



Persistent Systems Limited - Analyst Conference Call

Q3 FY13 Results

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PARTICIPANTS

Dr. Anand Deshpande

Chairman & Managing Director

Mr. Hari Haran

President, Persistent Systems Inc.

Mr. Rohit Kamat

Chief Financial Officer

Mr. Nitin Kulkarni

Executive Director & Chief Operating Officer

Mr. Vilas Kate

Chief Planning Officer

Mr. Vivek Sadhale

Company Secretary and Head – Legal & Investor Relations

Moderator

Ladies and gentlemen, good evening and welcome to the Persistent Systems Analyst Conference Call. As a reminder all participant lines are in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. We have with us on the call today Dr. Anand Deshpande, Chairman and Managing Director, Persistent Systems Ltd. We also have with him Mr. Hari Haran, President, Persistent Systems Inc. joining from the US, Mr. Nitin Kulkarni, Chief Operating Officer, Mr. Rohit Kamat, Chief Financial Officer, Mr. Vilas Kate, Chief Planning Officer and Mr. Vivek Sadhale, Company Secretary, Head – Legal and Investor Relations. I would now like to hand over the conference to Dr. Anand Deshpande. Thank you and over to you Sir.

Anand Deshpande

Thank you so much Shyma. Greetings and welcome to the first call of 2013 representing the third quarter results of financial year FY12-13. To get started, I am going to give you a few introductory remarks, mainly the highlights, then I am going to request Hari Haran to give us the context of the business and the growth during the last quarter then I am going to request Rohit Kamat – our CFO to provide financial details and other highlights regarding the financial numbers and the quarterly results. After that I will provide some answers of potentially anticipated questions that we get all the time and also summarize what was discussed. After that we will open it for Q&A and we will finish the call at 6 O'clock as planned.

In terms of the quarterly highlights, I am very pleased to announce that this quarter the revenue for nine months ended December 31, 2012 was US\$ 175.71 million representing a Y-o-Y growth of 14.7%. The Profit after Tax for this period was Rs. 135.73 Crores representing a Y-o-Y growth of 35%. The IP-led business constitutes 17.1% of our revenues for this period. Utilization which represents the efficiency improvement in the business improved Q-o-Q by 1.8% to 79.5%. During the quarter we acquired NovaQuest, a PLM and search based technology Solutions Company, thereby entering into a strategic partnership with Dassault Systèmes, which is a leading French company that builds PLM and 3D software. With this we now have a set up to sell, and offer support, maintenance and deployment services as an authorized VAR for Dassault Systèmes in the United States. The NovaQuest team is based and headquartered out of Charlotte in North Carolina in the US, which is on the East Coast.

I am also pleased to announce that the board has declared an interim dividend of Rs. 6 per share with a payout ratio of 20.55% for the financial year 2012-2013. This compared to last year's dividend for the entire year (financial year 2011-2012) of Rs. 6 per share at a payout ratio of 19.67%.

Some of the other highlights worth mentioning are, we have expanded our presence in Australia by establishing an office in Sydney and have acquired a few customers there. Last week we signed to acquire a new building next to our office in Goa with a plot area of 6,100 sq. mtrs. and a building area of 3,761 sq. mtrs. This allows us to increase our capacity in Goa by an additional 375 persons or so.

In our business recruiting and getting the top talent to join the company is a big achievement. I am really pleased to announce that we have appointed Dr. Sridhar Jagannathan as the Chief Innovation Officer. He is

based out of the Bay Area and will be responsible for driving innovation product, solutions and services. This comes at the backdrop of Nara Rajagopalan who had joined last quarter for leading the product related business. We also had Ashish Pandit and Nitin Urdhwaeshe, who is an expert in user experience, join us during the quarter. I am also happy to announce that we won the Institute of Chartered Accountants of India (ICAI) Silver Shield Award for excellence in financial reporting for FY11-12. This is the third consecutive year for us to have won this award. With this let me hand this off to Hari and he will give us an overview of the business aspects of it and then I will request Rohit to provide the financial details.

Hari Haran

Thank you very much Anand. Good evening ladies and gentlemen. It is a pleasure to have this opportunity to speak with you all about our Q3 results and some market updates. As Anand indicated Q3 was a good quarter for us and as you all know we had a large IP revenue in Q2 and this had given us a substantive growth in Q2. The fact that we were able to grow past that IP revenue with strong growth in engineering services reinforces the business climate and our ability to execute. As Anand indicated, our engineering services revenue grew steadily quarter over quarter. We opened about 50-plus new accounts out of which 7 are very large accounts. Further, we opened two new accounts in Australia. We grew our engagements in a few existing key accounts that contributed to the growth in engineering services. So given the large IP revenue in Q2 and the fact that we were able to grow beyond that opening a number of new accounts reinforces what we are able to do with our business. So we believe Q3 was a strong quarter for us.

