



Persistent Systems Limited - Analysts Conference Call

Q1 FY12 Results

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MODERATORS

Dr. Anand Deshpande

Chairman & Managing Director

Mr. Hari Haran

President, Persistent Systems, Inc.

Mr. Rajesh Ghonasgi

Chief Financial Officer

Mr. Nitin Kulkarni

Chief Operating Officer

Mr. Hemant Pande

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 Analysts conference call. As a reminder, for the duration of this conference all participant lines will be in the listen only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference, please signal an operator by pressing "*" and then "0" on your touchtone telephone. 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. We also have with him Mr. Hari Haran – President, Persistent Systems Inc. joining us from the US, Mr. Rajesh Ghonasgi – Chief Finance Officer, Mr. Nitin Kulkarni – Chief Operating Officer, Mr. Hemant Pande – Chief Planning Officer, and Mr. Vivek Sadhale – Company Secretary, Head-Legal and Investor Relations. I would now like to hand the conference over to Dr. Anand Deshpande. Thank you and over to you sir.

Anand Deshpande

Thank you Marina for the introduction. Good evening all of you and welcome to the Persistent Systems Analyst call. The way we are going to do the call today is that, I will give you a brief overview of the news release that we have just released after the board meeting. Hari Haran who is my colleague and Head of Sales will then give a sales overview. Nitin Kulkarni will give an operations update, Rajesh will talk about the financial items, Hemant will talk about some of the ratios. I will also give you another overview of some of the strategic items in the context of how we are planning the year and what we are trying to do, as I think some of that may help in addressing some of your questions and then after that, we will open the call for Q&A.

So let me get started in the context of our numbers and news release that we just announced. Our revenue for the quarter was \$50 million. That for us is a big achievement this quarter and it also establishes us as a \$200 million run rate company and we are quite excited about that. This 50 million represents a Y-on-Y increase of 26.6% and a Q-on-Q growth of 6.3%. The revenue in Rupee terms was Rs. 2,237.84 million representing a Y-on -Y growth of 23.6% and a Q-on-Q growth of 5.2%. The EBITDA was 401.06 million and Profit Before Tax was 400.34 million. The Profit After Tax was 275.68 million and this compares to the previous quarters number of 331.35 million. All these details are of course available on our website and revenue charts, so we will look at these again later as you have more questions.

Some of the key highlight that I want to identify is that we acquired the, the French chromatography data business of Agilent Technologies. We have co-invested with Life Technologies to develop instruments for the personalized medicine space. We have expanded our footprint in Japan through a strategic partnership with Realcom. We have announced a

partnership with CISCO for Quad, which is a new collaboration platform at the Enterprise 2.0 conference that was held in Boston last month.

In terms of updates from the AGM, Mr. Nitin Kulkarni who is the Chief Operating Officer was elevated as the Executive Director on the Board of Directors. The members have approved the final dividend of Rs. 1.5 per share; the total dividend declared for the financial year now is Rs. 5.50 per share including a one-time special dividend of Rs. 2 per share. This is as compared to the Rs. 2.50 dividend that was paid in the previous year.

With this introduction now let me hand it over to Hari who is calling from San Jose to tell us about the business side and the sales side for the business.

Hari Haran

Thank you Anand. We have started out the fiscal year with some good momentum on our strategy initiatives. Our investments on partnerships in the four key software vendors have begun to pay off. We added 31 new customers this quarter, out of which eight were addition through our partners. We expect this to help our scaling to get to the next level, which means helping in customer acquisition as well as growing our business in the cloud mobility, analytics and the collaboration area. We have launched a few transformational initiatives this quarter for this fiscal year to help our growth goals. Partnerships and the sell-with program are a key aspect of these transformational initiatives. Further, we started recruiting some high end technology consultants to help us have a richer engagement with our customers and enable a stronger mining of the accounts that are opened. This is the second transformational initiative.

As Anand indicated, we have also augmented these initiatives with the strategic acquisition of some key assets that will not only give us access to some IP but also add the right people in our delivery team, augment our delivery team in certain areas. We expect to do more of these in the coming quarters, so we can carve out a differentiated growth strategy. We are also able to see some growth in Europe and we are able to strengthen our funnel in Japan. Overall I must say that we continue to see the momentum and progress on our initiatives and we are optimistic that we are on the right path here for growth. These initiatives are long-term and we have taken particular scale in mind, as we had thought through these initiatives, so we know that it will take through the year for it to mature but we are pretty confident that based on the results in the quarter what we saw with some of the customers and the tractions, that we will continue to see this momentum and we remain optimistic.

Thank you very much, back to you Anand.

