"Newgen Software Technologies Limited Q2 FY '20 Earnings Conference Call"

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**MANAGEMENT:** **MR. DIWAKAR NIGAM – CHAIRMAN & MANAGING DIRECTOR, NEWGEN SOFTWARE TECHNOLOGIES LIMITED**
**MR. T. S. VARADARAJAN – WHOLE TIME DIRECTOR, NEWGEN SOFTWARE TECHNOLOGIES LIMITED**
**MR. VIRENDER JEET – SENIOR VP (SALES, MARKETING AND PRODUCT), NEWGEN SOFTWARE TECHNOLOGIES LIMITED**
**MR. ARUN KUMAR GUPTA – CHIEF FINANCIAL OFFICER, NEWGEN SOFTWARE TECHNOLOGIES LIMITED**
**MS. DEEPTI MEHRA CHUGH – HEAD, INVESTOR RELATIONS**

Please note that the transcript has been edited for the purpose of clarity and accuracy.

**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Newgen Software Technologies Limited Q2 FY '20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Deepti Mehra Chugh – Head, Investor Relations. Thank you and over to you.

**Deepti Mehra Chugh:** Good Evening everyone and Welcome you all to the Q2 FY '20 Results of the Company. I have along with me today Mr. Diwakar Nigam, Chairman & Managing Director; Mr. T. S. Varadarajan – Whole Time Director; Mr. Virender Jeet – Senior VP (Sales, Marketing and Products); and Mr. Arun Kumar Gupta – the Chief Financial Officer.

Before we move on to the discussion, let me highlight that this call may contain certain forward-looking statements, concerning Newgen's future businesses prospects and profitability which are subject to a number of risks and uncertainties, and the actual results could materially vary from the forward-looking statements. Past performance may not be indicative of future performance. The company does not undertake to make any announcement in case of any of these forward-looking statements become materially incorrect or update any forward-looking statements made from time to time on behalf of the company. For further details, you may please refer to the investor relation section of our website.

I would now hand over to Mr. Nigam for presentation of the results. Thank you.

**Diwakar Nigam:** Good Evening everyone and thank you for joining us at our Q2 FY '20 Post-Results Conference Call.

Overall, in the first half of the current year our revenues were up by 11% at Rs. 285 crores with broad-based growth across geographies. APAC and Americas region predominantly remained strong in H1. Our efforts at new logos have resulted in us adding 38 new logos. EBITDA is at Rs 16.9 crores and profit after tax is Rs. 7.3 crores.

Growth momentum in Q2 compared to Q2 FY '19 was particularly slow for us with revenue growth of 3% only. Growth rate in India and EMEA was muted on account of macro uncertainties and market headwinds. Overall macro uncertainties did lead to some slackness in project closures from the customer's end in the current year. However, we continue to remain focused on our operations and in investing in building capabilities for the future. We think there is sufficient potential in the market in the digital transformation space and we are well placed given our offerings and entrenchment. Our efforts on new logos has resulted in us adding 26 new logos in Q2 itself including five cloud deals.

Notable deals include license agreement with a commercial bank based in Kenya, license agreement with a financial institution in Americas region, license agreement with a leading Indian microfinance institution headquartered in Bangalore focused on providing micro-loans to women customers predominantly in rural areas in India, and five cloud deals across banking and financial services and healthcare segment in Americas region.

As we had mentioned last quarter keeping in mind the growth requirements, we continue to invest in our employees and have undertaken campus recruitments as well as lateral recruitments. This was largely on account of strengthening of the senior management team and additional sales and marketing talent hiring particularly in the international markets. We also completed our annual increment process across the organization as planned. In order to minimize the attrition rates, existing employee salaries have been increased in line with market trends.

The employee cost are high this quarter on account of these two impacts. We are now a team of 3000+ people with about 370 employees in R&D team.

Overall, our annuity revenues comprise 60% of our revenues and witnessed a growth of 27% YOY. Of this, cloud revenue were Rs 8.2 crores during the quarter and witnessed a growth of 43% YOY. Our cloud-based model is critical component of our growth proposition and reflects the growing acceptance of our solution in the market.

In terms of verticals, we saw robust growth across key verticals specifically banking, insurance, and BPO/IT verticals. We continue to invest in deepening our product capabilities, talent development, new market expansion, and brand initiatives. We are happy to share that Newgen has been positioned as a strong performer in the Forrester Wave report for ECM content platforms. The report recognized Newgen as a good fit for enterprises looking to modernize their critical content and process applications and seeking a fresh cost-effective alternative to older apps. We were also recognized as enterprise content management vendor of the year as Frost & Sullivan’s 2019 India ICT Awards. These recognitions encourage us to constantly improve our capabilities and meet market and customer expectations.