We acquired NovaQuest, Anand mentioned that, in Q3 and this puts us in the North America map as a key reseller and integrator for Dassault Systèmes PLM Solutions. With this acquisition we bring into our portfolio 44 additional large enterprise customers that span across industrial equipment, high-tech, automotive, consumer products and life sciences vertical. This is a very synergistic acquisition that gives us the full capability to do end-to-end product development as you all know PLM is a critical component of product development. Further, this strengthens our foothold on collaboration which is a key horizontal focus area for Persistent.

Talking a little bit about Q4 and the future, our discussion with the customers and the market, continues to be positive and we see a strong demand for cloud, analytics, mobility and collaboration social services. In Q3, and the future we are also seeing more start-ups and venture companies with innovative software solutions that are emerging in the horizontal area. This is a phenomenon we have been seeing on the uptick in the last 2-3 months and we see this to continue. Our conversations with large enterprises also point to increasing software initiatives within their business groups. We are interacting more and more with the business groups beyond IP and that is where we are getting this signal. Our partners in the sell-with programs are showing an increasing pipeline in the area of Cloud and Big Data Analytics going into the 2013 calendar year. The spend with the independent software vendors or traditionally as you call them ISVs continue to be at a healthy level. Anand already mentioned some of the hirings but we have started investing aggressively in sales and marketing, to pursue the opportunity presented in the market and you might have noted a slight increase in the expenses in that area but this is deliberate, we are deliberately investing because we know that is what is going to get us to leverage more and more of the opportunity presented in the market.

We added new leaders in the US team; Anand indicated that, Sri Jagannathan who was the CTO at Intuit. He joined as the Chief Innovation Officer. He along with Nara Rajagopalan as Chief Product Officer and Ranga Puranik as the EVP of new initiatives will play a key role as part of the USA management team in growing to the next level and the next scale. In summary, ladies and gentlemen, our sentiments regarding the market continues to be optimistic and strong. We will beat the NASSCOM guidance for this year. Going into the next year we definitely see tremendous opportunity and hence are investing aggressively and preparing to leverage them. Thank you all very much. Back to you Anand.

Anand Deshpande

Let me now request Rohit, our Chief Financial Officer to provide the financial details on the quarter.

Rohit Kamat

Thank you Anand and good evening everyone. As explained by Hari our growth in the quarter was mainly driven by product engineering business which is our core business. I will now give you some analysis of growth in terms of volumes and billing rates. Although it is not very relevant for our business, we have categorized our revenue into three broad buckets namely offshore revenue, onsite revenue and IP-led revenue. The offshore revenue for the quarter grew by 3.3% which comprised volume growth of 2.4% and increase in billing rate of 1.4%. As a result of impact of vacations in the quarter, that is Christmas vacations, our onsite revenue for the quarter dipped by 2.2% comprising volume decline of 1.5% and drop in the billing rate of 0.7%. As explained to you, growth of our IP revenue needs to be tracked on an annual basis rather than on quarterly basis due to the lumpy nature of this business. So IP-led revenue recorded 131% growth on Y-o-Y basis. The share of IP-led revenue in our total revenue remained at around 18%.

Now let me give you some colour on the movement of margins during the quarter. Gross margin for the quarter was 43.5% in comparison to 44.1% in the previous quarter. The margin decline of 60 basis points was mainly attributable to increase in the employee cost due to net addition of 333 employees in India and 16 employees in USA who joined us as a part of acquisition of Doyenz in America. The sales and marketing cost increased to 7.6% of revenue from 7.1% in the previous quarter due to hiring of senior resources in the sales and marketing team and increase in marketing expenses. The G&A expenses increased to 11.2% from 9.7% due to increase in administrative expenses associated with the new facility which we acquired as a part of Doyenz acquisition, setting up of a new office in Australia and also due to expansion of activities in our SEZ units. The DSO was maintained at around 67 days and we follow a conservative policy of providing for all outstanding invoices beyond 180 days.

