Persistent Systems

Analyst Call

PERSISTENT

Persistent Systems Limited - Analyst Conference Call

Q3 FY15 Results

Date: Jan 27, 2015

Time: 05:00pm IST – 06:00pm IST

MODERATORS

Dr. Anand Deshpande
Chairman & Managing Director

Mr. Ranganath Puranik
President, Persistent Systems Inc.

Mr. Rohit Kamat
Chief Financial Officer

Mr. Mritunjay Singh
Executive Director & Chief Operating Officer

Mr. Amit Atre
Company Secretary

www.persistent.com

Moderator Ladies and Gentlemen, Good evening and welcome to Persistent Systems' Analyst Call. As a remainder, for the duration of the conference all participant lines are in listen-only mode. There will be an opportunity for you to ask questions at the end of this presentation. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

We have with us today Dr. Anand Deshpande – Chairman and Managing Director, Persistent Systems; we also have with him Mr. Ranganath Puranik – President, Persistent Systems Inc. joining from US; Mr. Mritunjay Singh – Executive Director and Chief Operating Officer; Mr. Rohit Kamat – Chief Financial Officer and Mr. Amit Atre – Company Secretary. I now hand the conference over to Dr. Anand Deshpande. Thank you and over to you Dr. Deshpande.

Anand Deshpande Thank you very much and I would like to welcome all of you to this first call of this calendar year. Wish you all a happy new year. We had an investor day on the 19th of December and this is a short period since we last met but let me just walk you through the highlights of this quarter.

So the way we will run this meeting, I will go through a quick overview of some of the highlights and then I am going to invite Ranga to give us an overview of what is happening from the US side and the sales side. And then I will have Rohit share with you highlights from the financial stuff and also details about the margins and various other movement of numbers. And then I would want to conclude by giving you a quick overview of what is happening in the market, our strategy and how we have positioned and moved in the Enterprise Digital Transformation space. So that is really what I want to do and then after that we will open it out for Q&A at 6 o'clock as planned.

So in terms of the revenue:

The revenue for this quarter was US$79.52 million which was in Rs.4,946.38 million. The revenue in dollar terms constitutes of 4.2% quarter-on-quarter growth and in rupee terms a 6.6% quarter-on-quarter growth. The profit after tax was Rs.744.62 million which is a 4.4% sequential quarter-on-quarter growth. In terms of the consolidated numbers for the nine month YTD, the US dollar revenue was 228.50 million, 13.4% growth and Rs. **13,937.99** million, a 14% year-on-year growth and profit after tax so far in the first nine months has been 2,145.81 million. So in addition to this, during the board meeting the board proposed 1:1 bonus share and there is a process for completing this which we will start and also the board declared an interim dividend of Rs.10 per share.

Some of the other highlights that I would like to share with the group here is:

We added two senior gentlemen to join the team on the US side. Dr. Siddhartha Chatterjee has joined as Chief Technology Officer in January 2015; he has a Ph.D. from Carnegie Mellon and a B. Tech from Kharagpur and has been with IBM for the last several years. And we also added Tom Klein as the General Counsel and Senior Vice President of Corporate Development, he was at the event during the Investor call that we had.

I am going to stop here and then hand it to Ranga Puranik to share with you a little bit about what is happening from the US side. And then I will have Rohit talk about the financial things and then I will close with some statements on the state of the business. Ranga?

Ranganath Puranik Thanks a lot Anand. Hello everyone, from California this is early morning here 3:30, but good evening ladies and gentlemen. It is exciting to be with you all to discuss our market outlook and Q3 results. Being the first call of this calendar year just wanted to wish you all a very happy year ahead.

As Anand mentioned we finished the quarter 79.52 with a sequential growth of 4.2% in USD terms. As you heard from Anand, we have been hearing from Anand over the last several months, we are strongly positioning Persistent as a technology-led company and are focused on working with customers as they transform the way they do their business.

Our Enterprise customer base continues to grow on the strength of our platform partnerships. Enterprises increasingly want to leverage their core data and application assets, operate as Digital platforms and drive innovation around how they engage with their customers, on board partners, get better employee productivity etc. This is core to the how of EDT that we are actively in conversation with several customers; we are beginning to win deals around building some cool new solutions in this space. That's one very clear trend that we have been seeing last quarter. Other couple of trends I just wanted to touch base on how Enterprises are transforming include, one is on the telecom operator side, net function virtualization it is called technologies are helping launch new Services in a very short timeframe. As some of you know we have done some cutting edge implementations in the API and the video, over the top technology spaces and this trend in the industry throws up opportunities for us to capture so we plan to revive growth in the segment around the new opportunities.

On another trend – we are actively tracking Obama Care implementation in the US especially which was opened up opportunities driven by what they call new ACOs that bring together the healthcare providers as opposed to Insurance company. This and the fact that EMRs are moving to the cloud is leading to new regulatory compliance requirements and hence significant opportunities for us. We have begun with a major player in this segment and the partnership that we had mentioned last time with Appian for example continues to build very strongly as an example of how we are trying to play in this space as well.

