



**Sonata Software Limited
Conference Call
FY2012 (Q1)**

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CORPORATE PARTICIPANTS

B. Ramaswamy

Vice Chairman and Managing Director

P. Srikar Reddy

Chief Operating Officer

N. Venkatraman

Head of Strategic Finance and Risk Management

Sathyanarayana R.

Head - Finance and Accounts

Praveen Kumar D.

Company Secretary

Swati Sengupta

Head - Corporate Marketing and Communications

PRESENTATION

Preeti – Moderator

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

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

Thank you Preeti. This is Ramaswamy here. I have with me Srikar who is the Chief Operating Officer, Venkat who is the Head of Strategic Finance and Risk Management, Sathya who is the Head of Finance, Praveen who is the Company Secretary and Swati who is the Head of Corporate Marketing and Communications.

The purpose of this call is to announce the results and go over the analysis of some of the key highlights. The results have already been put on our website. For the quarter ending June 30th, the total consolidated turnover was Rs.334 crores which is about 4% growth sequentially and more or less flat 1% growth year on year. In terms of net profit at a consolidated level it was at Rs.8.84 crores as compared to Rs.23 crores. Now that is at the consolidated level and there are specific exceptional items which are contributing to this fall in

the profits which we will take you through as we deal with each one of the constituents. Let me just begin by talking about International Services and after that I will hand over the call to Srikar who will cover the domestic as well as TUI InfoTec and Venkat will take you through our financials in detail.

In terms of the performance in the International Services the turnover was Rs.73.75 crores, up by 7% year on year in terms of rupee revenue and 2% sequentially. In terms of constant currency the growth was 9% year on year and sequential growth of 4%. The EBITDA grew 7% year on year and it declined by 7% sequentially. The main reason being that there was an arrear in the tax that we had to pay in the state of Washington that was accounting for about Rs.1 crore and also the forex fluctuation was adverse during this quarter to the extent of about Rs.2.47 crores. So the net profit for the quarter was at Rs.13.34 crores. This is accounting for the increase in tax because now the STP scheme is no more there and only available incentive for us is the SEZ. So to that extent the tax impact has been hiked. Though the EBITDA has increased by almost about 7% year on year the PAT has decreased by - 6% for year on year in 26% sequentially. Now I will hand over to Srikar who will talk about domestic business as well as TUI InfoTec business.

Srikar Reddy – Chief Operating Officer - Sonata Software Limited

Thanks BR. Good morning everybody. I will cover the qualitative aspects of both the domestic (Sonata Information Technology Limited) and TUI InfoTec operations. As we had mentioned in the earlier calls, in the domestic business we are shifting from the low margin product distribution business to a more services oriented business. As we continue to do the shift and as we continue to further de-risk business we see continuing down trend in our product distribution business which has resulted in the negative result this quarter. On the services business, we see good growth. We are continuing to win good customers for all our services especially on ERP and development services.

On TUI InfoTec there are three parts to it: one is TUI Group's internal business, second is the business from the local German market, and third is what we jointly do to address the requirements of the Travel and Tourism businesses worldwide. As mentioned earlier there is a continuous pressure from the TUI customers on increasing better value and lower prices and that impact has shown this quarter basically because of the result of consolidation of two projects which is the communication project and the desktop services project. This is coming to effect starting now. We continue to see this trend going forward. With regards to customers in the German market we have had couple of good wins albeit not very large; one of them is with continental with a large timeframe for infrastructure service. Most of the success we see there is in the infrastructure services space. We continue to see good traction as we jointly work together in getting tourism



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customers in the global market and we will continue to see this trend going forward. For a more detailed quantitative analysis of the result, I will now hand over to Venkat.

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

Thank you Srikar. This is Venkat. Good Morning. Our results are available on our website since July 14th and the detailed presentation and analysis by segment is also available on our website. So I would request all of you to take a look at it if you have already not been able to view it. As it has been a practice I will take you through our consolidated financials very quickly and then analyze the results by three business segments. We need to do that because the rhythm of the three business segments is different to one another and they together form the consolidated financials. We need to understand how each of them move so that we can appreciate the numbers better.

