



“SQS India BFSI Limited Q1 FY16 Earnings
Conference Call”

July 24, 2015



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MODERATOR: **MR. DIWAKAR PINGLE – CHRISTENSEN**



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Moderator

Ladies and Gentlemen, Good day and welcome to SQS India BFSI Limited Q1 FY16 Earnings Conference Call. As a reminder, all participant lines are in listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference call over to Mr. Diwakar Pingle from Christensen. Thank you and over to you sir.

Diwakar Pingle:

Thank you Inba. Welcome everyone and thank you for joining us on the Q1 FY16 earnings call for SQS India BFSI. Please note that the results and the presentations have been mailed to you can also view this on our website at www.sqs.bfsi.com.

To take us through the results and to answer your questions we have with us today Dr. Martin Müller - Managing Director and CEO, SQS India BFSI; Mr. René Gawron - Director of SQS India BFSI and CFO of SQS and Mr. N. Vaidyanathan - CFO, SQS India BFSI.

We will be starting the call with a brief presentation, providing an overview of the company's performance given by Mr. Müller which will then be followed by a brief overview of the overall business by Mr. René and will be then followed by Q&A session.

I would like to remind you that everything said on this call that reflects any outlook for the future or which can be construed as forward-looking statement must be viewed in conjunction with uncertainty from the risks we face. These uncertainties and risks are included but not limited to what we have mentioned in our prospects filed with SEBI and subsequent Annual Report which you can find on our website.

With that said, I would now turn the call over to Dr. Martin Müller - Managing Director and CEO, SQS India BFSI. Over to you, Martin.

Dr. Martin Müller:

Many thanks Diwakar. Thank you for the introduction and good afternoon to all listeners. As already stated by Diwakar, I would like to highlight five topics and we will comment on that later. These five topics are, I want to first give you an overall picture of the results and the situation of last quarter and then step a little bit deeper into some result numbers, give you geographical segmentation and our opinion on that, give you information and comment on the onsite-/offshore split we reached for the last quarter and also give some comments on the debtor days resulted in the last quarter.

Coming now to the first point of the overall picture. During this quarter the company's revenues increased by 11%, the growth of the revenue has come mostly from Cards practice and also from



Europe region which performed very well. This growth is on a quarter-on-quarter comparison and if we look at the year-on-year comparison, we can see that the company's revenue grew by 14%. During this quarter we also have the profitability in terms of EBIDTA grow by 12%, what were the reasons behind it? The first reason was due to revenue increase as I already have mentioned and we also did an optimization of the overheads in this quarter which contributed to the profitability. Looking a little bit in to the future, we are gearing up for some new engagements starting in the next months and so efforts are on to do our homework and also be prepared to deliver those new project engagements.

Coming now to some numbers, I do not want to repeat all the numbers that might already in the circulated documents, but nevertheless I would like to state that revenue grew 11% sequentially and year-on-year growth was 14%. This shows that we are continuing step-by-step on a growth path.

Second point would be the EBITDA. We reached a figure of 10 crores for the last quarter, compared to the previous quarter it is more or less the same, but nevertheless we were able to keep that number at that level due to the increase in our income and we were also able to increase the PBT from around 9.4 crores to 13 crores. This is also quite encouraging and we will deal with more questions later on some detailed numbers when we come to that point.

Third point I wanted to highlight was the geographical segmentation. If we summarize our business into three regions we see that Europe is going to be the strongest and is now covering around 48% of overall revenue. Unfortunately we have seen sharp drop in the US by 4% which was made up by the uptick in business from Asia and Middle East region. But nevertheless US continues to be our main focus and we believe we have the structure and systems in place for a brighter future. I also stated in the last call and I think over the last two calls that we restructured our sales team there, we have added new logos, we are making good progress, however the same is not visible in the numbers so far. What is behind my level of confidence that we will be doing good progress in US. For instance just as an example, the SQS Group acquired Trissential in the US last month. Trissential is a leading IT project program and portfolio management consultancy firm which is focused on the mid-west region in US. This company is not primarily doing testing work but importantly Trissential brings with it established and valuable relationship with a wide range of customers and we would utilize this base for India BFSI to develop further business for it's testing activity including of offshore capability. This is also a further argument that we are well prepared in US and we will definitely see some results coming from our efforts in the US.