Our account-led strategy continues to be at the center of ensuring we expand and grow our named and growth accounts while winning new business. So we added about 32 customers during the quarter in our account-led and platform business. An example of recent success was that we recently won two large multiyear deals in our account-led model, multimillion multiyear deals. So we have also begun a program to help develop world class leadership in our AO process, AO is the account ownership process that we launched as of April last year and it has made a lot of progress in terms of how we are dealing and growing with several of these relationships. Given the pace of technology, I need to closely align with customer roadmaps, this is very critical and I think we have a big and a pretty strong initiative in that direction.

In our Accelerite business we added 28 customers. As you probably recall we had acquired this product called Radia from HP and now we are releasing what is called

Enterprise Mobility Management as the first major extension of that which basically adds mobile devices in mobile apps management for the Enterprise in addition to the end points around PCs. So that gives a very comprehensive EMM solution that we are planning to launch in the market. Also, as companies start to leverage cloud we are supporting through automation, new tools and Services to support migrations management, disaster recovery, data, and network visualization. So in that context we recently announced availability of a migration solution for Microsoft Azure as a service built around our in-house tool called Cloud Jump.

Our APAC and EMEA businesses have begun expanding with renewed focus on new countries and our trusted platform partner relationships as we move into this calendar year. Going forward, we are taking the approach of focused growth with our Digital Transformation strategy and specific bets on some of our accounts and platforms and our IP business as they can help to build significant scale given there is a lot of market demand. We are confident that our technology centric business model will help us grow in the coming quarters and position us as a strongly differentiated player.

So with that, thanks a lot for your time and attention. Let me pass it back to Anand and look forward to participating in the question answers.

Rohit Kamat Thank you Anand and good evening to all of you. It has always been pleasure talking to you. While Anand and Ranga have shared business updates and future outlook, I would like to give you more details about drivers of revenue growth, returns for margin movement and status of liquidity, CAPEX, and hedges.

The revenue grew sequentially 6.6% in rupee terms and 4.2% in dollar terms despite the impact of holidays and furloughs in Q3. Moreover, the revenue growth in constant currency was even better at 4.6%. As you know that we categorized our revenues broadly into two buckets that is Services revenue and IP-led revenue. During Q3 we saw broad based growth of 4.9% in Services revenue driven by volumes which grew at 5.9% while the blended billing rate dipped by 1%. If we further slice the Services revenue into onsite and offshore components, the revenue from onsite Services grew by 6.7% quarter-on-quarter mainly due to volumes growth while the onsite billing rates remained constant. Offshore revenue grew by

4% quarter-on-quarter driven by 5.8% volume growth and 1.6% dip in the billing rate. IP revenue recorded growth of 1.2% largely due to rise in Radia sales.

Now I will take you through the margin movement:

During the quarter we saw margin gains arising from better utilization, and favorable currency gains. However, increase in recruitment and training cost impacted margin by 40 basis points, actual provision for gratuity and long Services bonus pulled down the margin by 100 basis points and performance based ESOP schemes for senior management which we introduced in the quarter had an impact of 70 basis points on the margins. We had increase in spend on marketing and branding especially for the ADT Services which resulted in rise in S&M spend by 40 basis points. As a result of cumulative impact of all of this our EBITDA margin dipped by 50 basis points quarter-on-quarter.

During the quarter our treasury income was marginally lower at Rs.115 million as compared to Rs.119 million in the previous quarter, the exchange gain was also lower at Rs.130 million as compared to Rs.155 million in the previous quarter. As a result the PBT margin was at 20.1% as compared to 21.4% in the previous quarter. As regards to taxes, there was a tax credit for one of our overseas subsidiary amounting to Rs.17 million which reduced our effective tax rate to 25% during the quarter. The PAT for the quarter was Rs.745 million showing a rise of 4.4% QoQ and 16% year-on-year. CAPEX during the quarter amounted to Rs.109 million and it related mainly to acquisition of hardware and software. The cumulative CAPEX up to Q3 was Rs.487 million and CAPEX for Q4 is estimated as Rs.120 million.

Our cash and investments stood at Rs.8,166 million as on 31st December, 2014 as compared to Rs.6,868 million as on 30th September. The forward cover for exports as on 31st December amounted to Rs.111 million at an average hedge rate of Rs.65.34.

With this updates I would like to hand over the conference back to Anand for further discussions and updates.

Anand Deshpande Okay, thank you very much. Before we take questions let me walk you through some of the strategic directions that we have taken since the last quarterly meeting and the details that we shared during the annual investor summit in December. During that time I outlined our strategy to focus on Enterprise Digital Transformation. Let me reiterate a couple of points as context for what I want to share with you today.

First – our value proposition to customers and our differentiation in the market is based on technology and its role in the "how to" of the Digital Transformation process.

