



Q1 FY 12

Earnings Conference Call

July 25, 2011

Members of Nucleus Management

- Mr. Vishnu R Dusad
- Mr. Pramod K Sanghi
- Ms. Viveka Ragukumar

Managing Director & CEO
President Finance & CFO
Executive VP, Global Delivery



Meenakshi:

A warm welcome to all of you who have joined us for this Nucleus Software Investor Conference Call for the quarter ended June 30th 2011. We have with us today Mr. Vishnu R. Dusad, our CEO and Managing Director; Mr. Pramod K Sanghi, President and CFO and Ms. Viveka Ragukumar who has joined us as Executive VP, Global Delivery.

As you are aware, we do not provide specific revenue and earnings guidance. Anything said during this call which reflects our outlook for the future,, or which can be construed as a forward-looking statement must be reviewed in conjunction with the risks that the Company faces. We will now begin with the opening comments on the performance of the Company straight from the CEO, and post that we will open for the Q&A session. With this I would like to pass it on to Vishnu.

Vishnu:

Thank you Meenakshi and good afternoon ladies and gentlemen. I am pleased to announce the results for First Quarter Ended June 30, 2011.

Before I take you through the numbers, I would like to share some of the accolades that we have won during the quarter.

- **Forrester** recognized Nucleus as a **“Global Pursuer”** and stated it **“regained traction in 2010”**. Based on the number of deals and regions covered, Nucleus was ranked among top Banking Platform providers. Source: Global Banking Platform Deals 2010, Forrester Research, Inc., 31 March 2011
- Forrester accredited Nucleus Software with the highest number of lending deals in 2010.

We also announced a strategic partnership with **Wipro** Technologies, the global Information Technology, Consulting and Outsourcing business of Wipro Limited, to jointly provide product led customized solutions to banking clients. Nucleus's strong lending and cash management product portfolio in conjunction with Wipro's mature system integration, program management and peripheral service offerings will result in a robust proposition to the end customer.

Now I will take you through the numbers, first the quarterly figures.

- **Our Consolidated revenue** is at Rs.64.27 crore against Rs. 66.14 crore in the corresponding quarter previous year.



- **Revenue from product business** for the quarter is at Rs. 47.08 crore, 73% of the total revenue against Rs. 42.95 crore, 65% of the total revenue in the corresponding quarter previous year.
 - **Product revenue from own business**, for the quarter is at Rs. 44.61 crore, 69% of the total revenue against Rs. 39.52 crore , 60% of total revenue in the corresponding quarter previous year.
 - **Projects and services business revenue** for the quarter is at Rs. 17.19 crore, 27% of total revenue against Rs. 23.19 crore, 35% of total revenue in the corresponding quarter previous year. This line of business has declined by 26% on a YoY basis.
- **EBITDA** for the quarter is Rs. 5.48 crore, 9% of total revenue against Rs. 4.71 crore, 7% of total revenue in the corresponding quarter previous year.
- Taxes are Rs.1.75 crore 2.7 % of revenue against Rs. 0.64 crore, 1 % of revenue in the corresponding qtr last year.
- **Net profit** for the quarter is Rs.5.03 crore, 8% of total revenue, against Rs. 5.29 crore 8 % of total revenue in the corresponding quarter previous year.
- **EPS** for the quarter is at Rs.1.55 against Rs. 1.63 in the corresponding quarter previous year.
- **Our total Current investments and bank position** is at Rs. 190.36 crore as on Jun 30, 2011 against Rs. 186.98 crore as on March 31, 2011
- In terms of **manpower**, we are at 1638 as on June 30, 2011 against 1720 as on March 31, 2011.

Now an update on Sales and Markets

We have been continuously investing in sales and marketing in existing and new markets. We have bagged some valuable projects this quarter based on our strength and ability to innovate and customize products. This quarter, we have closed 6 new product orders for 11 modules. We added 2 new customers. During the quarter, we gave more than 49 demonstrations of our products in different markets and total number of RFPs that we received and submitted to the customers is 39. We are glad to



have received acknowledgements for our contributions and value additions from the IT analyst community in this quarter.

