"Subex Limited FY12 Q1 Results Call"

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SPEAKERS: **Subash Menon, Founder, Chairman, MD and CEO**
Sudeesh Yezhuvath COO and Wholetime Director
Ramanathan J, Vice President, Finance and Company Secretary Finance

Operator: Thank you for standing by and welcome to the Subex Analyst Result Conference Call presented by Subash Menon, Founder Chairman, MD and CEO, Subex; Sudeesh Yezhuvath, COO and Wholetime Director, Subex; and Ramanathan J., Vice President, Finance and Company Secretary, Subex. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session. Please be advised this conference is being recorded today. I would like to hand over the conference call to Mr. Subash. Over to you, sir. Thank you.

Subash Menon: Hi, good evening everybody, this is Subash here. We have got a power point presentation with a few slides, about 8 to 10 slides. Sudeesh will initially handle a couple of slides, Ramanathan will handle a few more slides and I will chip in when it's time for the summary, and after that we'll have the questions. So, I'll let Sudeesh start off.

Sudeesh Yezhuvath: Good afternoon everyone. This is Sudeesh. After going through this slide 2, I'll start with slide 3 which talks about the qualitative point for the quarter 1. The first one is that we have been talking about managed services as an important business area for Subex moving forward; and we are now starting to receive traction with customers with whom we are providing managed services and then willing to extend managed services to more and more areas. So, this European Telco that we speak about here is already a customer for managed service in a particular area. Now they have expanded the scope of the managed services to cover another area as well. It fundamentally means that we are growing deeper into the accounts and becoming more and more important to them. This is qualitatively an important point.

The next one is about ROC. ROC is also an area which we think very important strategically for Subex and we have signed the deal with Telco in Middle East who wants to try ROC – which consists of many different applications. They want to try one particular application and so they start with one particular application and they've split the order for that. And from that application with the results that they'll see, we hope that it'll just be a foot in the door kind of scenario and it'll open up many, many more opportunities

within that Telco. So, this is quite important as well. And we are seeing overall that ROC and managed services are gaining traction worldwide with decent kind of customers, given the current telecom scenario. Everyone is looking to reduce risk, to reduce cost, to see how to improve their margins and that is where these products come in. And I'm also happy to inform you that we won an award for innovation - Global Innovation Award - from Global Telecoms Business for 2011 a month back and this was win is in partnership with our customer, Swisscom.

Moving on to slide 4 about order intake, quarter 1 has been a very good for us for an order intake perspective. The core business has grown by 63% in order intake going from 14.1 million to 23 million. The overall business has improved, with the order intake improving by around 50%. The important point here is again that the core business is growing well and doing very well. That's what I'd like to point here from this slide. From here, I would like to hand it over to Ramanathan to take you through the financial slides.

Ramanathan J.: Good evening everyone. I'm in slide 6 now talking about the FY12 Q1 financials. As you can see, product revenue is flat as compared to the Q1 of FY11. However, costs have increased by about 6% in the quarter. This is mainly due to our annual salary increment which happens in Q1 of every year. When I look at the product EBITDA, it is at 27% as compared to 31% of the corresponding quarter of last year and the company EBITDA is standing at about 23% as compared to again 27% of the first quarter in the last year. When I look at the operational path, which is path excluding exceptional items, that stands at Rs. 141 million for FY12 Q1 which is comparable at Rs. 171 million for Q1 of FY11. As you can see, the profitability has been impacted due to poor performance of our FAS business. Our traditional business is still holding out our margins and EBITDA at about 40% whereas our FAS business is having a significant flat. In this quarter the cost has been more than the revenue which has overall impacted our product business EBITDA and consequently the company EBITDA as well.

If you move on to the next slide, it is on our product revenue by stream. We see increased traction in managed services and support. It's at 40% of our revenue; license is at about 55% of our revenue which is in line with our previous quarter. Customization is at about 6% and that also in line with our regular trending quarter-on-quarter. We are not seeing any major shift in that particular segmentation of revenue.

Moving on to Slide No. 7, by geography EMEA continues to be our significant geography in terms of revenue contributions. They have been about 52% this quarter compared to other regions and we expect for full year the revenue split between the geography will remain as it is in the previous financial years.

Moving on to slide 8 on pipelines, we have a very strong qualified pipeline at $426 million; we see that growing. And if you look at the share of our product business revenue, it has moved up 90% from 87% in whole of last financial year. Which means our product business is only contributing 10% and our core focus becomes our product business.