The second – The partner ecosystem we have has been built to strengthen this value proposition. Today I would like to draw your attention to what we are doing to implement this strategy around Enterprise Digital Transformation and highlight key steps as we have taken in the last quarter towards this. I will start with the statement and I strongly believe and why that is core to our strategy, without technology there is no Digital. Digital Transformation for Enterprises is undeniably linked to technology and has shifted to becoming a software driven business, this is the opportunity for us with our technology-led strategy and software product DNA. As you know we have a proven track record of building Products and platforms for customers who are in the business of software. With Digital Transformation Enterprises are now becoming software driven that is why the statement, without technology there is no Digital holds the key to the success for a Digital business. It reinforces the importance of thinking and acting like as a technology company. Digitally native business models are born unconstrained by legacy IT systems and processes. Established companies don't have the luxury of building from scratch or without legacy hence Enterprises must use technology to abstract, extract, and exploit the assets and data that can be trapped in their legacy IT to drive their Digital future. Doing this right will drive both scale and speed for such Enterprises. Our approach to Enterprise Digital Transformation is based on a technology centric approach for a platform approach to start from the middle of the Enterprise IT stack, this approach brings together technology such as API design and development with data abstraction to accelerate our customer's Digital Transformation journey. Many Digital businesses have data centric business models and we see data as a common denominator for Digital Transformation. APIs and apps have become the point of control, interaction, abstraction, or consumption for Digital business or simply put, the guts of a Digital business. These have become our focus for partnering as well as solutions and capability building combined with our strengths and early investments in smack technologies and commitment to agile methods.

Some important steps we have taken to implement our technology-led strategy and strengthen our ability to help customers in the 'how to' of Digital Transformation are:

1. Emphasis on full stack programming and employee development and training.
2. Commence companywide orientation and training on principles of experience design,
3. Strengthen our partnership with Apigee, a provider of API technology for Digital business and form a dedicated practice focused on API design and development.
4. And join the scaled Agile framework safe partnership program.

During this quarter we formed Persistent Computing Institute as an industry academia collaboration model to improve the quality of computers in science education and as I mentioned we also added Dr. Siddhartha Chatterjee as our CTO. We are very excited about our technology, roots and our vision and how it positions us for the market opportunity of Enterprise Digital Transformation. You can see that we strengthened our leadership team for this technology-led strategy to reflect the belief that without technology there is no digital.

With this preamble I am going to open it out for Q&A and we have some questions that we have received from Twitter as well, but let's take a few questions and then we will intersperse some Twitter questions in between.

Moderator Thank you sir. Ladies and Gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Omkar Hadkar from Edelweiss. Please go ahead.

Sandeep Hi, Sandeep here, thanks for taking my question, couple of questions here. One, on your strategy of you getting in senior people and bringing in the ESOP thing which Rohit mentioned. But the question is here which I have is that we are seeing consistent improvement and spend from US in terms of discretionary, now does that indicate that there is any increase in size of the deals which are coming, point one. And if yes then whether ample man power is available in India as we are also dependent on local recruit significantly that we execute in near term? So this was my part one of the question.

Part two, if you can add some light on how our marketing efforts are going on in the European region, I know it is fall for us but what is our course of action? Thank you, Sandeep.

Anand Deshpande Let me mention a bit on the deal size first. We are still early in the whole Enterprise Digital Transformation story and what we are seeing right now is essentially three phases of how deals are getting set up. The early deals are about $50,000 to $100,000 to get started; the next phase we see between $0.5 million and $1 million and then the third phase we think would be more around the $3 million to $5 million deal size. Now all these are pretty good deal sizes from our point of view, however they are much smaller as compared to very large IT modernization deals that maybe happening in the market. Now we do require full stack development activities as part of this Enterprise Digital Transformation that we are doing and in that context we have been training a lot of our people in the company on full stack programming activities. However for front end and other related skills we do expect higher local recruitment and more onsite consultants and people who would be required and their customer's location, so we do expect some of that to happen. I am not terribly concerned about rates for this kind of a business because potentially as we are providing better value one could charge more money, so margins itself are not issues, deal sizes will be smaller to get started.

Now regarding your second question on marketing in Europe, we have been looking at a few conference and other events in Europe but US tends to be still our major focus for the company. We have added more sales effort in Europe to having one person on the sales team in France and having a consultant in Germany. But definitely US is where our focus is at the moment.

Moderator Thank you. Our next question is from the line of Mohit Jain from Anand Rathi. Please go ahead.

Mohit Jain What should we expect in terms of your top 10 clients in terms of growth outlook, if you can give? And should we expect this trend of non-top 10 growing much faster than the top 10 going forward as well?