Our investment income from surplus funds which are passed into liquid and debt mutual funds and bank deposits amounted to Rs. 65.74 million and the exchange gain for the quarter was Rs. 18 million. As a result of above, the Profit before Tax for the quarter was Rs. 710 million as compared to Rs. 623 million in the previous quarter. The PBT margin improved to 21.3% as against 19.1% in the preceding quarter. The profit after tax for the quarter was Rs. 495 million as compared to Rs. 446 million in the preceding quarter. The profit margin improved to 14.8% as compared to 13.7% in the preceding quarter. The net profit after tax recorded a growth of 10.9% on Q-o-Q basis and 22% on Y-o-Y basis. Our effective tax rate was 30.3% during the quarter, the increase in the effective tax rate was mainly on account of increase in profit from the US subsidiary which is taxed at a higher rate. Our cash and investment position stood at Rs. 4,491 million as against Rs. 3,872 million as on 30th September.

As I have explained to you from time to time, we follow a consistent policy of hedging 40% to 50% of our net foreign currency earnings on a 12-month rolling basis through plain vanilla forward contracts. As on 31st December we had a total forward cover of US\$ 98 million at an average rate of Rs. 56.31. Total CAPEX during the first nine months of the year amounted to Rs. 680 million which also include assets acquired through the acquisition.

With these details I hand it back to Anand.

Anand Deshpande

Thank you Hari and Rohit. I will just give you some overall summary here to some of the questions we can anticipate. We continue to be thought leaders in technology areas. All our four technology areas that we have talked about, cloud computing, analytics, social or collaboration and mobility have all done well and overall the industry believes that these are the four areas for the future. We are expecting growth in all of these four areas in the next year. This quarter these four areas contributed to 45% of our total business and moving forward we see good pipeline and traction in cloud computing and analytics as was expressed by Hari. We are also seeing good activity in mobility mainly around medical devices and also with our acquisition of NovaQuest that should strengthen our collaboration activity. Another trend that we see is the fact that all four of these areas are working together which is providing us some very exciting opportunities of working with enterprises and the acquisition of NovaQuest gives us an additional 45 customers to go after with these four areas. The NovaQuest annual run-rate or revenue expected is about US\$ 7 million per annum and the team has 20 employees which are all experts in search based technologies or PLM software which is the Dassault product that they have.

The Doyenz team has 17 employees. These are experts in Cloud Computing and we are counting on their support as we enhance the Cloud Computing business for the next year. The annual run-rate expected in Doyenz is about US\$ 6 million per year in the first year. The attrition for the year was 16% and volume growth was 2.1% and utilization at the end of December was 79.5%. We have added 350 people during this quarter, some of them are fresh graduates and some are lateral hires. Net addition for the rest of this financial year, we expect to add another 300 people in this quarter and we have made offers to 500 fresh graduates for the next financial year and we will extend that as we get more clarity on the quarter.

Let me stop here and open it out for questions and then what we will do is try to restrict the early questions to maybe a couple and then as we go through the room we can come back for more questions if there are any. I will be a little bit more elaborate in the first few questions and then once we find repetition we will go faster.

Moderator

Participants, we will now begin with the question and answer session. We have the first question from the line of Kunal Tayal from Bank of America. Please go ahead.

Kunal Tayal

Firstly Anand wanted to understand how does your current deal pipeline compare with the same time last year and in general if you can talk about what is the sense you get from your clients on growth as well as visibility on their R&D budgets for this year.

- Anand Deshpande** The answer is yes, the pipeline this year is a lot better than it was last year. Now let me give you a little bit more colour on this particular aspect. One is that we have been changing our business model and the business that we are doing deliberately and successively over the last few quarters. So you will see that IP revenue has contributed to 17% as compared to 9.2% that we had last year and we expect that to continue so our growth in IP revenues will be better next year as compared to what we have had this year. I also see a lot more activity around Cloud Computing and Analytics and our ability to get business in both these areas, is definitely a lot better this year than it was in the previous year. We are seeing very definite pipelines; POC is completed and in both these areas. We are also getting good indications on both mobility and collaboration aspects and with the new customers we have acquired we are very confident about the pipeline. One other thing that we have done different this year is that we have added several senior people in the US including some of the people who have come to us from the acquisition of Doyenz that allows us to get much better onsite capabilities we have got an entry into some of these accounts and the growth on these accounts, we have a much better ability to sell many more things because of the senior expertise that we have in their company. So in general I am extremely optimistic about what we see forward as compared to one year back. Hari, do you have anything you want to finish off on this note?
- Hari Haran** Yes, just to piggyback on what Anand said, very quantitatively speaking our pipelines this year compared to last year have gone up by more than 50%. So it is certainly on the upswing when you see the deal pipeline.
- Kunal Tayal** And Hari the seven large accounts that you mentioned, should we assume that these are all software companies or some of these would also be on the enterprise side?
- Hari Haran** A combination of both. I can give you very specifically three of them are software accounts, meaning independent software vendor accounts and four of them are enterprise accounts.
- Kunal Tayal** Got that and just a clarification, the NASSCOM guidance speed, the comment was with respect to FY13 or did you mean next year, FY14?
- Hari Haran** FY13.
- Anand Deshpande** He meant FY13 but we should do FY14 as well.
- Moderator** Thank you. We have the next question from the line of Srivathsan Ramachandran from Spark Capital. Please go ahead.
- S. Ramachandran** It will be helpful if you can just give some more details on NovaQuest, specifically given that it is a Dassault reseller will we focus strictly on PLM number, or will we go out and work with some of the other Dassault products on design and other areas as well?
- Anand Deshpande** Let me give you a little bit of colour on what we are trying to do. We have been working with Dassault for a while and we find that some of these areas - cloud, analytics, collaboration and mobility, in the context of Dassault, and how they have changed their product mix has started to become far more important than they used to be for Dassault. In the past Dassault has been mostly a CAD PLM, a very mechanical