We now have 13 patent grantss in our portfolio across India and US.

Coming to profits, margins, and cash flows:

As costs are planned upfront due to the investments across sales and marketing and R&D, our profit has been impacted during the quarter. EBITDA was Rs. 9.1 crores and profit after tax is Rs 4.2 crores. Our net cash from operating activities was at Rs. 39 crores. The quarter cash flow was low primarily on account of the payout of incentives to employees and full impact of campus hires.

Expenditure:

In Q2 our R&D expenditure comprised of 11% of our revenue. The sales and marketing expenditure comprised approximately 24% of our revenues for Q2.

Trade Receivables:

Our gross trade receivables as on September 30, 2019, are Rs. 236 crores and the net trade receivable is Rs. 191 crores. The gross DSO stood at 133 days and net DSO stood at 107 days considering the revenue of trailing 12 months, an improvement in this area.

Moving towards the outlook:

H1 is typically a weaker period for our business and we do expect the business to pickup in the second half.

The overall demand environment is stable in the global markets, but in pockets like banking and financial services, we do see increased volatility and the decision-making has been slower due to overall macro-environment. The current market pressure is expected to continue in Q3 as well, however, the sales pipeline is strong and we are hopeful that we should be able to close certain large sized deals and recover the growth in Q4. On the cost front, since our costs are upfront, we expect costs to grow at 17% to 18% for the whole year. This is expected to lead to pressure on our margins in the current year. We hope that our investment in US, Europe, and Australia would start yielding results and help build up the growth momentum in the coming quarter.

We are now open for Q&A.

**Moderator:** Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

**Nagraj Chandrasekar:** My first question is on the annuity revenue side after a sort of slight dip in the last quarter which you would attribute it to lower product license and sales, we now had two quarters of slightly lower license sales, but have seen annuities sort of inch up, is this sort of an annual normalized revenue run rate on which we should see growth going forward or whether any one offs here? My second question was on the increased step up in OPEX in both employee and non-employee OPEX, on the employee side where have we hired people in senior roles, what exact functions have we hired at and are there any one-offs here?

**Virender Jeet:** The first question, you are right, the annuity revenue part for H1 has grown roughly around 24% for this year. While last year in the same period for Q1 and Q2 we did have lot of jerky sales in terms of license sales with typically four accounts contributing roughly Rs 45 crores, we did not get very large license deals this year though we got almost similar number of accounts and which all gave us license sales, but on the annuity side comprising of both cloud revenue as well as our accumulation of ATS revenue, there is always a higher growth rate, so I think going forward also this trend will continue, there will always be higher growth rate of annuity business, well that is what we are trying to do also in the cloud business and other business.

As far as your second question, I think at the beginning of year we do plan around our costs and I think we were not very off, we had planned cost growth around 17%, we are on track on that. We did few additions on manpower, one is that we hired some very senior people in growth related areas. We hired a senior person as VP Marketing, we hired a very senior person in managing our global delivery as well we had some sales leadership joining in, so predominantly these roles were created to look at the expansion of our businesses, so they are in a nature one-time. On the other hand, last year we had an extreme high pressure on attrition so we had roughly more than 25% of attrition, so in a product company retaining key talent is important, so this year we were slightly more proactive in hiring in the last quarter of the previous financial year as well as increasing the salaries for our key people on our product side and service side, so those two things is where the costs have increased on the OPEX side.

**Nagraj Chandrasekar:** Just one question on the India part, revenues here as we know it is a tough market, so revenues have been flattish, but we made a loss at the EBIT level this quarter, have there been any large debtors that you have written off that have caused this loss?

**Virender Jeet:** Not really, the ECL provisioning is typically more consistently divided between EMEA and India predominantly, the India margins are a reflection of lack of top line growth as well as the reason that most of the costs are attributed to India even when they are global in nature, so generally on India P&L you will have costs getting factored, so as I told most of the increments and hiring would happen in India, so that is where the costs come out here, that is why there is an effect on the EBITDA side.

**Nagraj Chandrasekar:** Just our debtors have come down again sequentially, what would be our target to get them down by the end of the year, and secondly, are we holding onto our sort of earlier long-term guidance of 20% growth and 20% margin?