An update on our Jaipur centre. The construction work for the Jaipur SEZ unit is complete and the development centre with a seating capacity of 250 people is ready for operations.

The future growth of your Company will lie on how well the Company addresses the challenges such as attracting skilled manpower, controlling high attrition and managing technology. With growth strategies led by innovation and intellectual property becoming more mainstream, we believe that the Company is well placed for growth. Greater focus in the coming years will be on processes to improve productivity.

Before we close, I would like to introduce Viveka Ragukumar. She has joined us in the quarter as Executive Vice President - Global Delivery and will be spearheading the Delivery Operations across the organization. Viveka is a seasoned delivery professional with over 26 years of enriched delivery experience in heading the Software Engineering Business Units for emerging as well as leading IT giants. With her strong leadership skills, international working experience and technical expertise, we are confident that she will ensure quality deliverables and increase customer satisfaction.

Over to you, Pramod.

Pramod:

Good afternoon, everyone.

- **On a sequential basis, revenue** for the quarter at Rs. 64.27 crore slightly lower by 1.94% against Rs. 65.54 crore previous quarter.
- **Product revenue for the quarter** at Rs. 47.08 crore, 73% of revenue is lower by 3.8% against Rs. 48.93 crore, 75% of revenue, previous quarter.
 - **Revenue from own Products for the quarter** is Rs. 44.61 crore, slightly higher than against Rs. 44.20 crore previous quarter.
 - **Traded revenue from products** included in this product revenue is Rs. 2.47 crore for the quarter, against Rs. 4.73 crore, previous quarter.



- **Revenue from projects and services for the quarter** is Rs. 17.19 crore, 26.75% of revenue, against Rs. 16.62 crore, 25.36% of revenue, previous quarter.
- **Cost of delivery** including development cost is 69.41 % of revenue, largely flat, with 69.94 % of revenue in the previous quarter. In absolute terms this is Rs. 44.6 crore against Rs. 45.8 crore previous quarter.
- **Marketing expenses** are at 12.74% of revenue this quarter, against 11.96 % of revenue previous quarter. In absolute terms, this is Rs. 8.19 crore against Rs. 7.84 crore previous quarter.
- **G&A expenses** are at 9.33% of revenue this quarter, against 12.07% of revenue previous quarter. In absolute terms, this is Rs. 6.00 crore against Rs. 7.91 crore previous quarter. Last qtr had significant provisioning.
- **Total expenses** for the quarter are Rs. 58.79 crore, against Rs. 61.59 crore previous quarters.
- **EBITDA** is Rs. 5.48 crore, 8.53 % of revenue this quarter as compared to Rs. 3.95 crore, 6.03 % of revenue in the previous quarter. Though revenue is lower, EBITDA has improved, but continues to be in single digit.
- **Other income from investments** is at Rs2.91 crore against Rs. 2.96 crore previous quarter. **Total other Income** is 3.28 crore against Rs. 3.08 crore last qtr.
- **There is a small foreign exchange gain** of Rs. 4 lakhs against a Rs. 54 lakhs loss previous quarter. This excludes hedging gains. Dollar closed end of June 2011 at 44.74, while it was at 44.68 end of March 2011 and significantly higher 46.70 end of June 10.
- **Total taxes at Rs. 1.75 crore**, 25.81 % of PBT against Rs. (14.43) lakhs (3.37%) of PBT previous quarter. With STPI sunset clause for taxes setting in, we are liable for full tax in India. The Jaipur centre in the SEZ is commencing operation in July 2011
- **Depreciation is at Rs. 2.01 crore** against Rs. 2.20 crore previous quarter.
- **PAT** is Rs. 5.03 crore for the quarter, 7.83 % of revenue against Rs. 4.44 crore, and 6.77 % of revenue previous quarter.