Anand Deshpande Yes, again this is a tricky question in some sense, let me give you a little bit of more detailed commentary on this one. So what we have observed and this is something we have mentioned in the last call, we talked about this during the investor meet as well. What we observe is that if you segment our customers at large into three segments, those which are born in the cloud, those which are born in the internet and those born pre-internet, we find that that there is an order of magnitude improvement in efficiency as you move from a pre-internet companies to internet companies to born in the cloud companies. So in this context many of the large customers that are there in the market are all under immense pressure from smaller, newer, nimble, agile companies and they are going to go through several changes as we look at the next 12 months to 15 months looking forward. That said, all of them are sitting on adequate amount of cash and will invest to make sure that they have reliable and credible Products in the market. So with this context what we see on an ongoing basis and we would expect to see this during this year as well is that we will see rapid changes in programs from all our customers which means we will see some dips and some growth on some of the large customers that we have. We will see adequate growth as well because these companies are going to find ways to invest their way out of this challenge that they have. So we will see a little bit of ups and downs on our existing stable business. That said, we know for a fact that we have to look at new and other exciting business opportunities, we are focusing through our platforms into a new area which is the Enterprise side and we expect growth in that area to grow. So we do expect that if you look at it in terms of percentage we do expect that the top 10 percent may go down by a bit in the next 12 months, predominantly because of growth on other accounts.

Mohit Jain And is it safe to assume most of your clients in the top 10 are from the pre-internet bucket?

Anand Deshpande That is correct because naturally they are the ones who have been outsourcing traditionally for a long time.

Moderator Thank you. We have the next question from the line of Kevin from Equinox Partners. Please go ahead.

Kevin Gallagher I had two questions, the first one was on hiring, I understand you are building up the workforce to be able to capture the Digital opportunity and my question was how is the pace of hiring for fiscal year 2016 compared to that of 2015? Is investing ahead process finishing up soon?

Anand Deshpande I am going to request Mritunjay Singh, our COO, to give you an answer on that question.

Mritunjay Singh Thanks Anand. See the hiring is we have done this year as per our target and going forward we are looking to add a minimum of 1,500 people. See there is a difference in the way we approach hiring these days, the market has become very volatile and cycle has changed dramatically now. So we actually do a monthly planning, we have an annual plan but we readjust the numbers on a monthly basis and that is the demand of the market today and we move much faster and take decisions much faster. So speed is very important so we hire people at a very short notice, so that is one thing. The second thing is that skill mix is very different, the law of technology shift is very different so we not only reskill our people internally, we also are looking for a different kind of people who can be skilled quickly on some of these new technologies that we working on. So a combination of these two is what our strategy is going forward and with this we think we are confident that we will be able to service our customer in this transformational journey that they undertake.

Kevin Gallagher So that 1,500 people number, what is the timeframe for that?

Mritunjay Singh This is a forecast for a year, as I said for the whole year. We are going to adjust this on a monthly quarterly basis as we go forward.

Anand Deshpande It could go up as well if it makes sense.

Kevin Gallagher And my second question, I wanted to ask about the transition about the CTO position, we are in the midst of an important technological shift towards Digital and I wanted to kind of get a better understanding of why we are switching CTOs part ways through this transition? Is this is just a shift in strategy, was there an opportunity that wasn't fully being captured before, would be great if you give some color.

Anand Deshpande No, actually we did not have a CTO, we did not have anybody designated as a CTO before that, actually every one of us thinks we have a CTO. But that aside, we thought it would be a good idea to get a bona fide CTO. So didn't have one, we are not changing one, this is a pure addition.

Mritunjay Singh Just wanted to add that one of the things we wanted to have somebody in the market and also being in the market it is much easier for him to stack what is going on in the industry.

Anand Deshpande Correct. So we had a choice of adding a CTO either in India or in the market that we are in, we thought at this time it would be better to have someone on the market side of things who can then help the India side as well rather than the other way round.

Moderator Thank you. Our question is from the line of Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain Just a couple of things, firstly on the scalability of the IP business, I mean we have been doing on the annual basis but we are sort of in the range of 14-15 million for some time now. So do you think if we have to scale to the next level maybe 20-25 million kind of run rate would it be more dependent on newer addition to the portfolio, all the current set of things can take us to those level?

Anand Deshpande No, absolutely we have to acquire new business to make numbers go up. We had as you know the predominant amounts of numbers that we are getting in our IP-led businesses are coming from acquisition of non-strategic projects from Products from our customers. So as we do some of that we do know that they are not going to grow dramatically. What I am pleased to say is that a product like Radia we have been able to take it up, we have been able to upgrade it, but in general, yes, we will have to go acquire other Products to make sure that our numbers are growing in that and definitely we are looking at several deals in the pipeline and we should see some in the next quarter.

Rahul Jain So if we have to do a check in terms of how all these investment have been paying us on independent basis and collective basis, yes, we have been growing more than 20% for some time but are most of the bets sort of giving equal kind of in distribution return or it is pretty skewed in terms of you giving multiple and rest going sort of dud?