The three segments that we talk about are: International IT Services which is essentially the software export business, the domestic products and services which is what Srikar talked about, that is done through our 100% subsidiary Sonata Information Technology Limited (SITL for short) and the third is the Joint Venture that we have with TUI InfoTec in Germany in which we hold 50.1% along with TUI AG. Now I will take you through the consolidated financials and I will try to analyse the changes. For the quarter we reported consolidated revenues of Rs.334 crores. This has actually shown a revenue growth of 1% year over year and 4% on a sequential basis. In constant currency we have shown a year over year growth of 3% and 6% growth on a sequential basis. So the revenue growth has been pretty good. Consolidated PAT for the quarter stood at Rs.8.8 crores and this is what has got maximum attention to the press because that is a de-growth or a drop of 51%. But like I said I will have to analyse it in the segments. But before I do that let me try and tell you on a consolidated basis how the movement happened. The reduction has been mainly on account of Rs.1 crore of tax that we paid in the State of Washington. That is a new tax which was levied. It was the tax which we were not aware of and it was a retrospective past period payment. So they actually asked us to settle so we settled for the past period by paying Rs.1 crore amount. There was Rs.3.5 crores one-time adjustment on account of impairment of deferred tax asset in TUI InfoTec. So TUI InfoTec was carrying a deferred tax asset on their books and every year or every quarter the auditors check for impairment and they checked for impairment and they said that this has to be restated and this has to be revised downwards by Rs.3.5 crores. Rs.3.5 crores is our share of the deferred tax impairment. The total effect is about Rs.7.3 crores. Then there is an increase in Income Tax provisional in our International IT Services. This is talked about, this is essentially because of sunset of the STPI scheme and this is an industry wide issue. We are

also getting out of most of our operations other than what we do through SEZ in Global Village, is coming out of the STPI scheme on which we are making a provision for Income Tax and that's about Rs.1.8 crores. And then finally on the forex restatement and loss in the domestic business, we have had to take Rs.1.3 crores adjustment because there are short term borrowings that we make in the domestic business. In SITL this time we borrowed in foreign currency at 2% interest rate but we had to adjust that for the exchange fluctuation which has caused this increase and that was Rs.1.3 crores. If I adjust all these numbers that I just talked about, our consolidated profit drop is really only 9%. It is a drop nevertheless but it is much more explainable as I can see it and this weakness is primarily on account of the domestic business which is what Srikar talked about. Now coming to the general issue of wage increase, because all over the place that has been talked about, we have also been hit hard and the impact is about Rs.3.5 crores but large part of this wage increase has been nullified to great extent by the revenue growth that we had shown. So essentially revenue has grown so has the wage grown so we have shown a nullifying effect and there has also been another income for us this quarter which has helped us.

We ended the quarter with cash and cash equivalence of about Rs.160 crores most of which Rs.115 crores was with the International Services, the domestic business had balance of about Rs.14 crores and Rs.31 crores with TUI InfoTec. Our short term borrowing with the domestic business is about Rs.55 crores. We ended the quarter with consolidated manpower of about 2887 people. Now what I will do is I will come to the International IT Services segment. For this quarter, this segment contributed to just 22% of the consolidated revenues where as it contributed to almost all or 100% of the profits because the other two segments had shown a loss because of one-time adjustments or other operating issues, so the entire profit that we are showing comes from the International IT Services business. In this business our revenues stood at Rs.74 crores and it showed a growth of 7% on a year over year basis and 2% on a sequential basis. In constant currency of USD it was a 9% year over year growth and 4% sequential. EBITDA was Rs.18.2 crores vs Rs.17.1 crores a year ago showing a growth of 7% on a year over year basis whereas on a sequential basis it was a drop of 7%. EBITDA obviously has the impact of the one-time other income that we have got, but nevertheless. Profit After Tax (PAT) for the quarter was Rs.13.3 crores which was 6% down on a year over year basis and this drop was primarily on account of the one-time tax that I mentioned in the State of Washington of Rs.1 crore and there was the adjustment for Provident Fund (PF) and statutory obligations, as you know the rate of interest on PF has been increased to 9.5% and companies which run their own trust have to provide for the increased interest burden and this is also been an industry wide issue or whichever company runs their own PF trust has to bear this loss. So that also contributed to about Rs.60 lakhs.