engineering centric company, but in the last few years what has happened is that the ability to collaborate across the ecosystem and data moving into the cloud has created a new set of opportunities for Dassault and we have been working and engaged with them on how to partner with them. And they encouraged us to acquire NovaQuest which was one of their resellers and VAR and with this we got 45 customers which were not included in the seven that Hari mentioned just now. So these are additional 45 customers and some of these are really large manufacturing, high-tech, oil and natural gas type companies typically 3D, CAD type companies. But what we are interested in working with and that is sort of where if you look at the more recent acquisitions that Dassault has made it will be very clear to you on how Dassault is changing their strategy and how it aligns very well with what we do.

Our long term plan is to provide analytics, cloud and mobility and other collaboration capabilities that we do very well in engineering and product companies to take them into the manufacturing domain or sort of design domain and go through that. I certainly believe that design user experience and that sort of front-end skills are going to be very important in product and product related matter. We acquired a small team called Radeus about six months back in product design. We now have added, Nitin U, who has capabilities and user experience in product design. The NovaQuest team has related expertise, so this is an area which is heavily data intensive, has same kinds of big data opportunities that we think are very leveragable and cloud mobility are big drivers in this industry and we get to it from a very different point of view and I think this is why it is extremely synergistic.

S. Ramachandran Sure. I will just stick to one more question on NovaQuest, if the consideration fades and the 7 million include any license revenue possible or is it pure services revenues?

Anand Deshpande No, there is license revenue. They are a reseller, it is a small 20-people team in Charlotte. The way NovaQuest sells is that when they sell, they sell Dassault licenses, they sell maintenance and revenues and then there are immense opportunities to do services which we think are under exploited today from their point of view but we can take this to the next level in the context of services opportunities on NovaQuest. And the consideration actually we have not announced but if we can send it, we will send it to you. We have not mentioned that number.

Moderator Thank you. We have the next question from the line of Shashi Bhushan from Prabhudas Liladhar. Please go ahead.

Shashi Bhushan I have a two-fold question around our inorganic growth strategy. Just wanted to understand that how critical is ceasing these inorganic opportunities in meeting our overall growth expectation of industry leading?

Anand Deshpande Actually it is again a loaded question. I do not know what exactly you are looking at but see here is the deal, from our context we think that for us to be a long term player the businesses are morphing. There are new technologies happening. The way we have done business for the last 20 years and what will happen in the next 15 to 20 years is going to be a different situation and we do not want to be left watching how the change happens. So gradually but steadily we are looking at trying to see how to improve the profitability

and the importance of IP in our business portfolio. We find that being early in this situation and the fact that we work with people who are ISVs, who have a lot of IP on their portfolio where we can better leverage than they can themselves, we find that all of this aligns very well. So it is definitely a significant part of our strategy moving forward and our growth strategy and we are doing this deliberately. So now one could argue that because we are paying much more attention to some of these things we may not be pushing as hard on some of the other things, but really, the market is changing for a fact and we want to be relevant in the market even few years from now. So this we think is a necessary and a desirable way of doing it.

Shashi Bhushan

Sir we understand that there are many end of life cycle products in the market, so what are our filtering criteria when we do these deals?