**Virender Jeet:** On the debtor side, we are continuously working on ways to keep on reducing it and we had given a guidance that on an average we should be able to bring down eventually to 120-125 days, so we are clearly on track on that. We may take few more quarters to reach there on the debtor side. On the guidance side, what is happening, as Mr. Nigam explained that there is a headwind in the financial services in India and also some part in the Middle East, so what has happened due to that is that lot of deals on the new logo side, which are typically the larger license deals, which affect our revenue in India and EMEA, have got affected this quarter as well as some effect was there in previous quarters. We do not see the situation improving drastically in the next quarter in terms of large deals coming in, but in Q4, we think that we should be able to regain some amount of momentum both in other geographies as well as in India, so we will still work in terms of our guidance to keep on getting the momentum, but for the quarters where we have lost some opportunity, I do not think this is a year we can really regain that whole in Q3 and Q4, so on the margin side our costs are clearly at 17% to 18%, so if our growth momentum exceeds that 17% to 18% there has to be an organic margin expansion, so for this year we do see some challenges on the margin, but we have seen that momentum, it could be an ad hoc year or ad hoc quarter, but I think we are very much on track to keep on improving our margins in coming quarters in the medium term.

**Moderator:** Thank you. The next question is from the line of Arya Sen from Jefferies. Please go ahead.

**Arya Sen:** Firstly, if you could talk a little bit about the US business because even there growth seems to have been slow in this quarter?

**Virender Jeet:** Thanks for the question, I think the US business in fact this quarter has been good on our deal wins as I said roughly we have got five to six deals on the cloud front and overall in US we have got around 12 new logos in H1, so I think in if you remember at the beginning of the year we said that we should project roughly around somewhere between 20 to 25 new logos in US that should help us, so on the H1 side we have got 12, but what is happening on the H1 side when you convert into numbers, you will not have any revenue because most of these are cloud deals where the revenue starts coming on beyond Q2, Q3 and onwards, so for Q1 deal, the Q2 or Q3 will be the start of the revenue and Q2 similarly, there is a quarter or two quarter lag between start of the deal, signing of the contract and actual revenue coming in. On the deal side we have done well, but the revenue as you know it is back ended, there is going to be some pressure. The other thing is last year in the same quarter we had a large license deal more than a $1 million license, so that increased the base of the quarter substantially. This is one of the challenges not only in US but across other areas also. Traditionally, if you look at all previous years, last four to five years data, our Q1-Q2 are very similar in numbers and margins are always in Q3, but last year was a unique year in which Q2 we had roughly around 40 crores of additional license sale on account of four orders and they were spread in US, EMEA, and India so the base has just got improved. On the other hand the growth which is in the US is not reflecting in the number yet, so I am sure in Q3 and Q4 the number will look much different.

**Arya Sen:** How do you see the demand environment in US, because you talked about issues in banking, is that relevant to the US market as well?

**Virender Jeet:** Not really, I think in US and APAC, we are not finding any demand challenges, in fact in both US and APAC, we expect to grow at a much higher rate than 20% and we do not see any headwinds out there. Headwinds are predominantly coming in areas because banking and financial services is a very strong segment for us and unfortunately in Indian market and some part of the Middle East that has been really hit very hard, so most of our new logo acquisitions which were larger deals because of this merger between the banks and some issues with banks, they are just not happening or they have been pushed out and eventually losing four large deals makes huge differences on the quarterly number.

**Arya Sen:** How different would be your margins in US and APAC versus India and Middle East?

**Virender Jeet:** I think we discussed this sometime back, broadly most of the costs are added to India and most of the aggressive sales marketing costs are added to US, so at this time really I will not be able to comment on what is going to be the margins, but I think US since our billing rates in terms of both license the way we are able to hold on to license with lesser discounting and the quality of revenue and quality of discounts is far better in mature markets, so that way yes, the US, Europe which always show better margin profile, but right now it is unfortunate for India because most of the costs are loaded to India.

**Arya Sen:** A couple of bookkeeping questions, firstly what was your constant currency YOY growth for Q2 as well as 1H?

**Deepti Mehra Chugh:** Q2 was 3.5% and first half was 10.5%.

**Arya Sen:** You are not shifting to the new tax regime, right, how should we look at it?

**Virender Jeet:** Right now, we are not shifting because we are already taking some benefits of SEZ and we hope to continue those benefits in coming years, so we will not be shifting to any new regime.