- In terms of foreign currency hedges, we had on Jun 30, USD 12.75 million dollars of forward contracts at an average rate of 46.74 which are designated as highly probable forecast transactions. There is a mark-to-market gain of Rs. 1.44 crore which is taken to hedging reserve in the balance sheet. We do not have any option outstanding as on Jun 30, 2011.
 - Mar 2011 we had a total hedge of USD 13.75 million.
 - Current hedge position is US \$ 13.50 million at an average rate of 46.69
- With regard to **receivables**, we are at Rs. 30.66 crore against Rs. 32.35 crore previous quarter and the **DSR** as on 30th June is at 43 days against 44 days as on March 31st, 2011.
- **Top 5 clients** at 50% against 53% last quarter.
- **The order book position** is Rs. 265.55 crore including Rs. 146.49 crore of products business and Rs. 119.06 crore of projects and services business, against Rs. 275.27 crore last quarter with Rs. 157.86 crore of products and Rs. 117.40 crore of services. In June 10, order book was for Rs. 190.12 crore including Rs. 156.82 crore of products business and Rs. 33.31 crore of projects and services business.
- **Total Cash and cash equivalents** is Rs. 190.36 crore. The breakup of cash and cash equivalents is as follows :
 - a. Cash in current accounts of Rs. 13.26 crore
 - b. Liquid fund schemes of mutual funds is Rs. 63.39 crore
 - c. Fixed maturity plans of mutual funds is Rs. 84.23 crore
 - d. Fixed deposits with banks is Rs. 29.48 crore

I will now hand over to Viveka for her comments.

Viveka:

Thank you, Pramod. I am new to Nucleus Family, joined only couple of months ago. Prior to joining Nucleus I have held various leadership positions in different Companies, some of them being leading IT giants HCL & TCS to name a few, in multiple roles; managing distributed deliveries across locations, converting captives into a service organization and prior to joining Nucleus I was instrumental in launching Innovation initiatives across the organisations.



Since I joined, I have been looking at the structure, people, product, process, culture and Operations at Nucleus, that are a part of Global Delivery. The banking industry that we serve is highly organized and structured. My primary focus is to look at the Industry structure and map Nucleus Structure with the industry expectations and deliver value to customer. The existing global delivery structure is good for the existing customer base, which has really gone beyond 150+, my primary focus will be to modify it to become more robust, self sufficient and scalable.

On the people side, the focus is on to have the right mix of skills – functional, technical, techno-functional, etc. On the functional side, we have great skills, we have industry experts who have worked in the BFSI sector for many years, have great domain knowledge. On the technology side, that is where there is a little gap; we do have technology experts. Focus will be on hiring senior architects who have been in building products for multiple years, similar to the functional experts on the technology side. This combination would form the right blend to offer the best solutions to our customers.

On the process side we are very, very strong. It is more or less similar to ISO 9001, but the challenge is a lot more, because the focus is going to be on trimming down those unwanted processes, make it more lean which adds value to the solution that we offer. With respect to this, the focus is going to be on adopting agile or strong methodology, to turn around things much faster, to do what is really necessary to really add value to customer.

The overall focus this quarter is going to be on performance, creating a performance-oriented culture; adding more goals to the performance-related parameters and making the process more and more lean. With that, I would like to pass this on to Mita Brahma who heads our HR Department.

Mita:

Thank you Viveka, Good evening ladies and gentlemen. HR focus for the quarter remained on enhancing domain and management competencies in the organization. Functional and Product Trainings were held in the area of Cash and Liquidity Management, and FinnOne collections. Project Management and Business Analysis Trainings (BABOK workshops) were the other major focus domain training areas.