Anand Deshpande

Some basic things that we are doing is we are trying to make sure that these are in areas that we understand and we know what we are doing. So most of the ones that we are looking at we are either working in those areas directly for those customers or the areas are so closely aligned that we know how to run these products without complicating things a whole lot. So that is one of the important criteria. So that allows us to ensure that we can actually leverage this. Now I would like to also add that most of the products that we are acquiring they are non-strategic from the customer's point of view but they are not necessarily all end of life. Like for example, the ones we have acquired we have a roadmap for most of those products and we think that there is a substantial life opportunity available in most of these products. The only reason that they have sort of been declared end-of-life or less strategic from some of the customers is because they did not want to continue to invest in it. Then the third criteria of course is to make sure that the profitability is good on these products and on a long term basis baring first investments that we need to make we want to make sure that they are profitable and definitely long term opportunities in this. And finally there is a strategic element to all of these acquisitions and that is why we are doing this with people who we know, so we know that in many cases you may not be able to always identify the complexities of these things and there are certain cases where you should be able to go back and renegotiate certain terms, if we need to, and the confidence that we have working with them and we are a partner is very important when we work with these kinds of deals. So we are not working with people who are dropping this off as a hot potato but working with people who want to partner with us on a long-term basis.

Moderator

Thank you. We have the next question from the line of Ravi Menon from Equirius Securities. Please go ahead.

Ravi Menon

Sir the new areas that you mentioned – social, mobility, analytics and cloud are the things that I heard you say that about 45% of revenue came from that, did you mean 45% of the incremental 1 million or so in the services side?

Anand Deshpande

No, What we are saying is that, as I mentioned to you, we are trying to make sure that instead of being a generic IT services player we want to be a leader in some of these areas and over the last few years we have been saying that if you are going to do software work anywhere we might as well work in areas that we want to specialize in, that gives us better critical mass, thought leadership and leadership in general. So we

have been focusing on these four areas and we have kept these same four areas since 2008. Now it just so happens that you might call us visionary or whatever but now everyone thinks that these are the hottest four areas and we have been steadily growing our business in these areas. So today 45% of our business across the board is from these four areas.

Moderator

Thank you. We have the next question from the line of Dipesh Mehta from SBI Cap Securities. Please go ahead.

Dipesh Mehta

Just to understand margin perspective, we have made some acquisitions, so I just want to understand what kind of criteria do we have to evaluate those opportunities from income statement margin perspective as well as on return perspective? Can you provide some broad counter as to what we consider as criteria to choose?

Anand Deshpande

So, one is of course on return perspective we are trying to make sure that return on investment is less than three years that is like a first cut-off. If it is more than that we are not even touching it. Most of the ones we have done have been significantly less than three years so that is one criteria. And the second one is again it is often very difficult to measure margins on a long-term basis because there are some investments and we have some levers on how to change the investment strategy because if you reduce investment you might get short-term margin but in the long term that may not be very beneficial but all the same we are ensuring that our margins on IP-led businesses on steady stream are actually significantly better than our business on our T&M and other businesses like platforms and other things we do but it has to be evaluated on a case to case basis and there is strategic intent in some of these things. Our ability to extend that product to something else, the kind of customers we are able to get, those are also factors that go into making this decision.

Dipesh Mehta

Just to understand it slightly in a different way, if I see our linear business and our organic business and if I explore a couple of transactions that we made in the last few quarters then that organic business appear to be very muted. So just want to understand whether management's intention is more towards finding those opportunities which can provide future growth. Is that why we are seeing some kind of impact on our organic business or how should one read it?

Anand Deshpande

Our existing business that we have in the organic side has been doing well, so there is no real impact except for steady ups and downs that are pretty normal. Now if you look at new business growth that has happened, most of the new business growth to some extent has been coming from the platform side which is the sell-with opportunities and with some of the business that we have acquired from various acquisitions. So if you look at the sales engine that we have the distributional sales engine has been readjusted to ensure that there is higher focus on platforms and acquisition related business that has come from acquisition. So yeah, one could argue that it is not on the new business in the same product engineering business that we have always done. That said we are deliberately and systematically trying to morph our business from being 100% into product engineering to something, where the product engineering piece is going to be lower because we are going to increase the IP piece and other pieces that are also execution related, so some of it is going to be at the expense of product engineering business.