The fourth point I mentioned is the on-/offshore split. We have seen that we have reached in the last quarter an onsite presence regarding revenue of 62% and following that 38% for offshore business in our test centers. While offshore business gets better margins, the way our projects work is that we are predominantly onshore centric in the initial phase of the assignment and then based on the comfort of the customer, the same potentially transferable to offshore.



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The fifth point I would like to highlight is on debtor days. We improved it significantly in the last quarter but it has gone up again this quarter to about 108 days. This was primarily due to one large client and we have solved the problem in the last two weeks. If we had to exclude this one client, the same DSO would be down to 86 days which is definitely an improvement over the previous quarter number of 97 days.

This was my comment on that. Now I would like to hand over to René, he already is in Germany therefore René, please give additional comments from your side.

René Gawron:

Yes, thank you Martin. Yes, the only few additional things I would like to say is we are very happy with the performance of SQS India BFSI and as Martin already alluded to, we have a very strong focus on further growth of the business with regional focus as a whole company on the US market. We already spoke about the acquisition we have made in the US which is further increasing our market footprint there. As of now if I take the current run rate we are between \$55 million to \$60 million annualized with this acquisition as our revenue in the United States which is a much bigger regional presence than the previous \$20 million run rate we have had. And I also would like to reiterate we are looking to do at least one further acquisition in the US because our aim is to bring the US operation to the size of close to 100 million by a further acquisition and further organic growth. And why is this important for SQS India BFSI, these acquisitions help us to have a more substantial market presence, to have existing master service agreements and to what we already do start further cross selling of the testing business into those clients from the acquisitions and some of that will also increase the business SQS India BFSI will have, that is the key reason. So US is a strong focus also for the group not only for the BFSI business.

Dr. Martin Müller:

Thank you very much René for your additional comments and as suggested by Diwakar I would like to hand over to him again.

Diwakar Pingle:

Yes. Inba, if you could open it up to Q&A please right now.

Moderator:

Thank you very much sir. Ladies and Gentlemen, we will now begin with the question-and-answer session. Our first question is from the line of Abhitesh Agarwal of India Nivesh. Please go ahead.

Abhitesh Agarwal:

My question is, I would like to know like a lot of bigger companies they are going digital and moving towards cloud technologies, technologies like pay per use and there is a fundamental shift happening, so do we have the operational model which is prepared for this fundamental shift or what is the strategy we look if it is not ahead?

Dr. Martin Müller:

Okay. I will take that question. I think cloud computing or cloud technology is just an example, I think there are several more developments in technology also specially in the mobile area which we can see as a progress in technology. We are not developing IT or developing software but we



are quite close to that because this is the technology of the future and we have to be prepared to understand technologies like cloud.

René Gawron:

Maybe I can add to this, I think your question was more do we have the right pricing models, so this is a clear yes, SQS as a group is doing almost 50% of it's revenue and that includes of course SQS India BFSI with what we call managed services where we typically have a service level based pricing model which may either be pay per use, pay per fulfillment of service level or risk and reward systems which is moving away where we are not doing time and material any more. So this is about half of all the business now as a group and I think this will probably in one or two years more to be 60% of the business. So yes, we have the right pricing model for this, for things like cloud or pay per use and those kind of models, yes.

Abhitesh Agarwal:

Okay, thank you. And another thing I would like to ask, what is the delay expected from the Growth-curve strategy that we had planned earlier for entering the US market, like the plan was to ramp up the US business, so what is the delay expected in that as there is a sales decline also and other things.

René Gawron:

Martin do you want to take that, I think this is related to SQS India BFSI.

Dr. Martin Müller:

I think it takes time in any market to set up shop, restructure the business so that the sales and execution team work in unison and other integration related efforts. As I mentioned earlier, a lot of spade work has been done in the US market, we have acquired a few clients, signed the MSA agreements and also working on a POCs. This means that we are getting a bigger foot print in the US market. Currently we are only in the POC stage, hence there will be not much impact on the revenue. We are confident that these efforts will ensure that we start the billing process in US soon enough.

Moderator:

Thank you. Our next question is from the line of Ishan Agarwal of Irevna Capital. Please go ahead.

Ishan Agarwal:

So my first question relates to Europe, if we see revenue from Europe has grown 16.8% quarter-on-quarter so just wanted to know whether this is due to new deal wins or is this due to the offshoring of the parent's business to India, what momentum can we expect from Europe going ahead?