Moving on to next slide on the product business EBITDA, as you can see, EBITDA has grown over the last two to three years and this first quarter is now down 25% as compared to last year's 33% - significantly because of the FAS business not contributing to the EBITDA level at all.

The last slide which I'm moving on to Subhash to take over. Subhash, over to you.

Subash Menon: Thanks. So, when we look at the qualitative aspects of the business, we have to focus on two elements which are really supporting the business - the growth in order intake and things like that. We saw that order intake for the entire product business has actually grown about 52% and for that of the core of the business which is RMS, Revenue Maximization Solutions, that has grown 63%. This compares with mid 40s kind of growth last year for the order intake. So, clearly order intake is moving in a direction that is most desirable. We are seeing significant pickup owing to the growth in orders from managed

services as well as from ROC. We have also heard earlier from Sudeesh that a customer who went in for ROC for a particular area has now expanded to another area in a managed services format. So, this kind of things essentially means that customers are finding significant value when they come with us for ROC and for managed services and that is exactly the direction in which we want to take this forward.

If you look at competition out there, of course, we have competition, but most of the competitors, what we are seeing is that, are unable to deliver anything like a ROC. We have been thinking about this for the past several years, we have started acting on it a few years ago and we delivered on this about one and half to three years ago. So, that sort of proactive action, that sort of foresight has not been demonstrated by any of our competitors until now. And they may, of course, try for a catch-up gain going forward but by then we have established significant position in the market where we are, not just head and shoulders but more than that, above the rest of the competition. Coming to managed services, that calls for extremely deep domain expertise - this is something that we have been building all these years. Plus it also calls for a structure which is very cost competitive. Now, given the fact that we are based in India and that we have managed to transition over the several years or managed to build a lot of expertise in this space locally here in Bangalore and domestically here and have been able to set up a model wherein we use these resources to deliver those capabilities around the world, given that we think we are in the best position to take advantage of a market which is clamoring for managed services.

So, let's move a little bit towards the macroeconomic environment. It is definitely a subdued environment today. Everybody is worried. But so are the Telcos and they are facing a lot of competitive pressures as well. In most markets the EBITDA and margins are coming down. So, what does this mean? Telcos have two pressures. One is they have to control cost and ensure that they sweat their assets to the most. The second thing is that they have to focus extensively on their core competence, which means they just don't have time for other things which would

distract them more than anything else and get them to de-focus on their core business. So, given these two aspects, Telcos around the world are looking for companies, let's call them partners, who will support them both qualitatively as well as operationally. So, that means someone who has deep domain expertise, who can bring a lot of knowledge to the system, which they even may not have - and also operationally this means they do not have to have that sort of people and they will be able to rely on this company and ensure that skill upgradation, knowledge upgradation and stuff like that need not happen in their organisation, that they did not have to focus on that and spend time on that. In turn, they can actually spend time on their core activities like marketing and serving a customer and things like that or rolling out new products and all that. So, we are definitely proving to be a great partner to the Telcos and that's exactly what is driving the managed services business forward. We ourselves from an organisation have put in a lot of effort into it, a lot of focus into it, people who are dedicated for that business and are really gunning for that business.

So, what you are seeing today we believe is just the beginning of a great opportunity which we will convert into a lot of orders and lot of revenues and cash naturally going forward. So, over the next few years, we hit a bottom sometime ago. We hit a very bad patch. But we used that time. We did not just sit idle and twiddle our thumbs and worry about the future. Instead we worked on these solutions, we realised how the world would change over the next few years and we started preparing for that. Today we are prepared for that; and that is what you are seeing there. So, in the order intake which then is proof for that in the strong traction in the business, the kind of order intake that you are seeing and the revenue growth that we are talking about which is going to be 20% annually starting with this year.

On the EBITDA front as well, when you look at the full year, we will have a very, very strong EBITDA. We have been talking about 35% plus. And all of these would translate into cash as we move forward. Our FCF, which was quite poor in the past couple of years, has started improving; and if you look at the next three to four years

we expect to have significant cash generation from the business which we will have for whatever purpose we may have at that point in time. So, in short, we are quite upbeat about what is happening. We are quite thrilled about the order and take and the way things have been generally moving in our business. Notwithstanding the macro-economic climate which is not supportive but rather the macro-economic climate we believe is supporting our business at this point in time. With that, I would like to throw the floor open for questions. Thank you very much.