- Hari Haran** Just a couple of follow-up thoughts. So I want to reiterate that we are not acquiring assets or taking over products, in some cases that we have done in the past. We are not doing this only for the sake of revenue. So to be frank if we were to not do any of those we would still organically grow but the reason for these asset takeovers is two or three reasons. There are gaps and holes in our portfolio and if we were to build those gaps ourselves it will take us a very long time because we have an ambition to grow very quickly to fill some of these gaps it makes much more financial sense and economic sense to acquire those. That is reason number one. Reason number two in many cases when we acquire these assets there are some existing customers of ours that are involved so there are some synergies that come about there as well. It is all these reasons put together that we are following that strategy and we are not acquiring for the sake of revenue, it is primarily for the long term objective of rapid growth is why we are doing this. So it rounds out our portfolio.
- Moderator** Thank you. We have the next question from the line of Priya Rohira from Axis Capital. Please go ahead.
- Priya Rohira** My first question relates to your IP business if you could share on the pipeline in terms of the visibility while we have got a broader color that FY14 would be much stronger than FY13, but any specific area we want to highlight. Second question relates to the margin, along with Doyenz and NovaQuest do you think that Q4 could see a little more deflation in margins? And just one more point I would like to add on the first question, Q4 is seasonally very strong for IPs. Do we see a repeat in the current year?
- Anand Deshpande** Again let me not speculate a whole lot. All I say is that the pipeline on IP business is actually very good. There are several deals that are in discussion and are always in discussion. The unfortunate part on all these things is that it is never done till you sign the deal. So it is very difficult to predict exactly what is going to happen on them but yes we are working with some of the largest companies who have many products that are on the table all the time and they keep shuffling around, so till we sign it we cannot say what is going to happen. That said yes, we do expect next quarter to be better on the IP side. That is always been the case in the past and there is no reason why it should not be the case this quarter. Again there is volatility in IP so I do not want to put a number to the bank and finally regarding the margins, we do expect that if we see more IP and the percentage of IP is higher you will see better margins overall.
- Moderator** Thank you. We have the next question from the line of Nitin Jain from Ambit Capital. Please go ahead.
- Nitin Jain** What was the percentage of cloud, mobility, analytics, and collaboration a year back compared to 45% today?
- Anand Deshpande** Last quarter it was 40%.
- Nitin Jain** And what was the percentage last year?
- Anand Deshpande** We ended between 35% and 40%, so it has been growing up steadily.
- Moderator** Thank you. We have the next question from Abhiram Eleswarapu from BNP Paribas. Please go ahead.

- Abhiram Eleswarapu** Could you please tell us how much of the quarter's revenue was from inorganic channels?
- Anand Deshpande** 11.3% of our revenue was from new acquisitions and inorganic numbers.
- Abhiram Eleswarapu** So were you implying that the organic revenue actually fell considerably then quarter-over-quarter?
- Anand Deshpande** I do not know most of the growth this quarter has been completely organic. There is only US\$ 1 million roughly of Doyenz business. Rest of it is all from existing business. Some of it is IP revenue which as I said is about total 17.1% for the year, Q3 number is 18.2%.
- Abhiram Eleswarapu** My follow up question was I was just looking at contribution from top clients and it looks like the largest client is actually now quite big in the sense that more than 20% of the revenue. So is there a plan to sort of increase contribution from the rest of the clients? Is there an active thought on that process?
- Anand Deshpande** The answer is yes, but here is the situation. Lot of the one that we have from one large customer has come in from the IP growth as well. So as you might imagine we are going to existing customers and asking them about their IP portfolio and how we could leverage them and we think there is more leverage here as well. So I am not going to get immediately concerned if that number even goes higher in the next quarter but in the long term of course we are starting to have similar conversations with other companies as well and we think that that will give us some more things. So, not all of the business that we have from the largest customer is all Product Engineering Business.
- Moderator** Thank you. We have the next question from the line of Rahul Jain from Dolat Capital. Please go ahead.
- Rahul Jain** Firstly it might sound a little repetitive, just to understand the IP part of the business a little more considering that you have been saying that this should grow faster in the next year because this is the biggest delta in terms of our numbers, I mean in terms of profitability as well as revenue growth factor. So if that is the case what gives you that kind of confidence and would that necessarily mean a much better margin in the coming year?
- Anand Deshpande** The reason we feel optimistic about the fact that the IP revenue will go up in general is because of the pipeline that we see and the fact that we have had about a year or two with some of our large deals that we have done last year that have been performing quite well. So we are very excited about the success that we have had so far and we believe that we can do this on an on-going basis. So that is the reason for our confidence in the IP-led revenues.
- Regarding the margin I would like to comment and caution in the following way. See in the IP-led business unlike the standard services business how much you invest is potentially up to us, so we can choose to not invest but then you will have long term implications. On the other hand if we choose to invest extra in making sure that the product roadmap is better and updated, you might see longer term uptake in the revenue. So there is a little bit of this we have to figure out and learn. As a company we have been operating predominantly in the T&M mode for the last 20 years. Moving forward we have to make these decisions as we go along. So today at this stage in the third quarter, I do not want to make any comments

on next year's profit margin. But we all understand that cost of employment are going to keep going up, rates are not going to keep going up for the same kinds of things. So unless you do some different things like we are doing with sell-with, platform, specialization in areas and IP revenues our margins cannot be sustained. So I am just following the Laws of Physics right now.