Dr. Martin Müller:

Yes, it is due to both the effects i.e. effect of increasing revenue of existing customers and also we added some new logos there, so it is effect of both you see there.

Ishan Agarwal:

So we can finally say that offshoring has finally picked up from the German parent to the Indian subsidiary?



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Dr. Martin Müller: As we have already stated, also in the last call that there is no change in our wording on that. German speaking offshore will take time, it will not come over night and also not from quarter-to-quarter, we are working on that, we try to bring or tear down the barrier, this language barrier and create also some models which allows us to work with German clients requirement but in order to get project out of those German speaking countries it will take a little bit more time. René, if you want to add something on that?

René Gawron: Yes, but in general I think your question was not so much maybe on the language but the business that is coming from SQS Group to BFSI has picked up, I think in the last fiscal year in 2015-2015 which ended end of March we had about 3% of the revenue coming from the group and in the quarter we have just published it is close to 10%. So it is picking up over the 10% of the business of SQS India BFSI, so it is generally picking up from various regions in Europe.

Ishan Agarwal: Okay. Another question, in April 2015 the Government of Maharashtra allotted the SQS Group around 2 acres of land near Pune, so will this land be used for the expansion of SQS BFSI or SQS India or is it mixture of both?

René Gawron: So we are focused here in India BFSI as our name also pointed out on those BFSI business, so that means that if we look at offshoring and if we look at banking, financial service, insurance business, this is supposed to be done here in India BFSI. And the other verticals, we also are focusing like in retail, manufacturing and these things are related to the Pune entity.

Ishan Agarwal: Okay. So majorly it would be used for the manufacturing business, the land that we have been allotted in Pune?

René Gawron: Yes, in Pune they do a lot of manufacturing if this was your question, yes. Manufacturing automotive is one of the key verticals of Pune, also retail and logistics and telecommunications.

Ishan Agarwal: Okay. So are we also planning to shift some BFSI business to Pune after this allotment of land?

René Gawron: Well, this maybe a mid-term plan to use the facility, but then it is on the account and on the P&L of SQS India BFSI. SQS India BFSI also does business in Mumbai, so it is not just in Chennai. If you ask about the location, yes we want to extend our business to more than just one location in India, but it is on the P&L of SQS India BFSI as Martin said because this entity is responsible, as the name suggests for the complete BFSI business.

Ishan Agarwal: Yes, so my question is since the last few interactions you have been maintaining that we would like to see our EBIT margins to be in the range of 19% to 21%, last two quarters we have been in the range of 17% to 18% and I do understand that is partly due to the onshore-offshore mix which is as of now higher on the onshore side, so do we stick by your 19% to 21% number say for a year down the line or so?



Dr. Martin Müller: Yes, of course what you already assumed it has to do with the onsite/offshore ratio and also has to do with the region wise mix, so if you see the margins in Asia Pacific and also in Middle East are lower than in Europe and US. You also will understand that our focus is on those two regions.

Moderator: Thank you. Our next question is from Abhay Moghe of IL&FS. Please go ahead.

Abhay Moghe: I have three questions. One, we have seen like Martin mentioned in his initial remarks as well but we have seen last year that there was a significantly pick up in revenue in one of the quarter and then later on two quarters the revenue dipped, then in this quarter again the revenue has jumped up. So how are you seeing the predictability of your revenue? You do not announce the deals but like there is a decent predictability over the two-year-period but how about like four quarters are you seeing a revenue growth or a significant decline can again come in as the projects get completed? That is first.

Second, how much can automation impact your existing revenue and EBITDA if it picks up significantly, although it is generally in a phased manner, but if it is so then how much it can impact and are you deploying automation techniques significantly in your current projects?

And third is, what was the utilization and attrition levels and should one expect margins to improve significantly with the utilization of onsite-offshore mix improve going forward or company plans to invest significantly in the SG&A going forward? That's it.

Dr. Martin Müller: Okay, so I will starting with your first question regarding the revenue. One of the reasons we report both quarter-on-quarter as also year-on-year numbers is to give you a fair idea of the nature of our business which will follow a bit of up and down path, but if you look at it over a two year period, you will see that we are on the growth path as I already reported. There is no worry on question of growth. And as I also pointed out we are starting some new projects in the near future, so this gives us the confidence that we are also looking for further growth.