Operator: Participants, at this time if you wish to ask a question please dial "0" "1" on your telephone keypad and wait for your name to be announced. If you wish to cancel your request, please dial "0" "2". I repeat, if you wish to ask a question please dial "0" "1" on your telephone keypad and wait for your name to be announced. Thank you. Our first question is from Mr. Manish Gupta. Manish, your line is unmated. You can go ahead and ask your question.

Manish Gupta: Yes, thanks. Ram, how much was your free cash flow generation in this quarter?

Ramanathan J.: $2.2 million.

Manish Gupta: Free cash flow?

Ramanathan J.: Yes, it is about 9.3 or 9.4 crores in number, yes.

Manish Gupta: Okay and there was no CAPEX; so, essentially the operating cash flow and the free cash flow is the same?

Ramanathan J.: Yes.

Manish Gupta: Now, you know, Ram, when you were reading out Slide No. 9, I missed some of the numbers, when you were reading out the EBITDA slide and I think you were giving some explanation of FY11 EBITDA over Q1 FY12. Could I request you to repeat what you said, please?

Ramanathan J.: FY11 Q1 EBITDA 33%.

Manish Gupta: Right.

Ramanathan J.: FY12 Q1 EBITDA was 27%.

Mr. Manish Gupta: Right.

Ramanathan J.: The drop in those EBITDA is simply mainly because of the FAS business. The drop is normally because of the FAS business being impacted.

Mr. Manish Gupta: Right, could you talk a little bit about that?

Ramanathan J.: Okay, in this particular slide, we had our cost significantly more than the revenue for that particular business. We had our negative EBITDA of about 2.5 million dollars in that particular business.

Manish Gupta: Okay. In this quarter?

Ramanathan J.: That's what I am saying, I am talking about this quarter only.

Manish Gupta: Okay. Just one second. Negative 2.5 million, you said. There seems to be a very bad line?

Ramanathan J.: That is right, that is right. Yes.

Manish Gupta: Okay. Minus 2.5 million. And Subash, you have said 20% revenue growth, 35% EBITDA, do you have some kind of indicative number of free cash flow for the year?

Subash Menon: Yes, if you look at the FCF, free cash flow, after paying bonus and stuff like that and CAPEX, but before paying down the bank, we are potentially looking at about $11 million roughly.

Manish Gupta: So, $11 million free cash flow without any… it includes interest payments?

Subash Menon: Of course, it's after interest.

Manish Gupta: After interest payments?

Subash Menon: After CAPEX, after interest, after all that. We would not pay it back otherwise.

Manish Gupta: Okay. And this $11 million would include any previous year items also or is it just for the current year?

Subash Menon: It is only for the year.

Manish Gupta: Okay. For the year. On this qualified pipeline of 426, how much of this is the core business?

Subash Menon: A significant portion; we could be talking about upwards of about 80%.

Manish Gupta: Okay. That's it from me.

Operator: Thank you, Manish. The next question is from Mr. Jehan Bhadha from Darashaw & Company. Mr. Bhadha, your line is unmuted, you can go ahead and ask your question.

Jehan Bhadha: Sure. Hi, Good evening. My question is on the order intake. I am a bit confused as to what is the order intake in Q1 FY12. That is the current quarter that just ended?

Sudeesh Yezhuvath: Sudeesh here. The order intake in Q1 was $23 million. In Slide No. 4, it is $23 million for RMS and $3 million for FAS.

Jehan Bhadha: And for FAS, what did you say?

Sudeesh Yezhuvath: $3 million.

Jehan Bhadha: $3 million, okay. And my second question is on the FCCB conversion front, what is our outlook? Stock price doesn't stabilize above Rs. 80. Will the FCCB conversion date be revised as you had mentioned later than that is a possibility?

Subash Menon: Subash here. The plan is still the same.

Jehan Bhadha: Okay, fine. That's all, thanks.

Operator: Thank you, Mr. Bhadha. Participants, once again if you wish to ask a question please dial "0" "1"on your telephone keypad and wait for your name to be announced. Thank

you. Once again the next question is from Mr. Manish Gupta. Mr. Gupta, your line is unmated, you can go ahead and ask your question.