Increase in the Income Tax provision on account of the STPI scheme was Rs.1.8 Crores and again an industry



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wide issue. And as Mr. Ramaswamy mentioned we had lower than what we had as exchanged gain in the last quarter. So all put together that accounts for the swing on a sequential and an year over year basis. In this business we have added 6 customers in this quarter and as regards to our operating metrics, our utilization is 79% which is the same as the last quarter. DSO has been at 54 days compared to 56 in the previous quarter and we believe that this is quite good from a peer comparison standard. We had closing head count of about 2320 at the end of the quarter in the International IT Services business.

Now I will come to the domestic products and services business which is what we do through our 100% subsidiary SITL. For this quarter this business contributed to 38% of our consolidated revenues. Revenues were Rs.127 crores and have shown a drop of 6% on a year over year basis. Operating margins which is a key metric here, has dropped on a year over year basis by almost Rs.4.2 crores, whereas, it has improved on a sequential basis by about Rs.80 lakhs. So what I am trying to say is I am trying to refer to the trend here. So we had a drop year over year but on a sequential basis we have shown an improvement. Drop in sales volume due to the tighter controls on the business internally, because this business has got host of credit control issues, quality of receivables issues, tax and regulatory issues as we have discussed earlier. So we are trying to improve the quality of the revenues on this business. Complicated and business unfriendly tax policies both at the Central and the State Government which has been highlighted very effectively by NASSCOM in their report, has really led to a large part of the situation of the domestic business. So, domestic software hardware business has been really hit by the unfriendly tax policies that we see across the states. And a lot of this hopefully should go away once we have the new GST regime in place. We have been monitoring the business carefully such that the operating margins improve. The margins are very thin and we should essentially improve the operating margins which we have done on a sequential basis by really changing the product mix. So we essentially will be changing the product mix, cost reductions and also increasing the services element in our domestic business. So business strategy going forward is to turn the operating margins at SITL. On the highlights we have managed our DSO which is the very key element in the domestic business at about 61 days; this is compared to 69 days in the previous quarter. So anybody who has done business in India will tell you that this is really a good metric. ROC has been a focus and will always be a focus and we have to get that back on track and that is what we will be striving in the next 3-4 quarters. We ended the quarter with a head count of 139 people and most of them are sales people in this business.

On the Joint Venture (JV), this is TUI InfoTec which is the JV with the TUI AG and we hold a 50.1% share in that company. From a financial perspective we consolidate the total revenues and total cost into the consolidated financials which is a line by line consolidation. When we come to the PAT we only take

50% of the share. So that is something which needs to be borne in mind. On the financial results of the JV we also adjust for certain intercompany transfers between the International IT Services in India and TUI InfoTec and those adjustments have been done in the presentation that has been put up. On the financial results, TUI InfoTec's adjusted revenues for the quarter were Rs.134 crores. This has shown a 5% increase on a year over year basis and 4% on a sequential basis. Now the increase in the revenue is primarily on account of certain main frame usage and past pass through costs which is called pass through of purchased services, so we have passed them through to our end customer and that has led to the revenue increase. Operating costs have gone up by about Rs.10 crores which is about 1.574 million Euros. This is primarily on account of the increase in purchase services that I just talked about. But a large part of this operating cost is also on account of the transition costs that we had to bear. Because there are two large projects which are getting transitioned out, as has been explained earlier in our conference call, which is the desktop support project and the unified communication project. So both of these are getting transitioned out and we have to bear a certain element or portion of these transition costs. So that has impacted this time's operating margins. Interestingly another operating cost increase has been the staff cost increase that we have had of about Rs. 3.2 crores. This is primarily on account of the leave approval. In Germany, as per the German accounting standards when they do not take leave you have to keep on accruing leave and on an actuarial basis which is very similar to India but there it is done for your normal leave/annual leave as well and when the annual leave is taken this gets released back into the P&L, so that was about Rs.3.2 crores. So the above two increases of the transition support cost and the leave accruals in the staff cost has approximately accounted for Rs.8 crores of the operating costs in the JV. We believe that this should not recur in future going forward.