**Arya Sen:** You are unlikely to shift in the foreseeable future?

**Virender Jeet:** Yes, we are unlikely to shift in the next three to four years.

**Moderator:** Thank you. The next question is from the line of Prasad Padala from SBI Mutual Fund. Please go ahead.

**Prasad Padala:** I joined the call a bit late, so in India and EMEA geographies I understand that there is a demand slowdown, so when do you expect this to recover or what gives you the confidence for recovery and subsequently flowing into your overall revenue growth guidance?

**Virender Jeet:** There are two-three things. On the business side, we are slightly moving our sales energy to other segments - insurance is looking good out in India where we do not have the same challenges, similarly we are shifting a bit to manufacturing and what you call shared services captive and non-captive, so that is one thing as a part of planning which we are doing which will mitigate a part of that. Second thing is in financial services the recent announcements of the merger and acquisitions about banks has affected roughly around 10-12 enterprises where we had some large deals going on in the pipeline, so our indication is that they will be able to resolve, take a quarter or so to resolve in terms of how they are going to do the order processing or which are the companies which will issue the orders, that should start getting us some of these large deals back on the table which have been pushed out and unfortunately they got pushed out at almost like the closure stages, so we do not see the macro situation changing drastically over the next few quarters, but we think the disruption which was caused with the recent announcement, I think that goes back and some more sales momentum we start shifting to other enterprises that have got less affected, I think we should be able to recover some amount of that momentum. On the Middle East side again, it is more political, I think we have seen some tensions (Saudi/ Qatar), so that is just holding back. Again, what our teams are telling us on the ground it is a temporary phenomenon, next couple of quarters it should settle down because that is what it takes. On the business side what we are doing, we are trying to derisk by getting into other segments where we can build business while in the meantime we are hoping for things to stabilize.

**Prasad Padala:** What has been the license revenue growth in these geographies?

**Virender Jeet:** Overall, we did roughly around Rs 53 crores of license in H1 vis-a-vis roughly around Rs 70 crores last year, but Rs 70 crores had large three to four orders which were one-time kind of orders of around Rs 40 crores, so we have done well but I think last year the same quarter had an abrupt jump, so we are just fighting that jump, the percentages are just getting affected because of that, so broadly we have done roughly Rs 53 crores and I think as the second half is much larger for our license sales, so we hope to gain better momentum next half.

**Moderator:** Thank you. The next question is from the line of Aman Vij from Astute Investment. Please go ahead.

**Aman Vij:** The first question is you have been talking about slowdown in insurance in banking specifically, but if we see our half yearly results and even Q1 results, banking has been growing well you see at least the segment which you have shown, it is the healthcare segment and the Government PSU segment which is not growing, so in Government PSU sector, what is the clarification regarding this?

**Virender Jeet:** I think you are right, it is a good observation, but when we are looking at healthcare, if you are part of tracking the last quarter we clearly said, the healthcare growth last year was account of the large deals coming from existing customers which were not repeatable, so as a result our healthcare business as such is not growing, so most of our growth comes from segments like banking, Government, BPO, IT, so in that most of the growth expectations also come based on banking and Government, so when we had made our planning, we had factored in some amount of slowdown in Government because that was continuing for now many quarters, but we had expectations of large deals coming from banking, so we are not saying that the banking for us has not contributed, but the new logo acquisition where the large license sale is supposed to happen in banking, especially in India and EMEA that is what has got impacted, our numbers do not reflect the macro situation, but macro situation does reflect our decrease in license sales.

**Aman Vij:** On the other segment that has degrown significantly, so what customer type of segment or customers we did not get or?

**Virender Jeet:** Others is anything but those five segments, so it could be any ad hoc sales coming from partners, any of those things so I would not be able to comment.

**Deepti Mehra Chugh:** We have got 12 verticals which are clubbed into others, which include manufacturing, retail, telecom, etc., so that is a combination of all of them put together.

**Aman Vij:** Any particular segment that has degrown than others, my question was that?

**Virender Jeet:** No, we do not even track it segment wise but I think this we can send you exactly the data what were the large deals which came in others and what did not happen this year.

**Aman Vij:** The second question is on the 38 logos which we have won in H1, could you give the breakup that you did last few quarters greater than one crore and greater than 10 crores?

**Deepti Mehra Chugh:** This time we did not have many large size deals as such, the average size would be close to Rs 1 crore plus, so therefore we have not given a bifurcation this time, but I can get back to you with the division.