Manish Gupta: Thanks. Ram, one more clarification, in the investor release, this talked about the product revenue as about 106 odd crores. In the consolidated result which is the published one, PDF, the product revenue is given as 98.8 crores. So, what explains the difference?

Ramanathan J.: There is also other operating income of about 6 crores in the quarter. And that is essentially all products.

Manish Gupta: Got it. Thanks.

Operator: Thank you, Mr. Gupta. The next question is from Mr. Hero Choudhary from J. Goldman. Mr. Choudhary, your line is unmated, you can go ahead and ask your question.

Hero Choudhary: Thanks. On slide 7, you have broken down the things by regions. If you can give some colour on why America looks soft compared to the other regions and if there is something related to demand or company-specific or anything that will be helpful, thanks.

Subash Menon: Okay. This is Subash here. No, it is not quite that, this is really a relational thing comparatively. Middle East Africa did extremely well for us and moved up. We cannot say America is particularly low. So, quarter-on-quarter or in a year, you compare different years, because it is not relative, there could be variations, but in absolute terms I cannot say it went down too much.

Hero Choudhary: Okay. And then specifically related to demand commentary, I mean what is happening in Europe and specially economical data was also weak in last three or four months, so have you observed any softness in client behavior or anything that gives an indication about demand environment going forward?

Sudeesh Yezhuvath: Sudeesh here. Mr. Hero, in the telecom space in Europe, we have not really seen much softness, so to speak. Obviously, everyone is low on registration and taking quite deeply, but the teleecom companies over there seem to be reasonably

fine. Of course, you have one company letting people go, another company hiring. Those things are specific. But overall as a trend, macroeconomic issues that are there seem not to be significantly impacting the telecom players in this business.

Hero Choudhary: Okay. Thanks.

Operator: Thank you, Mr. Choudhary. Participants, I repeat if you wish to ask a question please dial "0" "1" on your telephone keypad and wait for your name to be announced. Thank you. Our next question is from Mr. Rudain Chadda from Value Quest Research, Mumbai. Mr. Chadda, your line is unmuted; you can go ahead and ask your question.

Rudain Chadda: Hello.

Male Speaker: Hi.

Rudain Chadda: Hi sir, I joined the call little late. Top line has – they grew by 5% this quarter year-on-year. Could you throw some light on it? Hello.

Ramanathan J.: Hi, this is Ramanathan here. The top line has been flat compared to the first quarter of last year. If you look at, it's probably caused due to the significant drop in Service business. If you look at the FAS business including other income is almost… it's the same number; it's kind of flat. Service business is one that really has dragged us down.

Rudain Chadda: How do you see the service business going forward or would it remain flat or we are expecting some growth in services business?

Ramanathan J.: Services business annualized, we are looking at about $10 million to $11 million revenue.

Rudain Chadda: Roughly 45 crores or 50 crores.

Ramanathan J.: 50 crores, yes, for the whole year.

Rudain Chadda: Okay, that will show – there will be a dip of roughly 20% in services. So you're expecting around 30% growth in products business, 25% growth?

Ramanathan J.: Sorry?

Rudain Chadda: You've said, full year, you were expecting $10 million revenues from services business, right?

Ramanathan J.: $10 million will be a revenue on the services business, correct.

Rudain Chadda: Last year, revenue from services was Rs. 65 crores?

Ramanathan J.: Right.

Rudain Chadda: So, this year it'll be roughly around 45-50 crores. A 20% dip in services.

Ramanathan J.: Right.

Rudain Chadda: And over all we are expecting 20% upline growth?

Ramanathan J.: It's only in the product business. Only the product business we expect a 20% growth.

Rudain Chadda: Okay, only the product business. And what was the reason for flat growth in this quarter in product business?

Subash Menon: Okay, this is Subash here. As we had explained earlier, there was some dip in the performance of our FAS business unit.

Rudain Chadda: Okay.

Subash Menon: And that is why.

Rudain Chadda: Okay, this is one quarter, not any …

Subash Menon: No, this is just a one quarter issue.

Rudain Chadda: Sir, the tax rate in this quarter was only 60 lakhs on a PBT of 14 crores, what would be the tax rate for this whole year?

Ramanathan J.: Ramanathan here. I had told this in the past, we operate in a tax free zone as India is concerned and that is where all the significant profits reside. And we do not have tax rate concept. We only look at absolute tax number for the whole year. We expect that to be in the region of $2.5 to $3 million in the whole year.