Anand Deshpande No, naturally not everybody grows at the same rate, it is a portfolio, and there are some businesses that grew rapidly last year which did not grow much this year, so there is a mix bag in this one. It will be hard for me to share with you all the details at this time but if you have specific numbers you would like to know we would be happy to help you out. The largest of the ones that grew this quarter was Radia which is a significant part of our IP portfolio at this time.

Rahul Jain Sir what I am trying to understand, is there a learning based on our past experience or is it a very generic thing to look at?

Anand Deshpande No, so a couple of things on the learning side. So we have figured out and we know now that we have a methodology on what it takes to rejuvenate existing projects to look better, so that is one thing that we will be publishing a white paper on that pretty soon and we had some hint on exactly what we do in the investor meeting that we had, so we know how to take old Products and make them look better and feel better. Second thing we also find is that there are certain Products that after a point it is best to operate them on a high efficiency basis which means reduce the cost and investment on the new products development but focus a lot on squeezing revenues and so we have been categorizing our Products into different categories and some of them we are investing more and others we are actually not investing at all and we are just squeezing them for the last revenues that we can get out of them.

Rahul Jain I think the white paper thing would actually help us understand it better. There is another question in terms of, there is a recent transaction of Symphony which has happened I think based on the data which is given in the market, it was roughly around 2x of the revenue and last year we saw Global Logic transaction also happening. So what is you say in terms of how things are shaping up, why there is so much M&A ,and does it change the competitive landscape in any way in terms of new guys or bigger guys handling this?

Anand Deshpande No, I don't know exactly how it will change but what was very interesting and intriguing was the fact that Herman acquired Symphony Teleca and Herman would not be traditionally considered as an outsourcing company but very much a product company, so it is definitely along the lines that we find that many companies which are Enterprises want to become software-driven businesses. So as a company like Herman looks at becoming a software-driven business, it chose an acquisition route to acquire a company and a fairly large one at that I mean 8,000 people and all that stuff to make that transition happen. But we do expect many of our customer and we show this in many conversations that we have been having, there are many companies who are in a position who want to become software-driven businesses and that is really fuelling our Enterprise Digital Transformation story. So in some sense what we see in the market especially with the acquisition Herman acquiring Symphony Teleca we see this is very consistent with what we have been saying as the fact that Enterprises need to look at Digital technology in a big way and they have to find ways to get there.

Rahul Jain But in your opinion these companies go into like Herman does not change their overall positioning in terms of client traction and something like that?

Anand Deshpande I don't know what their moving forward position is going to be on clients and customers, we will watch and see this.

Moderator Thank you. Our next question is from the line of Srivatsan Ramachandran from Spark Capital. Please go ahead.

Srivatsan Ramachandran Just wanted to get your thoughts on the Enterprise Transformation that you are talking about. A lot of focus is more on domain or technology, what is your take probably Dr. Deshpande because on a technology front we are pretty strong but when it comes to say building deep domain knowledge be it in Financial Services or Retail or some of the verticals which seems to be forefront on adopting the Digital, just wanted to know would our incremental investments be more on domain than technology?

Anand Deshpande It is a loaded question in multiple ways. Overall, we have been technology centric and the fact is that when people are looking at Enterprise Digital Transformation, technology is a big component of what companies are trying to do, and many of the customers who we are dealing with are weak on the technology side, they know the domain on their site. That said, we do need to have people on our side who understand domain and not only domain they need to understand how that particular customer works. So just because you know Banking is not good enough you need to know how a particular customer responds in the Banking context, so a little bit of that is as well useful and we are looking at partners, hiring some people and some of those things. So yes, we are looking at making investments in domain expertise, especially customer centric domain expertise as we look out in the future. However, I think if we have to take a position on our strength being domain versus technology, the fact that our strength is technology and is an advantage at this moment because the people who we are working with already have a good understanding of the domain and are lacking the technology part of it.

Srivatsan Ramachandran My next question is from this whole transformation that we are going towards the Enterprise side, how do you see it impacting your margins for an 18-24 month period. If we have to look at what we have delivered in the first nine months vis-à-vis last nine months, we are down on average at the gross margin level about 300 bps. So just wanted to understand is this the way you would broadly look at it because as things stand now not as sufficient on S&M spend or not as efficient on direct cost or do we think this metrics can change to more favorable numbers maybe 18 months out?