When we come to the PAT, in addition to this adjustment unfortunately during this quarter we had to also take this impairment of deferred tax asset, which is about Euro 1 Million and Rs. 6.4 crores. So, what happened is these two components put together has effectively accounted for the swing of about Rs.14 crores and led to an effective loss of Rs. 6.5 crores this quarter. When I say swing it is from the profit of the last quarter to the loss of this quarter. The swing is about Rs.14 crores and the loss of this quarter is Rs.6.5 crores. So, we have had the one-time adjustment of deferred tax, staff cost adjustment and also the transition cost, which we had to bear as per the agreements in place.

As part of the consolidation, we have taken Rs.3.25 crores of this drop in net profit, which has impacted the consolidated results. So, like I mentioned the consolidated result is the amalgam of the international IT services, which has done well. SITL (the domestic operations), which is having certain challenges, but which is being addressed, because whatever we have seen in the past quarters in the domestic business has



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primarily been on account of variable exchange gains and certain good other income, which has currently disappeared. And the third is the swing in the profits of TUI InfoTec on account of certain one-time adjustments like deferred tax and transition costs. So, all these put together really explain the drop in the consolidated profits. The JV ended the quarter with a head count of about 428 compared to 431 in the previous quarter. I know the explanations and the statements that are made are a little complicated. Please do feel free to call me if you want any further clarifications in detail and I can surely address them.

Thanks for hearing me out and we will now open up the call for questions.

Preeti – Moderator

Thank you very much Sir. We will now begin the question and answer interactive session for all the participants, who are connecting to audio conference service from Airtel. Participants who wish to ask questions may please press “*” and “1” on their touchtone enabled telephone keypad. On pressing “*” and “1” participants will get a chance to present their question, on a first-in-line basis. First question comes from Mr. Sandeep Hemrajn from Bangalore, TCS. Mr. Hemrajn you may ask your question.

Sandeep Hemraj – TCS – Bangalore

Good morning Sir. My question is that what is the current debt that you have on your books?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

We have only short-term borrowings of about Rs.55 crores, our International IT Services is debt free and TUI InfoTec also is virtually debt free. So this is the working capital arrangement of about Rs.55 crores.

Sandeep Hemraj – TCS – Bangalore

And you have cash approximately of about Rs.162 crores?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

Yes, we have cash of about Rs.162 crores and more importantly, we have also got an advanced tax refund due from the Government of about Rs.80 crores in SITL. In fact if you look at it the borrowing in the

domestic business has been mainly on account of the tax that is stuck with the Government.

Sandeep Hemraj – TCS – Bangalore

Okay and when is this excepted or likely to come?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

This is again an industry issue. There is a litigation, which has been going on. In our financial statements we have given great length disclosures on this and that was something which came up at the High Court of Karnataka last month. And hopefully we should see some kind of resolution to it and whenever that happens, which should be no sooner than let say another two months, we should hope to get a refund.

Sandeep Hemraj – TCS – Bangalore

Sir just doing a little bit of maths, I am unable to understand why is there an interest cost, because on one side you have decent amount of cash and debt is really not that large and that is working capital why is it there is an interest out go?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

The interest out go is on account of working capital borrowing at SITL. So at Sonata Information Technology the business is that we buy software and we sell the software and when we sell the software we charge let say Rs.100 for the software. The customer when he pays us, he pays us only Rs.90 because Rs.10 he pays to the government as tax deducted at source.

Sandeep Hemraj – TCS – Bangalore

Sir I will rephrase my question, what is the breakup of other income?

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

This quarter's other income is on account of certain provisions, which were no longer required. Those on account of a time barred, we had made a provision



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about 3.5 to 4 years back and that has become time barred and so it is no longer required and based on legal advice we have written a provision back.

Sandeep Hemraj – TCS – Bangalore

So it is basically reversal of the provision. So where are you accounting for your interest income?

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

Other income.

Sandeep Hemraj – TCS – Bangalore

So could you give me a further split of the Rs.74.62 lakhs of other income?

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

Where are you looking at this other income?

Sandeep Hemraj – TCS – Bangalore

Consolidated numbers of this quarter

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

Consolidated numbers. Okay we will give that to you.

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

We are seeing about Rs.477 lakhs of other operating income and other income of about Rs.74 lakhs, so where are you getting the Rs.7 crores?

Sandeep Hemraj – TCS – Bangalore

Yes, Rs.74 lakhs.

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

Okay, that is primarily coming in because there is an interest dividend income and in TUI InfoTec also we have these provisions, which are written back and we can give the details to you, if you send me an e-mail I will give your breakup.