Anand Deshpande

Let me now invite Nitin Kulkarni to tell us a little bit about the hiring recruitment and other activities on the operations side.

Nitin Kulkarni

Hello everybody and good evening. In terms of the addition to the staff, we added close to 260 people in the last quarter. Our first batch of freshers joined us towards the end of the last quarter and as we look forward, we are seeing that the joining ratio for us has been almost 90% for the freshers, which is very good. We did some targeted hiring for our Pune SEZ because that was the new initiative that we started. Our attrition rates were lower as compared to Q 4 and the entire integration for Infospectrum as well as employees from Arion and Realcom were completed in Q 1 successfully. So that is a brief update on the operations side. Back to you Anand.

Anand Deshpande

Let me now invite Rajesh to give us some of the details on the financial numbers.

Rajesh Ghonasgi

In terms of revenue, we reached revenue of 224 crores versus 213 crores sequentially. And some of the cost increases on account of the 260 additional people during the quarter. Now the ratios have not moved much because revenue also has moved up and we have controlled the cost in that sense. In terms of sales and marketing we had two additional people. There is a marginal cost increase, so our ratio has not really jumped up much there. In addition you see there is the Other Income which has gone up and that includes a Forex gain of 6.4 crores and Other Income of 6.2, which is largely on account of the fact that interest rates have gone up over the last six months. In addition the standout numbers that we have here, which we have explained for the last one year, is that the tax regime has changed from 1st of April and currently our effective tax rate for this quarter comes to 31.1% as compared to just under 5% last quarter. So that is a major financial change. And we hope to make sure that that tax rate stays around 31 or is marginally lower than that using SEZ as a variable.

In addition to this to give some other inputs, if you have access to the presentation we presented the consolidated balance sheet in the new Schedule VI form. This is the form that has become applicable from April 1st this year. This is slightly different from the balance sheet that was published earlier. And just to give you some bits of information which would be of interest which is not shown here, earlier we used to show the hedge reserve. The hedge reserve on a like-to-like basis is 75 million in this quarter as against 79 million in the last quarter. This is the value of hedges that we have, the dispositive value sitting on our books. In addition, you will see there is cash equivalent of 1060 million of which 771 million is fixed deposit, the balance is cash. This was the last day of the month, so we had cash to pay salary that is why it is a large number. But 1060 million, a round number, was there in cash. In addition, we have investments which are fixed income, no risk kind of investments which sits in the current assets and that figure would be 217 crores. So if I take this 1060 million plus the 217 crores we have 323 crores in cash, which would be an interesting number you would like to have.

There is one more financial metric I would like to talk about. We had a total hedge of around \$86.25 million, we have a rolling 12 months hedging program and we decide on how much to hedge etc. using firm order and net cash flow basis. This \$86.25 million was at an average Dollar-Rupee rate of 47.39. In addition to this, if you see a metric, there have been some changes that we have done and I would request my colleague Hemant to walk us through the changes.

Hemant Pande

Thanks Rajesh. I just wanted to point out a couple of statements that we have in the fact sheet. And as we had mentioned in the last quarter's call also, it relates to the way we put things pertaining to the IP led business. Utilization and rates are only appropriate for a linear business. What we used to do earlier is, consider a particular rate for IP led business and then the inherent variability of IP led business used to impact utilizations. So moving forward, including this one, what we will be doing is, we are reporting the rates for linear business, so which is the time and expense in fixed cost business. And while calculating utilization what we have done is, that we have removed the investment made into IP led business from the billable count and the bill number when we calculate that, we are considering the bill resources in the linear business that we have and the resources which directly lead to the IP led business. So those are the changes that we have made and we have restated it for the previous periods also.

So with that I would like to pass it back to Anand.

Anand Deshpande

I thought I would just recap some of the stuff that we are trying to do and how some of these acquisitions align and what exactly we are doing, when we talk about personalized medicine etc. as that might help address some of the questions you might have.

So overall as we have done in the past, we continue to focus on the four technology thrust areas, these are cloud computing, analytics, collaboration and mobility. All of these have continued to gain momentum in the market and we are seeing continued activity and traction in these areas. We also have continued to invest in implementing and building new technology and IP in these areas. In addition to the normal product engineering business, which is the OPD business that we have traditionally done, over the last two years, more so in the last one year to six months, we have started to create new business lines around what we call sell-with, technology consulting, as two new business lines that we have created in addition to product engineering. In this sell-with business what we have done is, in each of these four areas, cloud, analytics, collaboration and mobility, we have identified a key partner, and we are jointly selling with their sales teams as partners in those areas and actually working with customers directly who implement new products and new technologies in their customer domain or in their particular business. We are doing it at two levels; one is at the high end through a technology consulting group that is doing consulting in these four areas and also doing sell-with arrangements with some of these

customers. So one of them we announced during the quarter was the partnership with CISCO's Quad group as part of their collaboration initiative. We already have a partnership with Microsoft and SharePoint, in which SharePoint and Quad is our strategy to sell-with, in the context of collaboration related activity. For cloud analytics, we have had a partnership for cloud with Salesforce.com and few other partners and some of those we have had excellent relations in the last one quarter to help in trying to grow these businesses effectively.