Anand Deshpande See the thing is, let me comment a very quickly in the following way – So if you look at it in the long-term side, the value that we are producing in the Enterprise Digital Transformation area is significantly higher than just outsourcing work. Second, the competition that we are competing with potentially in the Digital Transformation space is very US-centric large companies. So again there is an opportunity for charging more, and we have seen trend of that within our existing Enterprise customers where we are selling better packaged Services. So the opportunity to get better revenue per person is definitely better on the Enterprise Digital Transformation projects than it is in another projects. That said, there are some short-term headwinds in some sense. One is that since it is still early days project sizes are small, gaps between projects are things that we have to worry about, and we are training a large number of people on some of these newer technologies. We are also adding people on the US side who are early in their game, so we will have additional capacity and higher bench on the US side then would be expected in a normal situation. So absolutely we think that there is opportunity to improve margin. We are not getting into low-end Services with low-end rates for this new addition to our business so absolutely we can improve margins. Now the second thing I would like to point out and this is a question that keeps coming in a different context again and again, should we be managing on the EBITDA level or at the profit before tax level, so just one comment on this one – what we find is that if we exchange our EBITDA numbers in some sense are very highly correlated to changes on the exchange rate. So if you see the exchange rate change dramatically impacts the EBITDA margin. And if you look at our numbers at the profit before tax or the PAT level overall for the last 10-15 quarters you will find that they have been maintained and been quite steady. So in general what we find is from our point of view the fact that we know we have US$111 million at 65.34 forward in the next 12 months should that be used as expense or should that be kept out is where the discussion has been. Our belief has been that that is the money that we know we are going to get at a certain rate and we should use it to spend in the business rather than hold it out as profit. So that is really how we have been operating it and I am happy to hear from other people on what their suggestions are or I will be happy to do a call with anyone on this issue. But I just wanted to share with you how we are operating on this, so we think that our margins have been quite steady at the profit before tax level and we want to maintain it at that level.

Srivatsan Ramachandran Just one quick question on ESOP spread, after quite a bit we are having a hit on ESOP so is it safe to assume that this is beyond the 10% pull that we had created that more or less exhausted and this is fresh dilution that would be happening?

Anand Deshpande Yes, that is correct. So we have a new RSU-based ESOP scheme that we have announced for some of the key executives, so it is a small number of people in the company and it is linked to their performance but more importantly linked to the company's performance. So there is threshold that needs to happen every quarter and if that happens then some of the senior rewards are linked on RSUs and other benefits to be linked to that. Irrespective of what happens on how those get distributed, it is just safe prudent policy that the accounting on it and all of those are being taken quarter-on-quarter so you will see that every quarter for the next few quarters, it is a three year scheme and that is sort of why it is happening. There will not be any dilution. ESOP Trust shares will be used for this and additional shares required will be purchased from the market. Now permissions for this were taken in the July AGM and we have those approved. There were some SEBI regulations that we were waiting on which got cleared in November so from 1st of October we have launched this scheme.

Srivatsan Ramachandran Sure. And just on the quantum, if you say 70 bps is about 3.5 crores on quarterly number we should look at it?

Rohit Kamat Actually speaking the impact is a bit higher this quarter, next quarter onwards it could be less than this, about half of this.

Anand Deshpande So the reason is that we started this thing from July but we waited for the SEBI guidelines to get through to really put it into practice. So two quarters of number has gone into this quarter's ESOP so it will be approximately half of this.

Let me just pause a bit here and I am just going to read out the questions we got from Twitter feed. This is one question from Rakesh Tribhuvan on what is the hiring plan for FY16? And I think Mritunjay already answered that question, so I will suggest that this question has been answered as about 1500 people that are being planned for FY16.

I want to also answer a question from Ankit Jain and I will have Rohit respond to that. So what is the CAPEX plan for FY16 and Rohit if you can answer to that then we will go back to the queue again.

Rohit Kamat Yes. Our budget for FY16 are actually in the process of getting finalized. Currently our estimate is about 100 crores of CAPEX for next year.

Anand Deshpande Can we go back to the board for questions now?

Moderator Sure. Our next question is from the line of HR Gala from Panav Advisors. Please go ahead.

HR Gala I just wanted to know that from the commentary it appears that we are becoming more an IP-led company. Now currently our revenue composition is roughly 80-20 between Services and Products, so say going ahead may not be next year but over a couple of years where do you see this composition?

Anand Deshpande No, so we have stated that we are going to definitely take it to 25% over the next two years and I think it is healthy to have a mix so we will definitely take it to 25%. The whole point of doing this is to not do it abruptly. So the idea would be to systematically keep growing the IP-led business but do it incrementally over the next four-five years.

HR Gala Okay, I appreciate that. Sir as far as the horizontals are concerned, we remain in this digitization space only with SMAC as the focus area?

Anand Deshpande Yes. See again what we have observed is that and this is sort of the theme for us this year as to do few things, Ranga has been calling it bigger, bolder, and fewer and the idea is to do a few bold things and stay focused on a few things. We think that Digital Transformation is a huge opportunity, it is a big market, it is very bold step, it is different from what we have done, and at this time trying to distract out of this would not be appropriate and doing few things and doing big deal out of small things would be the right thing for us to do.

HR Gala Okay. Just one observation from our results, this is more of a bookkeeping type of question sir that our unallocated expenditure that we show in the segmental analysis is a very high number related to the PBIT which we show segment wise. So what happens is, say for example in nine months our segmental PBIT was 592 crores whereas unallocated expense as net of income was 297 crores which is a very high composition. As a result what is happening that the PBIT percentage for different verticals that we can work out is very high, in fact we are not earning that kind of PBIT? So what will be your observations on that sir?