Sandeep Hemraj – TCS – Bangalore

Sure my last question on your staff cost, have you considered the whole of leave expenses what you are telling in this quarter alone or would this continue for another quarter or so?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

In TUI InfoTec their provision for leave is based on a valuation that they run on an actuarial basis. So this quarter we have not seen this kind of a trend. It is based on leave not taken and typically in European countries people take their vacations very seriously, but in this quarter it has not happened and so the valuation got hit.

Sandeep Hemraj – TCS – Bangalore

So going forward what would be the guidance?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

We do not give guidance, but when the leave is taken this will get released back into the P&L.

Sandeep Hemraj – TCS – Bangalore

Fine. That's about it from my side.

Preeti – Moderator:

The next question comes from Mr. Chetan from Mumbai, JHP Securities. Mr. Chetan you may ask your question.



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Chetan Varaia – JHP Securities - Mumbai

My first question is, do you have any recruitment targets? The number of people you might add by the end?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

We do not give guidance Chetan, so, in fact giving numbers is actually a proxy to how our growth will be. So it is a board mandate not to give forward looking statements.

Chetan Varaia – JHP Securities - Mumbai

What is the actual drive Sonata in FY'12 in the next few quarters?

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

In the next three to four quarters it will be in terms of first the International Services business, where we are focusing on making sure that we are getting back to organic growth of the levels that were there two to three years ago and that is going to be primarily driven by let us say some of these large customer relationships that we have built over the years and that in our opinion is poised to grow. Also our focus is on new client additions by introducing some of the new services in the area of Mobility, Cloud and Analytics. That is what is going to drive the growth in the International Services segment. In the domestic as Srikar was saying the growth would be driven primarily in terms of margins by the services business.

Chetan Varaia – JHP Securities - Mumbai

Okay. This Rs.3.5 crores impairment that you have provided because of the auditors observation, is it kind of a one of or more to come in the come quarters?

N Venkatraman as Head of Strategic Finance and Risk Management – Sonata Software Limited

That was a whole of the provision for deferred tax that was there, so that is gone, so that is completely impaired.

Chetan Varaia – JHP Securities - Mumbai

So it has been completely provided, there is no more left in this. Sir, just one thing, in the last four quarters there has been a decline in growth in terms of number

of clients that you have added, so any change in approach?

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

See we have seen that in the last three to four quarters we wanted to make sure about the quality of customers, that is in terms of their ability to at least grow to one million in the eighteen months time frame is the criteria rather than accepting any customer who has a point project, which is sub \$500,000 kind of thing. So to that extent I think that has been one of the reasons why you see that we have focused on these large opportunities, which tend to take time in terms of closure. That is why you see that the numbers are somewhat declining over these last three quarters.

Chetan Varaia – JHP Securities - Mumbai

You are saying that you tend to focus on the quality as well as the client?

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

Because, we have a long tail, if you ask me, in terms of our own existing client relationships. Yes we do not want to get out of this just abruptly, but the point is that we do not want to add it to the whole thing.

Chetan Varaia – JHP Securities - Mumbai

On the domestic front, in the earlier initial remarks what statement was made that, in domestic you are moving from low margin business to, if I have heard it correctly whole sale product business, transition from low margin to?

P. Srikar Reddy - Chief Operating Officer - Sonata Software Limited

We are moving to a services business, I think Venkat mentioned that we are trying to change our product mix to de-risk the business. We are trying to shift to more services oriented business in the domestic business not wholesale business.

Chetan Varaia – JHP Securities - Mumbai

So, what is likely to be your approach in that segment, so when do we see it contributing significantly?

P. Srikar Reddy - Chief Operating Officer - Sonata Software Limited



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We are seeing a continuous gradual shift, whatever strategies we are employing are showing results for the total strategy to make its impact would be sometime in the financial year, next year.

Chetan Varaia - JHP Securities - Mumbai

Fine I will take that. Last two questions from my side, what is figured almost 100% jump in the taxation provision from Rs.5 crores to Rs.10 crores?

Sathyanarayana R. - Head - Finance and Accounts- Sonata Software Limited

That is because of the current year the STPI scheme is out, basically 100% is taxable current year, except for the SEZ, which is not taxable so because of that the tax provision for all software companies will go up.