**Virender Jeet:** The average deal size for these logos is roughly around Rs 1.35 crores whereas the last year the same number of deals, the average deal size was Rs 1.6 crores and that growth was on account of four large deals, but we can send you the data and this is also so far the billing numbers and not the booking numbers. There is also an unexecuted order book of these logos, so finally at the end of the year that is the right time to look at the size of the account and the size of the deal because not everything in that order has got really billed.

**Aman Vij:** You have been talking that US is still doing well for us, so in terms of non-SaaS customers I think that has remained flattish or degrown little bit, some slowdown there also?

**Virender Jeet:** Our sales engine is all pursuing SaaS, so non-SaaS was relevant last year with a large deal coming through Health which is an existing client, so typically a Rs 10 crores- 11 crore license deal, so the slowdown which is visible is on account of that. Non-SaaS is flat, so they have grown but not really grown, but most of the sales push is coming on our accounts which are SaaS-based accounts.

**Aman Vij:** The final question, there was a net additional write-off or provisions of 5 to 6 crores, any particular customer we have written off or any debt?

**Deepti Mehra Chugh:** That is based on the ECL provisioning wherein you take the 12 quarter trend and then based on that for each of the ageing bucket of debtors provide a percentage, so it is not relating to any particular debtors as such, it is basically an overall percentage applied to each of the buckets of receivables.

**Aman Vij:** Maybe you can give the receivables greater than 180 days?

**Deepti Mehra Chugh:** Yes, so receivables greater than 180 days would be roughly Rs 96 crores.

**Moderator:** Thank you. The next question is from the line of Nitin Mangal, an Individual Investor. Please go ahead.

**Nitin Mangal:** I had two questions, firstly I would want to understand your debtors ageing schedule, so I believe in Q4 last year, that is, FY '19 you recognized revenue of Rs 204 crores while your debtors for 0 to three months was around Rs 195 crores gross amount and net amount would be Rs 190 crores, so that comes out to be 93%, so I just wanted to understand this kind of a number that 93% like can you throw some light?

**Virender Jeet:** Sorry, I could not understand your question fully, but I can give you the data, one thing is our Q4 is the largest quarter of sales with 35% to 40% of our annual sales happening in Q4, so at the end of Q4, you have a large debtor base getting created and also you have the three months and the six-month bucket debtors also coming into that. If you look at historically quarter after quarter, typically the total debtors at the end of March between last year and this year has reduced substantially and also from comparing from September to September has reduced substantially, as on September 30, 2019, we were at debtors of Rs 236 crores.

**Nitin Mangal:** My question was you recognized debtors, as on March 31, 2019, your debtors of 0 to 3 months which is 0 to 90 days was around 93% of your revenue recognized for that quarter?

**Arun Kumar Gupta:** I will explain, the major billing as far as the last quarter is happening is in the month of March. The major license deals are closed in the last month and accordingly they are getting billed in the end of the month, and those become debtors and the collection happens in the next quarter, so that is why it is seen as lopsided because last quarter has major deal closures, the new logos happen in the last quarter majorly and those deals are getting billed in the last month itself, I hope I have answered your question.

**Nitin Mangal:** Another question regarding the same issue is about your weighted average loss rate, so last year as on March 31, 2018, your rate was 4.03% and as on March 31, 2019, it has come down to 2.85%, so any reason for that?

**Deepti Mehra Chugh:** That is based on the last 12 quarter trend, as the trend improves the percentage changes so we have seen in the past quarters improvement in that trend in terms of collection.

**Nitin Mangal:** So your collection has improved?

**Deepti Mehra Chugh:** Yes.

**Nitin Mangal:** My other question would be regarding your online versus off-line breakup of implementation of software, so can you just give me the breakup like the percentage of online versus off-line regarding the implementation of software?

**Virender Jeet:** Does that mean on-site and off-site?

**Nitin Mangal:** Yes, online as in it would be in-house implementation or using third-party such as you know Amazon or Google.

**Virender Jeet:** When you are talking of implementation revenue stream, most of it is, our own office development, so there is nothing external to that, the only thing is basically we have a payout for Amazon Services for cloud services which is a very small payout right now, it is not significant, almost $1 million or even less than that.

**Moderator:** Ladies and Gentlemen, as there are no further questions from the participants, I would now like to hand the conference over to Ms. Deepti Mehra Chugh for closing comments, thank you and over to you, Madam.

**Deepti Mehra Chugh:** Thank you everyone for joining us on the call. For any other queries, you can connect to us or go to our website for further details. Thank you.

**Moderator:** Thank you very much. Ladies and Gentlemen, on behalf of Newgen Software Technologies Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.