In the Talent Acquisition area, focus has been on expat hiring in locations outside India, a special hiring drive for our Jaipur campus, strengthening the Sales force and on hiring for critical leadership positions like Head of Delivery Excellence, and Product Development. Manpower numbers have decreased from 1720 to 1638 quarter on



quarter. For the future, the hiring of 50 freshers from reputed colleges is in progress; another 25 freshers from Tier-I engineering colleges would be hired in Q2. The process has been started to hire MBA freshers from reputed management institutes.

Assessment parameters and processes have also been strengthened for better and more standardized hiring. The annual Appraisal process closure was done across all onsite locations and for the senior management team.

Nucleus celebrated its 25th anniversary on 9th July, 2011. A month long series of events and engagements were organized for the employees to mark the occasion. Some innovative ideas were having an NGO exhibition, and mass participation activities like quiz contests, treasure hunt and talent contests. The Annual award distribution ceremony and a Grand Finale on the evening of 9th July were other highlights. The celebrations received overwhelming and enthusiastic participation from all employees.

Going ahead, focus for the year will be on retention, enhancement of sales competency, and improvement of internal policies and processes. For awareness of policies, and better implementation, initiatives have been started by the Business-HR representatives. A Business-unit dashboard has been created for tracking the same.

Thank you.

Meenakshi:

Thank you, Mita and with this, we are open for the Q&A session now.

Mr. H. Sangameswar Iyer from Alf Accurate Advisors Pvt. Ltd.

Sangam:

Sir, could you just give us some more clarity on the kind of growth power that we are looking at going forward? Also on the margin profile, with 73% of our business in the product segment, could you give me a breakup of the margin profile of products and services and how do we see that going forward as well?

Pramod:

If you look at EBITDA margins, they have been falling for sometime and they were lower last year than the previous year and this quarter also it has been a single digit number. This is largely because the top line has not grown and we are well aware that we need to grow the top line and average our infrastructure cost as well as manpower cost.



There is a fairly large product development expenditure that we incur on an ongoing basis and when the turnover is low, it can affect the EBITDA margin, play negatively at the margin actually. Given the large product development expenditure at this point of time, the services margin would be higher than the product margin while normally for a product company, the product margins should be much higher.

Sangam:

Typically, would it be fair to assume that if we reach a ballpark figure of say, Rs. 75 crore to Rs. 80 crore, which we were may be five to six quarters earlier, that is the kind of run rate the company achieves. That is when we would see the true margin profile of the company in terms of the product businesses, etc. after factoring the development cost.

Pramod:

Yes, If you look at even Rs. 70 crore to Rs. 75 crore run rate, Rs. 75 crore run rate would translate to Rs. 300 crore and we did Rs. 320 crore and Rs. 290 crore earlier and if we go up to Rs. 75 crore run rate, the margin profile definitely will improve substantially and the product margin will definitely grow.

Sangam:

Do we see those kind of run rates coming in, in the coming quarters with the kind of the deals or contracts that we are getting or do we think that there is still some time before things revive and hence the pain still persists for us for some time?

Vishnu:

Currently we have a good number of implementations in a number of countries like U.K., France, Brazil, Belgium, Netherland, Luxemburg and Italy and soon three more European countries. Now, the way we are working at this point of time essentially, almost only one implementation per country and obviously all these countries have need for replacement systems. We are working aggressively, as you have seen our partnership announcement; we are working along with our partners to reach out to the customer who are looking for replacing their systems. The initial discussions have started and they look very encouraging. However, timeline we would not be able to share but then we would be able to lead back to Rs. 75 crore –Rs. 80 crore kind of quarter. But we are really very confident that we will be back there soon.



Sangam:

In terms of the product development expenditure per quarter, could you give me a ballpark idea of how much would that be?

Pramod:

It can be between Rs. 6 crore to Rs. 8 crore per quarter.

Sangam:

Among the 1,638 employees that you have currently, can you give me a break up between the products and services?

Pramod:

In Projects and services we have 277 personnel and for Product we have 958 personnel and for sales marketing, quality, finance, HR and Infrastructure etc. we have about 400 plus people.