Rahul Jain That is true but considering the fact that we are confident that it should be higher and obviously we would continue to invest, we are not saying that margins should be higher than the current level but the best of the margin which we have delivered of late in the quarters where our IP revenues have been good should be sustainable provided the IP revenue momentum remains intact which we see as of now.

Anand Deshpande That is correct and all of that you said is true. It is just that on the third quarter call today I am not going to go out and tell you that I am going to improve our margins. Let me be a little pragmatic here and leave it at that.

Rahul Jain And the other part we have been trying to say that there is some mainstreaming of some of the next generation technology efforts which we have been doing but so far the revenue growth contribution has marginally increased to 45% of revenue as compared to I believe 35% to 40% a year ago. So do you see this share to go substantially high and why if yes?

Anand Deshpande The answer to both those questions is yes, we expect that to go up, but when you talk about percentages it is always a dual question. If it goes up you will the expense is something else. Now the absolute numbers are going up and we will push those higher. We are very optimistic about how we see the business shaping up in cloud computing, analytics, and the other focus areas. We are also very confident about our positioning in the new markets that are happening. So as people start to make deployments happen we think we have an inside track on some of this new business that will come and some of these things just take a little longer in terms of how long it will take for these deals to keep closing. But there is definite solid momentum on an on-going basis.

Rahul Jain And just a little extension on the same, some of the larger guys have said that there are several small projects, I mean small is relative to the size of the kind of project one may pursue. So do you consider these to be small deals and several or you would classify these are decent size deals and there are plenty of them.

Anand Deshpande Our context of small from a large company to us there is always a difference. A US\$ 100,000 to US\$ 200,000 deal for us is not considered very small. So we will see a lot of deals and yes, so they will be in this range and higher.

Rahul Jain So, you subscribe to small and several kind of deals?

Anand Deshpande Yes.

Moderator Thank you. We have the next question from the line of Sandeep Muthangi from IIFL. Please go ahead.

- Sandeep Muthangi** I had a question on the sell-with business. Anand, can you give me some color on what happened with this business during the quarter and also the kind of outlook are you seeing for the next year?
- Anand Deshpande** The sell-with business this quarter was slightly lower than the previous quarter in terms of numbers specifically they are not called out in the way they are reported. Some of it has to do with project completion and the fact that they are project based, but it is a smaller base on which we are operating. In the long term or rather next quarter or the quarter after that we are already seeing pipelines are fairly strong. During the last quarter being Christmas, the holiday season, some deals were pushed around and so if you look Q-o-Q for sell-with it might seem that this is lower than the previous quarter.
- Sandeep Muthangi** Just a quick follow-up. See this business seems to be the primary way to play the technology game into cloud, mobility and all these things and given that this is a nascent market the buoyancy seems pretty high. To me it is just as if we are waiting for a tipping point in the future. I am just wondering when do you expect this tipping point to happen and the growth rates to really start mattering for the overall revenue growth?
- Anand Deshpande** Again, you are right on both those counts and we think that it will happen eventually. It is very hard to predict exactly which quarter it will happen but from various readings on the cloud that I can see and if you read the announcements from the large players specifically all the major guys you will find that in 2013 second half, 2014 first half, I would think that you would start to see more mainstream numbers.
- Moderator** Thank you. The next question is from the line of Mohit Jain from Trust Group. Please go ahead.
- Mohit Jain** Can you please repeat the revenue number which came from acquisition in this quarter?
- Rohit Kamat** NovaQuest acquisition happened almost towards the end of the quarter.
- Anand Deshpande** The date of acquisition is 31st December and people joined on 1st January so that number will only flow into this quarter. There are zero revenues on NovaQuest last quarter.
- Mohit Jain** So the 1 million number that you were referring to previously came from the cloud opening that we have had?
- Anand Deshpande** From Doyenz and it goes into the IP side of the portfolio. So it is counted in the IP revenues. NovaQuest will not get counted as IP. It will get counted as sell-with and platforms for the next quarter.
- Moderator** Thank you. The next question is from the line of Neeraj Dalal from Fortune Equities. Please go ahead.
- Neeraj Dalal** I wanted to understand one thing, what are the opportunities of mining existing clients since your revenue per client on an average has remained more or less flat for the past several quarters. So where do we see the existing client opportunity?
- Anand Deshpande** Good point and you can see that some of the larger ones have grown so if you look at the number of customers on the top-tier of our customer list you will see growth on those. We are also adding large