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

As we go forward, this should improve because we have Global Village facility, which is an SEZ which has got seating capacity of about 938, so all future growth will be in the Global Village facility. So the tax break will be available on that and on the existing facilities we will be paying tax. So the mix should change, but that will come as we go forward.

Chetan Varaia - JHP Securities - Mumbai

You had some other operating expenses, it is turned for Rs.76 crores to Rs.86 crores, so what are the key components that are showing some variation in this quarter?

Sathyanarayana R. - Head - Finance and Accounts- Sonata Software Limited

You are referring to the consolidated results or the stand alone?

Chetan Varaia - JHP Securities - Mumbai

Yes, consolidated numbers, other operating expenses, of which Rs.76.95 crores, it has gone up to Rs.86.91 crores?

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

Are you referring to the consolidated numbers?

Chetan Varaia - JHP Securities - Mumbai

Yes. There is a one-page table that you have I am referring to that?

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

Other operating expenses, it includes everything, it includes all other costs other than staff cost. The exchange rate of Rs.2.4 crores and we have purchase services, which I mentioned in TUI InfoTec, which has gone up by Rs.10 Crores. We had purchase services, which we bill out to our customers, that has gone up by about 2 million Euros. If you were to ask me one big line item this would be the biggest line item which would take care of that increase.

Chetan Varaia - JHP Securities - Mumbai

I will take that. That is it from my side.

Preeti – Moderator

The next question comes from Mr. Alok Kumar from Mumbai, Way2Wealth. Mr. Kumar you may ask your question.

Alok – Way2Wealth - Mumbai

Hi, this is Alok from Way2Wealth. I would just like you to throw more light on domestic business, basically what is our strategy and what kind of Capex we are going to do on the change of the strategy and when can we start this turnaround?

P. Srikar Reddy - Chief Operating Officer - Sonata Software Limited

I think I have already answered the question saying that that we are already seeing the results of the strategy and the complete results will be seen next year. We do not see any significant Capex in the turnaround strategy. The strategy I have explained is that we are changing the product mix and we are moving towards more services oriented business.

Alok – Way2Wealth - Mumbai

Are we looking forward to adding some more clients in the domestic market and are we looking forward to like winding up this hardware like this product selling business?

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited



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Alok this is BR. We are not wanting to wind down the product business. Product business has low margins we know that, but it has got some synergies, which we want to leverage. The way we want to operate the product business is that in spite of these low margins we should ensure that it is risk free, that means free of all the kind of liabilities that we have had in the past, whether it is a VAT, or service tax or customs duty or TDS and so on and so forth. Now that is one dictum, that we do not want to add to any of these so called risks that we already seen in the past.

Number 2, we need to focus and ensure that we get a return on capital employed of 30%. Now the problem there is that about Rs. 55 Crores is borrowing and Rs. 80 Crores is stuck with customs, I mean advance tax. If you get that refund that business is operating with negative working capital.

Second is as Srikar said there is no Capex there in the product business, so that is how it will be operated by let us say 100 - 120 people, but emphasis and growth area in terms of margins at least will be in the services business and we are seeing growth already and we are investing in sales and pre-sales, which is very, very different for the product business and that is why the results will take three to four quarters in terms of actual profit & loss turnaround. That is what Srikar is saying, but we need to gain momentum, we should get \$15 - \$20 million kind of volumes in the next two to three years.

Alok – Way2Wealth - Mumbai

Thank you.

Preeti – Moderator

Participants who wish to ask questions may please press "*" "1" now. The next question comes from Mr. Chetan Varaia from Mumbai, JHP Securities. Mr. Chetan you may ask your question.

Chetan Varaia - JHP Securities - Mumbai

My question is on the combining all the three divisions that you are reporting that the International Services, domestic, and TUI. Right now what is driving the net profit is the International Services business and for domestic it seems there is a change of strategy that you have adopted, where the growth will be reflected on the next financial year. The International Services contributes to almost 75% of the profit. Going ahead the percentage might just go up to 80% almost?