In addition to these we continue to invest in new IP. During the quarter we have made some good strategic initiatives and investments in specific IP, with one of our biggest customer where now, we have built connectors for more platforms and some of these will start to generate revenues in the last quarter of this financial year. So this quarter, it has been mostly an investment. We have also two new small products that we have built internally; one of them is called eMee which will get launched pretty soon. That is mostly a performance appraisal related and visualization related software and some others are also in the pipeline.

So that is the overall high level picture of what we are doing with respect to the four technology areas and how we are selling in the market. I want to spend a couple of minutes trying to share with you, the reason for acquiring the French software business and the life technology deal that we have invested in. As we have now for the last many years been working in the life sciences and related areas and we find that for us to become a significant major player in these areas, in addition to the technology expertise that we bring to the table, we will be far more effective if we are able to bring in domain expertise in these areas. So we have been building up our domain expertise within our company for the last few years but this whole opportunity of acquiring a 30 person team in Grenoble which has a very detailed and deep expertise on chromatography data systems was very attractive. And this team will start the acquisition process, which is underway and in the first week of August we expect this team to be a part of Persistent and this is the reason why we have created a French S.A.S. in France and we are going to operate this from Grenoble. The other one I want to point out is that we are co-investing with Life Technologies to build an instrument that will help in personalized medicine.

Now, just to give a little bit of an overview on what exactly this means. New medical treatments that are coming out, are observing that certain medicines especially the harsh ones such as chemotherapy and other drugs, typically work well if you have certain biomasses present in your system, some DNA sequences that are predetermined, if you have those DNA sequences then the medicines are effective, if you do not have them then the medicines do not work. Now, to identify those specific DNA sequences, Life Technologies has had a machine which has been in the research field for the last many years, so it is a leader in that market. We have been working with them jointly on trying to rebuild a software for this, so that it can get an FDA approval and

then can be used in clinical settings, where we believe that in about two years, we should be able to bring this instrument to the market where you can go to a hospital, get specific DNA markers identified and help on specific medicines that you might want to take. In addition to that, we have had a very heavy US footprint in the past. We realize that we need to increase our footprint in other parts of the world and in that context we acquired Infospectrum last quarter, which has a good presence in Nagpur which was aligned with our business in Nagpur and we have also added a set of people in Europe with the new business in Europe and that has helped us increase our European businesses here. We have also extended a partnership with Realcom, who is a player in the collaboration space in Japan, and gives us business in the Japanese market in the collaboration area.

So again all the work that we are doing it is fully aligned with these four technology areas. We are focused on product engineering, sell-with, technology consulting and the IP led business. And that is the overall strategy for the business and some of the acquisitions of research we are acquiring are essentially to allow us to become thought leaders or specific leaders in these areas.

Now, with this I want to just make two other points. One is that, we have already established a SEZ in Pune and in Hyderabad. New business that we are getting is being executed out of these SEZ's. But as one would expect a percentage of business out of the SEZ, is relatively low this year and we see this is as more an investment for next year rather than for this year. So while SEZ activities in full swing, the impact of the tax number on SEZ is marginal.

The other point I want to make is the pay hikes for this year, we had made a pay hike in the month of January 2011 and that was in the last financial year but we saw a significant improvement in the reduction of our attrition rates because of that pay hike. The next pay hike, we have announced already is from 1st of July 2011. So this will factor in this particular quarter as there was no specific pay hike in the previous quarter.

So with this brief introduction I think we would open it out for questions.

Moderator

Thank you. The first question is from Rishi Maheshwari from Eman AMC, please go ahead.

Rishi Maheshwari

I have the question for the last point on wage hikes that were supposed to come in. Was this earlier designed to come in from July or from Q2 FY12 or is that an aberration, that as a result of your recent pay hike in January you have deferred it from the 1st Quarter to the 2nd Quarter?

Anand Deshpande

We want to be reactive to the market and the conditions that the market comes up with and since we did a pay hike in the month of January this year, we thought it would be prudent to wait till July and not do these as of 1st of April and when we did the pay hikes, that we did in the

month of January, we had told our employees that that would be the case. So this is not a surprise. It is just that I want to make a specific point that the pay hikes will happen and has been already announced and rolled in from 1st of July 2011 for this Q2 FY12 and there is no additional impact from salary wages in the previous quarter as compared to the Q4 2011.