The second part was if I got it right was about automation, is it right?

Abhay Moghe: Yes.

Dr. Martin Müller: This is an important topic to us, up till now we see that most of the work that has been done in the testing area is manual based, so we have good skills on automation, we have good framework on how to implement automation and we look for projects where using the fixed bid or managed services model, it is possible to drive in more automation as opposed to a T & M project. Automation is not a solution for everything but it is a path we have adopted where possible and it also depends on other factors like time cycles of software in certain projects and also our customers, but nevertheless we do recommend for greater automation from our end.



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Coming to that point I mentioned just, people and utilization, you asked about our utilization, it remains regarding the last quarter means end of March quite stable at around 70%.

Abhay Moghe:

Okay. And attrition?

Dr. Martin Müller:

In attrition, attrition went up a little bit but it is at manageable levels so it is below 20%. We made use of the utilization levels to adapt our skills in a way that we look what is really required for our next coming projects, which skills do we really need and therefore attrition is not only something bad, it helps us in order to adjust that. We are there below 20%, that's good for us.

Abhay Moghe:

Okay. Just two sort of follow-ups, one, when is your wage hike planned like effective which date? And second follow-up is that, if whatever utilization I see on the onsite-offshore mix that you mentioned, if those were to improve further do you see margins going up significantly over the next 12 to 18 months or you see that now there will be more investment on the SG&A side because you want to build up more of US region?

N. Vaidyanathan:

The wage hike is generally in July that is this month and it will be effected for the offshore people from July onwards.

Dr. Martin Müller:

Yes, and second you asked on the margins, they are still under pressure. It is coming from our customers in that way that they are not reducing their overall IT budget but they have to manage more IT-Projects and therefore margins will be still under pressure and you have to find a way for the company profitable way how you can manage that. We are looking for ways to increase our managed service business also in the future, which should give us more flexibility and also gives us the confidence that the work is done as stated in the contract by service levels which are defined.

Moderator:

Thank you. Our next question is from Samrat Dasgupta of Esquire Capital Advisors. Please go ahead.

Samrat Dasgupta:

We had in the last conference call in the last quarter had discussed about the sales processes in the sense that sales force from the original SQS parent should not be clashing or there should not be any conflict between the sales force of original SQS versus SQS India BFSI and you had said that the rationalization the processes are on. So just wanted to know what is the status of that? So has it been rationalized in the sense that which sales person gets the project in which part of SQS the project is allotted to?

Dr. Martin Müller:

We have two regions where we have the overlap within the group. That is in Europe, especially UK, and in US. As the client is most important, we look what is best for the client, so that means if it makes sense to work on a project or on a proposal in a joint manner, we do that. After that,



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behind that curtains, we have our transfer pricing methodology in place which ensures that we are acting there on arm's length principle.

Moderator: Thank you. Our next question is from Krunal Shah of Amideep Investments. Please go ahead.

Krunal Shah: Sir my question is related to the clients, initially we were in the phase as in we were focusing on the limited number of clients but with a potential to give us higher revenue, but now the number of clients is increasing, the stage has come wherein the number of clients has started increasing again. So has that strategy been left behind?

Dr. Martin Müller: No, we still go on with that strategy. So we have now around 83 active client, yes you are absolutely right, we have increased by 4 clients but we are looking at each client every quarter or even every month and every week again if this client has the capability to grow. That means that we do not look at a client when we start a project with one or two consultants or doing POC that this is a small client with small revenue, we just look at if they have the potential to garner a bigger share of wallet of their testing work, this is how we look at that. And this number might go up and down a little bit, but the strategy is not changing that we want to realize more revenue with bigger clients and get rid of some smaller clients where we only see extended bench work for us.

Krunal Shah: So the current 64 clients that we have, do you feel them at least have a potential to give on an average \$1 million revenue per client, something like that over a longer period of time?

Dr. Martin Müller: Not all clients we have in that portfolio have that potential, but that does not mean that we reject those clients, we have to develop that, this is a question of two or three years' period where you can then see that we have improved on those numbers revenue per client.

Krunal Shah: Okay. So the potential is there?

Dr. Martin Müller: Yes.

Krunal Shah: Okay. My next question is regarding the total number of employees that we have, can you give me a count as in including the consultants plus the sales team and the admin staff, what is the total number of employees this quarter, last quarter, and year-on-year?