Rohit Kamat So actually unallocated expense comprise of G&A and sales & marketing expenses. So these are the common expenses incurred across different companies, across multiple locations and geographies and it is very difficult to allocate them to specific projects, that's why we disclose them as unallocated. So basically as spend is increasing the portion of unallocated cost is going up, but it is actually meaning towards the entire business so hair splitting and allocating it to specific business on ad-hoc basis also does not make much of sense. So all the identifiable cost are allocated to the individual business segments and those which are not identifiable are being disclosed as a separately as unallocated G&A and S&M expenses.

HR Gala Okay, I do understand that but just because the magnitude of that unallocated expenditure is very high I think it does not probably reflect the correct profitability of the individual segments.

Rohit Kamat No, so you have to look at the profitability of these businesses at the direct cost level that is at gross margin level.

HR Gala Yes, I understand. In fact PBIT what you are showing should be taken as a gross level only.

Rohit Kamat Yes, absolutely.

HR Gala And sir last question from my side, this nine month result has got a boost of 48 crores at PBT level because of the FOREX gain vis-à-vis 6 crores of FOREX loss in nine months.

Rohit Kamat Yes, that is because of our hedging policy, we hedge on 12 months ruling basis and depending on the exchange rate movement it will either get reflected at EBITDA level or at other income level.

HR Gala Okay. So this is a realized gain or it is because of the mark-to-market or something like that?

Rohit Kamat It comprises of various elements – it includes the hedging gains from forwards which mature during the quarter. It also would include the restatement gains because you have to restate all your foreign currency assets at the quarter end. And it also to some extent includes MTM gains.

HR Gala Okay, all put together?

Rohit Kamat Yes.

Moderator Thank you. Our next question is from the line of Deepesh Mehta from SBI Cap Securities. Please go ahead.

Deepesh Mehta Sir, transition to cloud and this Digital Technology appears to be not that smooth for our client also. So I just want to understand whether it is leading to any kind of less predictability for Persistent per se? And for last nine month whether at the beginning of year what predictability and related issues what we face, we are facing similar or it has come down or it has increased in magnitude for us?

Anand Deshpande I don't know what to tell you, but see as we have talked in the past right we live in a world of systematic chaos in some sense so there is a set of uncertainty but we know it is predictable uncertainty.

Ranganath Puranik Yes, a quick comment to add on that Anand and I think the Enterprises are spending more and more on technology-led transformation so I think that one thing is definitely emerging if that can help you look at this topic.

Deepesh Mehta Yes, it helps. The only thing is where we require some more clarity is whether things are smoothening out or it remains in the same kind of mode which we used to let's say at the beginning of year.

Anand Deshpande I would not say it smoothening out, I can tell you that there is a lot more activity. Activity has not gone down, there is very high amount of activity, customers are spending, and people are doing Digital Transformation. But yes, there is a lot of activity. We can take this off line, I can give you more color when we meet next.

Deepesh Mehta Sure. And the last question is about offshore billable volume – we are seeing last three quarters it has declined despite additions, so if you can help us whether we have seen any change in the mix between IP and IP Services and Services volume? If you can help us understand that mix change in offshore side?

Rohit Kamat See couple of reasons actually, large part of addition especially in this quarter was to our fresh trainees which did not become billable by the end of the quarter. So those were counted as non-billable. They will be allocated to billable pool only after the training is complete and it also depends on the trend and people getting allocated to IP and to Services because the disclosure about billable resources is only applicable to Services part of the business, their resource is getting allocated to IP also.

Deepesh Mehta Yes sir, I understood. What my question is in nine months offshore side we have seen steady decline in billable volume. So my question is whether we have seen shift in Services and IP-related thing, if any materials please let us know what is the shift we are seeing there?

Mritunjay Singh There is no material shift between these, if you look at overall the percentage our staff has not dramatically changed for the IP allocation. There are between quarter-to-quarter you will see some changes and that is about it.

Anand Deshpande And also the onsite percentage has gone up which is also causing some of the numbers to go up without necessarily offshore numbers, absolute numbers coming.

Moderator Thank you. Our next question is from the line of Shivam Gupta from Equirus Securities. Please go ahead.

Shivam Gupta So one question for Anand is that, what are you seeing in terms of as these Enterprises move towards their EDT Transformation in the roadmap that they design so where do Persistent today come in? Is it right at the stage when they are designing or is that the incumbent or maybe a general management consulting firm designs a roadmap and then we come in at the part of some SOW which is being bid out?

Anand Deshpande No, right now it is still early so it is coming in very early in the game. We are helping people design it. We are coming in after the customer has decided that they want to do something. So once they have decided that they want to do something that is sort of when we are getting called.

