain capability?

**Srikar Reddy:** Yes with the consulting and domain capability.

**Moderator:** Thank you. Next question is from the line of Abhishek Gupta from Goldman Sachs. Please go ahead.

**Abhishek Gupta:** Sir, just to stress a little bit on this IBIS acquisition you mentioned that about 50 odd people is what you are acquiring with this acquisition?

**Srikar Reddy:** Yes.

**Abhishek Gupta:** So in that case you have earlier mentioned the revenue run rate is about \$12 million what should be your gross margin I am assuming then this business should come with a very high gross margin for you.

**Srikar Reddy:** Gross margin, you are saying gross percentage or...

**Abhishek Gupta:** Yes, either ways, given the fact there is just 50 odd employees? And for the \$12 million run rate then what should be your gross margin in this business?

**Srikar Reddy:** I think I am not sure, I can ask Prasanna to share, but I think gross margin is about 40%.

**Prasanna Oke:** Yes, just to answer Abhishek, yes it is in the range of about 40%. Overall obviously it is a mix of what we will get from services and what we will get from the software which is based on IP. But at this point of time it is in a range about 40%.

**Abhishek Gupta:** Okay. So then is this serious amount of investment which is going on because you alluded to the operating margin profile about 5% to 7% right?

**Srikar Reddy:** Yes.

**Abhishek Gupta:** Which means that there is huge investments which are going on probably S&M and G&A?

- Srikar Reddy:** Investment in IP, where we are capitalizing it.
- Abhishek Gupta:** Investment in IP. Okay. So where we are we in terms of ability to monetize product and what could be the incremental investment needed just trying to understand the roadmap which you are highlighting that the margins can be improved. Is it purely a lever from gross margin or you are going to take benefit from G&A and the other expenses?
- Srikar Reddy:** Yes I mean there is a cross selling opportunity from of other services like managed services and application maintenance services which they are not able to provide today on the platform which they are deploying and implementing and other Microsoft relate services around Azure or BI and so on and so forth so that is one this thing. There could be some lever in terms of moving some of the work which they are just doing on-site/offshore. So that's the low-hanging fruit kind of staff. We could take this platform to other global markets where we operate, where they do not operate so that is a trade-off kind benefit of stuff but, there will be investment. We need to make more investment in the IP to keep it current so that will continue.
- Abhishek Gupta:** Got it. So, this business right now only North America focus?
- Srikar Reddy:** Only.
- Abhishek Gupta:** Only North America.
- Srikar Reddy:** Yes.
- Abhishek Gupta:** Got it. I am sorry if I had missed what would be the price you would have paid have you disclosed the amount.
- Srikar Reddy:** We disclosed in stock market, we said it is about I think \$14 million, \$8.6 million upfront balance is earn out.
- Abhishek Gupta:** Okay. Balance is earn out. One more thing I have witnessed that last four quarter we had seen revenue shift towards onsite. Now Rezopia acquisition happen way back for us so that could not be a reason along with the prices that Halosys is also a reason acquisition so what could be the reason behind this onsite revenue shift?
- Srikar Reddy:** Some of the client we started. There is higher onsite component, as people are going onsite to learn transition and stuff like that. So there are two or three of them fairly significant onsite work. In one client almost, just for a quarter there a lot of people who went onsite kind of stuff. So it is been nature of the client work.
- Abhishek Gupta:** Do you see this trend continuing with this acquisition because again as you highlighted?
- Srikar Reddy:** Yes, that will definitely I mean when you consolidate you absolutely see it. So I think when we report it next time around we will have to segregate it and talk about.



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November 03, 2015*

**Abhishek Gupta:**

Okay. So than this trend continues for you on the onsite side. Just the last one from my side having understood that you are talking about the vertical strength which you are requiring now with IBIS on the distribution. We have seen recently a lots of activity around Microsoft Dynamics and of one of your competitor recently made an acquisition again North America focus. I understand earlier we were technical player and we get the upfront it capability but where do you rank in terms of your relationship with Microsoft Dynamics so does that bring you and makes you compete with the other players of similar footing or still you have to climb up and become the partner of preference for Microsoft Dynamics. So mean just trying to understand on the picking of the where do we stand now?

**Srikar Reddy:**

I mean I think with the merger we have seen lots of interest from Microsoft in the last one week and what this merger bring for them. Obviously it is long hill to climb. Separately we were at very different pecking orders, together I think we will move up to the pecking order and our aim is in next three years to become the top three players in this space.

**Moderator:**

Thank you. As we have no further questions from the participants, I would now like to handover the floor back to Mr. Srikar Reddy for closing comments. Over to you Mr. Reddy.

**Srikar Reddy:**

Alright. Thank you all very much, Pleasure talking to you and look forward to talking to you soon in the next call. Thank again for making the time to attend this and thanks for your support.

**Moderator:**

Thank you 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.