Sangam:

Have you witnessed challenge in retaining employees, considering that all your bigger peers in the sector are also facing that kind of a challenge with regards to holding on to their employee base. Are we also seeing that kind of a challenge and going forward do we see supply being an issue for us when things are turning positively?

Pramod:

Yes, attrition we do face and have been facing for some time, in excess of 20%. We are not very different from other companies and this has been growing in the last one year since the market opened up.

Vishnu:

First of all, I have to admit that we face the retention challenge as much as our industry colleagues much bigger, much larger, face. And having said that, the work profile that we are able to offer is of course distinctly different, with just couple of products we have now implementations in 50 odd countries. So our colleagues get opportunity to travel to all these countries. They get opportunities to work on latest technologies, to



architect, design solutions, which is not something that happens very routinely in the Indian software industry. So, with these attractions, we are able to do a slightly better job of retaining, especially those colleagues who love to create value over the long term.

Sangam:

Your targets for hiring for this year would be?

Vishnu:

As far as that is concerned, we will by and large maintain this number. We would essentially be hiring people to take care of the attrition.

Sangam:

Once the Jaipur SEZ gets operational, what would be the kind of effective tax rate that we would be looking at for this financial year?

Pramod:

It is a small center, with only 250 seats, and initially we will probably start with about 20-50 people, and so the tax rate will not come down very substantially.

Sangam:

Finally, if you could just hint on a quantitative front, what is the kind of growth that we are looking at internally and also on the margin front?

Pramod:

No, we don't share any growth numbers either on revenue, internal or external is the same thing.

Sangam:

Just to get a sense.

Pramod:

In all fairness, first we have to come back to where we started and achieve what credit we have at all and then only we should be talking further than that.



Sangam:

This quarter would have already had the impact of salary hikes?

Pramod:

Yes, salary hikes effective 1st April.

Mr. Sunil Jain from Nirmal Bang Securities

Sunil:

In terms of the order book which we have right now?

Pramod:

Rs. 265 crore end of June 30, 2011, of which Rs. 146 crore is product and Rs. 119 crore is products and services.

Sunil:

And what was that in the previous quarter?

Pramod:

It was Rs. 275 crore, Rs. 158 crore of products and Rs. 117 crore of products and services.

Sunil:

This is executable over a period of about? Any timeline you can give?

Pramod:

If you look at the services order book, it did contain a large order which is a 10-year order as we mentioned in the last two calls, that it is an order which is to be executed over 10 years. So the services business has an element of 6 months plus the 10 year order and the product business, excluding about Rs. 20 crore would normally be executable within a year.



Sunil:

Can you throw some more light on the alliance with Wipro and how will it benefit the Company?

Vishnu:

Wipro has had selling record in terms of their services offerings to clients all over the world including U.S. and Europe and they have a large number of clients in the BFSI segment as well. Now, these clients essentially address for the time as services clients, but they also need good products to replace their mainstream base systems and that is where our products come handy for Wipro's customers and collectively we are able to take these to them. The other part is, there are situations where we do not have a reach for a large RFP, where they are looking at both product as well as systems integration offering. So that is where using their reach and systems integration experience, we collectively would be able to bid for such projects and that's what the partnership is all about.

Mr. H. Sangameswar Iyer from Alf Accurate Advisors Pvt. Ltd.

Sangam:

Just a clarification, you said excluding Rs. 20 crore, the remaining would be executable within a year or those Rs. 20 crore executable within a year?

Pramod:

Of the products part, excluding Rs. 20 crore will be normally executable within a year.

Meenakshi:

Thank you, Vikas and I would like to thank everybody for joining us in this call, with this I pass it on to Vishnu for his closing comments.

Vishnu:

I would like to take this opportunity to thank you all very much for joining us for this important call and we reiterate our commitment to continue to deliver value to our customers and in turn to our shareholders. Thank you very much.