Rudain Chadda: So, we do not have to pay MAT 18% or like that?

Ramanathan J.: Yes, that has also been factored into this number.

Rudain Chadda: Okay $2.5 to $3 million. And what is the outstanding debt on books?

Ramanathan J.: Okay, the outstanding debt at this point of time - on the balance front we have about 32 crores, on the FCCB, it is about 419 crores. And on the secured loan portion, we have another 85 crores.

Rudain Chadda: 85 crores. And what is the cost of debt - excluding FCCB - cost of debt on 100 crores?

Ramanathan J.: It is about 13%.

Rudain Chadda: 13%. So, their operating income is roughly 6.7 crores, 3% is because of the settlement of claim, and what's the other 3 crores?

Ramanathan J.: See, that's on account of FOREX gains which we have on account of realization from a customer because of hedging.

Rudain Chadda: Okay, it's because of hedging. What is the outstanding hedge position?

Ramanathan J.: We normally have covered for about two quarters of billing and collection, so our outstanding or hedging position is currently close to about $27 million to $28 million.

Rudain Chadda: And it would be at what rate?

Ramanathan J.: Average strike rate to be in the region of about 46.8 to 47.2, it could be hovering within these two rates.

Rudain Chadda: Okay, we have said in the presentation, cost has increased by 6% mainly due to annual salary increment, but when I see the result, the personnel cost has come down from Rs 68 crores last year in first quarter to Rs 66 crores. So, it has actually come down by 2 crores.

Ramanathan J.: Right. See, the service business has seen a significant drop in the revenue; that's a linear business, so cost also comes down significantly along with the revenue.

Rudain Chadda: Okay.

Ramanathan J.: See, the product business cost has essentially increased. If you look at the segment results for services, EBITDA has a loss of 1 crore. So, the cost is more than 12 crores.

Rudain Chadda: Right. Okay, sir. Thanks a lot.

Operator: Thank you, Mr. Chadda. Participants, once again if you wish to ask a question, please dial "0" "1" on your telephone keypad and wait for your name to be announced. Thank you. Our next question is from Mr Siddharth Deshmukh from Networth, Mumbai. Mr. Deshmukh, your line is unmuted, you can go ahead and ask your question.

Siddharth Deshmukh: Hi, good evening, sir I want to ask, do we expect the order intake will be in line with the present scenario ad?

Ramanathan J.: What do you mean by in line with the present scenario?

Siddharth Deshmukh: Sir, I mean to say, for the FAS and your RMS business, like in previous quarter, it was also around 23.6 and this time is in 23 for RMS, so would it be the same line in the future?

Ramanathan J.: The question is whether it's going to be running.

Siddharth Deshmukh: Pardon?

Ramanathan J.: If the question is whether it's going to steadily run at $23 million, no, that's not it. Because from the quarter 1 onwards, you will see growth moving up and each quarter has it's own growth. Overall for the year, we definitely do expect to get to around $110 million in order intake.

Siddharth Deshmukh: Okay. And, sir, one more thing, Mr. Ramanathan, as you told about the total debt, can you please give me the breakup for FCCBs?

Ramanathan J.: FCCB as of June is about 419 crores.

Siddharth Deshmukh: Okay and regarding this FCCB 1 and FCCB 2 part?

Ramanathan J.: FCCB 1 remains at $13 million and FCCB 2 is at $54.8 million.

Siddharth Deshmukh: Okay sir. Thank you, sir.

Operator: Thank you, Mr. Deshmukh. Participants, to ask a question please dial "0" "1" on your telephone keypad. And after you are announced, please ask your question. Thank you. At this time, there are no further questions from participants. I would like to hand over the floor back to Mr. Subash Menon. Thank you.

Subash Menon: Good evening once again. As I stated earlier while handling the summary slide, for us it's been a very good quarter with excellent order intake and we expect this momentum to continue versus because of ROC doing very well and the traction that we are experiencing in managed services. So, on the whole we believe that the business is doing very well with the kind of order intake that we are experiencing and what we expect to have going forward. With regard to EBITDA, when we look at the full year… I mean we would have quarterly variation as this is the products business, but when we look at full year, we expect that to be a very strong EBITDA better than what we had last year in the products business. With that, I would like to close the call. Thank you very much. Have a wonderful evening.

Ramanathan J.: Thank you.

Operator: With this we conclude our conference call for today. Thank you for your participation and have a pleasant evening.