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

Mr. Chetan, there is just a small errata on that slide that you referred to. In fact if you look at it, TUI and SITL are

at loss, so as I said 100% of this times profit has come from the International Services business and going forward that will be a significant part of the growth strategy and profit growth strategy because we are very focused on the bottom line and as you rightfully saw on the consolidated side, the more you focus on the higher leverage business of International Services it should really propel your PAT growth.

Chetan Varaia - JHP Securities - Mumbai

On the TUI front, in the earlier remark you said that you continue to work with them to add more clients and to offer more Travel solutions, so where do you see the profitability of these divisions in the coming quarter?

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

You are talking about the TUI JV segment right?

Chetan Varaia - JHP Securities - Mumbai

Yes.

Srikar Reddy – Chief Operating Officer - Sonata Software Limited

The result of the business we are doing together as Sonata and InfoTec, part of that will start reflecting in the books of Sonata, most of the revenues would not flow through TUI InfoTec. As we see the share of the German business from third party customers is growing, that will start showing an impact on the better bottom line of TUI InfoTec. As I have said the margins from the TUI Group are decreasing.

Chetan Varaia - JHP Securities - Mumbai

What is your approach?

Srikar Reddy – Chief Operating Officer - Sonata Software Limited

The approach is to get more customers from the German market and leverage the IP and Travel expertise, which is there in TUI InfoTec for the global markets.

Chetan Varaia - JHP Securities - Mumbai

Thanks sir. That is it from my side.



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Preeti - Moderator

The next question comes from Mr. Arpit Rakka from Gurgaon, Tavctica Capital Management. Mr. Arpit you may ask your question now.

Arpit Rakka - Tavctica Capital Management - Gurgaon

Good morning Sir. If you look at TUI's consolidated FY'11 numbers, the EBITDA was Rs.64 crores, which is translated in to a PAT of about Rs.11 crores that is a pretty wide disparity if you consider. What explains this? Will you just throw some light on this if possible?

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

Rs.64 crores of EBITDA

Arpit Rakka - Tavctica Capital Management - Gurgaon

Translated into a PAT of Rs.11 crores?

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

First I will take you through TUI InfoTec financials, so EBITDA of TUI InfoTec is about Rs.64 crores, you are right. So that comes directly to my EBITDA. Then there is a depreciation charge of about Rs.30 crores. Because in TUI InfoTec, 80% of the business comes from IT operations, which includes mainframe, desktop services, you have lot of pass through revenues. We buy the asset and give the service to the other customer companies. So, when I buy, I have to take the depreciation cost. So that is the model. So Rs.64 crores, you come down, it comes to Rs.30 crores of depreciation, it comes to Profit Before Tax of about Rs.30 crores. Then I get 50% of that after tax. Tax is also high in Germany. So, that is about Rs.9 crores, what we are left with is Rs.22 crores and 50% of that is about Rs.11 crores for myself.

Arpit Rakka - Tavctica Capital Management - Gurgaon

So basically it is a very capital-intensive business and so could you just tell us what is the capital employed in the whole business of TUI segment?

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

We will tell that to you, but if I remember right it is about Rs.350 crores.

Arpit Rakka - Tavctica Capital Management - Gurgaon

Okay then this typically shows that in our domestic and International Services business is very good in terms of ROCE but both our product and domestic products and services and TUI are not, we probably have to optimize this loss before we can sort of improve that. So do you have any plans or do you see any room for improvement and returns over there or do you think it is very competitive space and it is difficult to do that?

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

You are right, the International Services ROCE is very good and competitive. On the domestic space, it has been good ROCE. It has actually deteriorated over the last one, four or five quarters because of the tax issues that we talked about, due to change in tax rules. As Srikar had mentioned the change in strategies that we are adopting there is essentially change in product mix because in the product business we deal with about 16 principles mainly and each of them have a different profit margin and incentive system. So we have to change the product mix to ensure that what gives you more margin is what gets pushed into the market and also we have to increase the service revenues. So when we go to a customer and sell a product, let us say Share Point Portal or SAP license we have to then back it up with services as well, which is what we are really seeing the increase traction in India. So that is how the changeover has to happen and that is the effort that is being done.

Arpit Rakka - Tavctica Capital Management - Gurgaon

Are there plans to infuse more capital into the TUI InfoTec or do you think we have already gone through the investment cycle and we will not need significant investments over the next few years where do we stand it terms of investment cycle?