Shivam Gupta And the next one is around that this thing obviously our utilizations have gone up and thanks to the offshore. So can we just write in a way that last time when we won like 14-odd non-ISV companies so some of those deals are ramping up and they are fueling the offshore part?

Anand Deshpande Yes, and also the onsite ones.

Moderator Thank you. Our next question is from the line of Yogesh Agarwal from HSBC. Please go ahead.

Yogesh Agarwal Anand, just one question. You made a comment that we should look at the PBT margins and that has been rather stable over the past few years now but obviously the operating margins have come up, so a large part of the difference is the hedging gains or the FOREX gains we saw a few quarters which obviously will not continue over the next few quarters. So going forward if you are guiding for a stable PBT does that mean that the operating margins will improve?

Rohit Kamat Yes, it depends on what it is right. See there are two parts here. If the dollar exchange rate changes in the direction that it goes closer to 70 then our margins on EBITDA will automatically look good because of the way the exchange rate comes. So what I am saying is that there is a very high correlation between exchange rates and this thing. So second thing what we are doing is, the way we look at it and we can do a more offline discussion on this, we have a budget on which we are operating a budget without really factoring a whole lot of other things in it. So just the budget is on a rupee rate and how much are we spending in rupees against the dollar expenses and the earnings that we are going to make. So we have a sense on how much money we are going to be making on our operational side. We have some extra resources and money that we have available with us. Some of our discretionary spend especially in training and other things have gone up. Now we find that this timing has worked out well for us, there is an opportunity for us in the

Enterprise Digital Transformation space, and we are taking advantage of the fact that we have some FOREX available.

Yogesh Agarwal So you mean since there was a bit of a tailwind you took that opportunity to increase investments. So in that sense there is a leeway for you to go back on the operating margins if rupee remains stable where we are today?

Anand Deshpande Yes, absolutely there is a lot of room for us. See let me be very honest here, at the moment I do not see that many tailwinds to rather headwinds, I don't see a real problem in maintaining margins at this time, that's one. Second, that said, at least right now for the next 12 to 24 months my priority is on growth rate and not on margins.

Yogesh Agarwal Okay. And when you say maintaining margins it is PBT you are saying?

Anand Deshpande Yes.

Yogesh Agarwal Okay, got it. And just quickly I know it is early in the year but based on your conversation with your customers and all this the transformation which is happening on the Digital side, any color on the growth for 2015, any early expectation for you?

Anand Deshpande No, actually I am only focused on Q4 right now, I know we have committed a big number for our growth for this year and I think we have a shot at it so I am going to do everything to make sure we are fully thinking about Q4 right now.

Moderator Sure sir. We have the next question from the line of Ankit Pandey from Quant Capital. Please go ahead.

Ankit Pandey My question is just around the top customer, can we just go through what engagements are we doing with them, and there has been some decline with them over the past few quarters. So if you could just highlight what is exactly going on at the IP, at the Services side of the business and are there any new engagements on the Enterprise side?

Anand Deshpande I am going to be very brief in answering this question, we can follow up later. The largest customer is a very large company and they have been going through certain challenges on their side and they have been rearranging and readjusting their business portfolio and as a consequence of that we have had certain projects that have gotten cut in the last two quarters. Next year they have pushed out at least on the Engineering side a much more promising outlook and we expect some of these projects could come back so we are not giving up. They are a very large company so they do have cash and they are going to invest their way out of this problem so we do expect growth in the next quarter.

Moderator Sure sir. We will take the last question from the line of Nandish Dalal from IIFL. Please go ahead.

Nandish Dalal My question is to Rohit, you said that ESOP is pertaining to two quarters, other than that gratuity bonus and other recruitment business are they one-off or they will also continue for the remaining quarters going forward?

Rohit Kamat See, gratuity impact has come because of actuarial valuations. The interest rate went down and that's why the present value of futures liability has gone up. So that is typically for this quarter but depending on interest rate movement it may impact future quarters also.

Nandish Dalal Okay. And one last question to Anand, you said during the Analyst Meet your 4Q guidance was 86 to 88 million, do you stand by that?

Anand Deshpande Yes, we know we have to do about 10% quarter-on-quarter growth to get to 15% number. So it is like a cricket match, we know the last few overs the rate has gone up, but it is too early to give up there. So we are going to try our best and hope for the best. Let me not say too much more than that. It is possible to make the number, let me not say it is impossible. It is not so horrible a situation. We could make it but it is tough, let me leave it at that.

Moderator Thank you. I now hand the floor back to Dr. Anand Deshpande for closing comments. Thank you and over to you sir.

Anand Deshpande I would like to thank all of you for being on this call and for asking your questions. I would also like to thank Ranga for being up very early in the morning to take this call. And I would like to wish you all, all the best and hope to see you again on a similar call quarter from now. Thank you.

Moderator Thank you Sir. Ladies and Gentlemen, on behalf of Persistent Systems that concludes this conference call. Thank you for joining us, you may now disconnect your lines.