number of smaller customers with project sizes that are small. So very honestly I do not worry too much about the long tail. We are going to see that in our business and companies like Doyenz when we acquire we are going to get a large number of very small customers. They do not show up as explicit customers in our portfolio because they have thousands of customers at very small volume. It is a SaaS business so it is very different. So I am not too concerned on that but there is a huge opportunity from the existing customers and we have added one gentleman, as I mentioned, Ashish Pandit who has expertise in doing that and we are trying to find ways to grow our existing accounts as well.

- Neeraj Dalal** What I understand is one can assume that large part of the growth would be driven from new smaller customer accounts rather than the existing ones?
- Anand Deshpande** I do not want to draw that conclusion per se but we will see how it goes. We are not slowing anything down. We are pushing on all fronts. Whatever we get we will take.
- Moderator** Thank you. The next question is from the line of Madhu Babu from HDFC Securities. Please go ahead.
- Madhu Babu** Sir our hiring has improved substantially, so does that reflect volume growth outlook for the coming quarters in the services piece of business?
- Anand Deshpande** Yes.
- Madhu Babu** Okay and second, can you quantify what is the core CAPEX and what is the spent on IP and acquisitions, about 68 Crores?
- Rohit Kamat** Around 28 Crores was on CAPEX in the existing business in our existing facilities and 40 Crores was through acquisitions.
- Madhu Babu** So can we model, I mean, continually we are looking at acquisition driven to us, we would be spending 80 to 100 Crores kind of CAPEX every year?
- Rohit Kamat** See in terms of next quarter's position we will be spending about 30-32 Crores in terms of CAPEX. So this year it looks like 100 Crores.
- Moderator** We have the next follow-up question from the line of Kunal Tayal from Bank of America. Please go ahead.
- Kunal Tayal** I just wanted your sense on the dividend strategy. I think the payout has increased this quarter. Should we treat that as a one-time increase or sustainable?
- Anand Deshpande** For the last several years we have had this deliberate policy of trying to increase the payout ratio gradually but deliberately. So last year we did 19.67% payout ratio. We have done around 21 now. As we get the fourth quarter results, we should see the final dividend payout in the range of 21 to 24%.

- Kunal Tayal** Anand one more follow-up on your offshore realization which has been going up steadily, wanted to understand whether it is more led by increase in billing rates or just a change in your revenue mix?
- Anand Deshpande** Both meaning the billing rates on the revenue mixes are a lot better than the regular one. But we are not reducing rates on the product engineering business. That is actually going up steadily. But it is not going up by huge numbers, meaning see what happens today when a contract is up for renewal you can get between 0 and 3-4% increment on the rates offshore. But that will not reflect over a company growth as you see here. So a lot of this comes because we are able to build platform and other services at higher rates as compared to previous quarters.
- Moderator** We have the next follow-up question from the line of Srivathsan Ramachandran from Spark Capital. Please go ahead.
- S. Ramachandran** Just one quick question on the overall demand environment. Any change in the typical competitive landscape that you are seeing for any of the new forms especially out of Eastern Europe or India turning up more.
- Anand Deshpande** No, not like it is in Europe, but as we have mentioned in the past I expect that the real competition is going to come from the US market. There are lots of boutique firms in the US. Cost of product development is going down. You can build products much cheaper than you have built in the past. So this competition is not going to be in India or in Europe, it is going to come from US companies and that is one of the reasons why we are trying to significantly enhance our US work force, which is what have done with Doyenz, NovaQuest. We are more interested in acquisitions that happen in the US rather than those in India and other eastern geographies. We are not trying to compete for low-cost resources right now.
- Moderator** That was the last question from the participants. I would now like to hand the floor back to Dr. Anand Deshpande for closing comments.
- Anand Deshpande** Thanks a lot. Thank you all for being on this call. I am glad we are on time here and if you have any further questions please do not hesitate to send us a mail and I look forward to talking to you again at the end of our financial year and thank you very much.
- Moderator** Thank you gentlemen of the management team. On behalf of Persistent Systems Limited that concludes this conference call. Thank you for joining us.