Srikar Reddy - Chief Operating Officer - Sonata Software Limited

The investments are directly based upon the contracts we get from the customers. If we get a contract we will invest, so if we invest it will later show increase in revenues then an increase in margins. We do not just make investments without contract from customers. They are all back to back



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Arpit Rakka - Tavctica Capital Management - Gurgaon

Just to understand your mindset here capital is a constraint always and if we have growth opportunities in domestic division and also say in the TUI InfoTec and we do realize that TUI is more capital intensive, so it is fair to assume that you have more focus on domestic or just throw some light on how you position yourself for growth in terms of these divisions going ahead? Would that be possible?

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

Just to answer the first part of your question you talked about allocation of capital. Allocation of capital, you are absolutely right, International Services is where we will do the maximum because the return on the bank for the buck is the most there. So that is where our investments will be. Mr. Ramaswamy mentioned that we are trying to build Mobility solutions, we are also getting into analytics, we are analyzing the other focused areas in ERP where we will be making inroads into and also the acquisition plans that we are making are all targeted at the International Services business. So absolutely, capital that is going to be rationed will go maximum to International Services. In fact in TUI InfoTec like Mr. Srikar referred to, it is more of a back-to-back kind of an arrangement. If there is a customer requirement to give them increased mainframe whatever mainframe lease lines, desktop support those kinds of things and they come to us for a full solution we will do the heavy lifting of getting those assets on our books and offering that as a solution to our customers. In domestic service again Mr. Ramaswamy referred to we are actually if you adjust for this Rs.80 crores that is stuck with the government, which is likely to comeback we are a negative working capital business. So we really do not need money to be pumped in there, if you really look at money that needs to go and that is to increase our services business. So the service delivery that we are talking about to the domestic business again will ride on what you are building for the international services business. So if build an SAP expertise in my International Services business I will use that to deliver services in the domestic area as well. So again capital is going into the International IT services.

Arpit Rakka - Tavctica Capital Management - Gurgaon

Okay thanks for that and just a final comment. Can you throw some light on the dividend policy of the company? Do you have something or depending on opportunities do we look at it and give dividend?

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

No, over many years the policy that the board has adopted is that we will pay dividend of up to 40% of net profits and in practice I think it is offering around 30% to 32% in actual distribution terms.

Arpit Rakka - Tavctica Capital Management - Gurgaon

The board is very clear on that. That is great. Thanks a lot Sir.

Preeti - Moderator

The next question comes from Mr. Subhash Oswal from Ludhiana, Master Trust. Mr. Oswal you may ask your question now.

Subhash Oswal - Master Trust - Ludhiana

Good afternoon Sir. My question is what are the main challenges that the IT sector in general and Sonata Software in particular will be facing in the near terms?

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

From the point of view of the demand side European issues might create bumps, if they get worse. US, we still do not know what will be the effect of so-called stopping of quantitative QE3 as we call it, and how the economy will react and how the IT budgets are going to be sort of viewed. So these are some imponderables that will affect from the demand side. From the cost side definitely the employee costs are raising. Attrition levels are very high and also the demand from the customers, now to say that look not to pay for just effort but more to pay for outcome and output, so there is demand on margins from that point of view. So these are some of issues that the industry will have to grapple with and on the regulatory issues I think there are concerns on the domestic front, which was highlighted by Venkat in terms of NASSCOM having taken up these issues of taxes, lack of clarity whether VAT is applicable or service tax is applicable or both are applicable and which one comes after which so there are very, very sort of tricky issues on the domestic front too. So this is affecting the industry in the domestic market. Hopefully these issues should get resolved. The issue of VISA misuse it is going to take the whole industry in a very bad light if it is not resolved quickly and amicably.

Subhash Oswal - Master Trust - Ludhiana

Thank you Sir.



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Preeti - Moderator

I request participants who wish to ask questions please press "*" and "1" now. At this moment there are no further questions from participants. I would now hand over the call to Mr. B Ramaswamy for the final remarks.

B. Ramaswamy - Vice Chairman and Managing Director - Sonata Software Limited

Thank you Preeti. Thank you for participating in the analyst call. Like Venkat said if you have any more questions please mail it to him. We will be able to address any other questions or issues that we have not had chance to address here and thanks once again, have a good day.

Preeti - Moderator

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