Dr. Martin Müller: Compared to last quarter the billable consultants it went a little bit down but this was on the back of better utilization and restructuring of some projects where we could do more work with less people. But for the future, we have to see what is required from client and I think when I talk about growth path that means that we will also look to add people in the future.

Krunal Shah: No, no my question is majorly related to the entire SQS India BFSI team including the sales team what is the total count, I wanted the count.



Dr. Martin Müller: The total number, 911 and last quarter was 907.

Krunal Shah: And year-on-year?

Dr. Martin Müller: Year-on-year was...

N. Vaidyanathan: It was 925 last year first quarter and it is 911 now.

Dr. Martin Müller: So it remained more or less stable as I said.

Krunal Shah: Okay. My next question is to René, just a number I want in terms of, see if SQS Germany, the parent, out of the total revenue how much would be the German speaking revenue?

René Gawron: The German speaking revenue!

Krunal Shah: As in the client whom we have to service in German language.

René Gawron: Yes, in German language it is kind of three regions, let me add this up, it is about 130 million or so on an annualized basis, it is Germany, Switzerland, and Austria.

Krunal Shah: Okay. So EUR130 million?

René Gawron: EUR130 million yes, so it is about \$145 million roughly.

Moderator: Thank you. Our next question is from Pranav Mehta of Value Quest. Please go ahead.

Pranav Mehta: So just wanted to understand this employee cost increase, so our headcount is broadly flat quarter-on-quarter whereas our employee cost has increased by almost 11% quarter-on-quarter, so what is the reason for that?

Dr. Martin Müller: The main reason is the onsite/offshore split. So if you have higher people or more people working on on-site the salaries have to be adjusted to the local salaries which are paid in certain countries.

Pranav Mehta: Right. So can you repeat the onsite-offshore mix, I missed it earlier?

Dr. Martin Müller: Yes, the onsite was 62% and 38% offshore.

Pranav Mehta: And what would be the same ratio been in Q4 of last year?

N. Vaidyanathan: 58% was onsite and 42% offshore.



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- Pranav Mehta:** Okay, right. And so going forward can you share with us any headcount addition plan say for the next 12 months or so?
- Dr. Martin Müller:** No, it depends, as I already said we want to grow in a profitable way and depends on the forecasted revenue and we do not give any guidance. Suffice to say that we will add people based on the needs and demands of the clients.
- Pranav Mehta:** Okay. And just last one more clarification, if I heard it correctly you said 10% of SQS India BFSI revenues have come from the parent, is that right?
- Dr. Martin Müller:** Yes, for last quarter it was 10%, it started about 3% in the last year and came up to 10% of the revenue in the last quarter.
- Moderator:** Thank you. Our next question is from Krunal Shah of Amideep Investments. Please go ahead.
- Krunal Shah:** Sir one more question, you said that in the US you are looking towards few projects coming up, so could you just highlight into what field they are into in terms of banking or capital markets or cards or insurance? And also if you could give the comparative margins across the segment in terms of banking and capital markets or insurance, which is the highest margin, lowest margin that way?
- Dr. Martin Müller:** It is focused on banking, cards, and insurance, so all those three areas the biggest footprint wise, now they are in the US and this is also the future upcoming projects I spoke about. On margins we cannot give a break up between various segments.
- Krunal Shah:** Okay. I just wanted to compare as in which would be the highest margin segment if possible.
- N. Vaidyanathan:** Generally the billing rates are pretty good in US you can draw conclusions on that.
- Krunal Shah:** The new projects in the US will be across banking, capital markets and cars and payments across all, not just one specific?
- Dr. Martin Müller:** No, no we will go for whole portfolio there.
- Moderator:** Thank you. Ladies and Gentlemen, that was our last question. I now hand the floor back to Mr. Diwakar Pingle for closing comments.
- Diwakar Pingle:** Thanks Inba. I think I would like this opportunity for everyone who joined this call. Martin, would you like to make some closing comments before we close this call finally?
- Dr. Martin Müller:** Yes, I think we touched upon important points from our side and we want to say thank you to all listeners. Wish you a great weekend.



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Moderator:

Thank you members of the management. Ladies and Gentlemen, on behalf of SQS India BFSI Limited that concludes this conference. Thank you for joining us and you may now disconnect your line.