Rishi Maheshwari

So just to understand what could be the quantum of the wage hikes that you are looking at offshore onsite and what will be the impact on the same as a result on the margins?

Rajesh Ghonasgi

See, we had given the hike in January and currently we will give about 7%. The financial impact of that and I will give it in percentage terms, a shade over 2% in margin terms. So our margins will get affected from between 2 to 2.2% or so.

Anand Deshpande

Just to give you very specific numbers, salary hike for offshore business is about 7%, for onsite it is about 4%. Now, we have a policy of having appraisals for all the employees and that was done during the quarter. People were banded in three categories; the pay hikes are different for the three categories. Those in higher categories have higher pay raise and also it is a little more complex and depends on the current pay rate. So when I say 7%, this is the total salary versus new salary.

Rishi Maheshwari

In the light of it, you still stick by the guidance or the indicative number that you had come across and shared on CNBC a few days ago of \$220 million and expecting to keep about the same number and PAT that you had registered in FY11?

Anand Deshpande

We are giving the guidance of top line of \$220 million that is correct. And we want to make sure that the EPS that we had, which is the PAT that we had last year, we will maintain or keep that on a year-on-year basis.

Moderator

Thank you. The next question is from Viju George from JP Morgan. Please go ahead.

Viju George

I am trying to understand, in this quarter your margins have not gone up despite the fact that you have not given any wage hikes. Next quarter giving your wage hikes and the margins will probably come down to maybe 10% or so of the operating margin side. It looks like you will have to kick in 8% plus sequentially at least for the next three quarters on the top line, if you got to keep your EPS flat YOY as you indicated. Are you seeing that much of strength on the top line coupled with the cost management?

Anand Deshpande

Yes. You have the calculations and we have them too and that is what we are hoping to do actually.

Viju George Can you also just tell us if you strip out the contribution of Info spectrum in this quarter, what might be the organic growth rate Q-O-Q?

Anand Deshpande So this quarter's number was \$1.4 million is the Infospectrum part of the total number. I think they are counting quite a bit on the IP revenues to improve for the last two three quarters during the year, which is the reason why we think we can get our earnings EPS to improve. We have made some fairly significant investments in IP contribution through some of our key partners during this quarter and the next one. So we will continue to invest in the first two quarters but we expect an upside towards the end of the year.

Viju George Any particular reason IP revenues were down so sharply Q-O-Q is that seasonal, how should we interpret this?

Anand Deshpande It is seasonal. See what happens is there are two factors. I might as well link those. If you look at our top 1% customer and the dip on that top 1% customer and the dip on IP revenue you will find that there is a correlation between the two. And the reason that is the case is because a good percentage of our IP revenues come through building components, such as connectors and other things that our top customer sells as part of their portfolio. Now this particular product that we sell has some seasonality. We find best revenues for our customer, is in the month of December which is the year ending for them and that reflects in our earnings in January being the highest. So there is a seasonality that we see in Q4 of the year when the revenues for us, in IP led revenues are higher for this particular component which is about 60% of our total IP revenues.

Viju George One last question, how are you seeing the general macro-environment for your particular service lines? In the sense there is a lot of talk otherwise about the global macro and which I understand is the specific environment for your market, is it still looking up as maybe even three months back or are you sensing some hesitation from clients to give technology budgets?

Anand Deshpande No, actually they are not seeing any hesitation on technology budgets. We are seeing continued growth on existing business as well. We are actually betting very heavily on some of these sell-with opportunities, that we are looking at where some of our partnerships are very new. But from the meetings that we have attended with our partners, we find that that should give us a healthy upswing on our revenues and we are expecting better margins on both sell-with technology consulting and also on IP revenues.

Moderator Thank you. The next question is from Kunal Tayal from Bank of America. Please go ahead.

Kunal Tayal If I understood it right that, IP led revenues at 6%, you think that was only because of weakness in the top client and there were no other weaknesses in that business? And for the full year FY12, where do you see the IP based revenues contributing to the overall revenues?

Anand Deshpande There are two parts to answer this, firstly being in terms of the revenue implications for this particular quarter. Here let me give you a some more detail, we are reporting the percentage number that is the combination of about seven or eight components of IP revenues, which we get from completely different areas of business, 60% of our IP revenue in Q4 FY11, came from one particular customer, who happens to be our top customer. I do not want to name them but it is quite obvious. They are the top customer for us and we are building connectors for their products and they sell their products and we get royalty fee out of that particular product. Now that particular product sales has the best revenue numbers for the month of December, which reflects in our earnings for January and that is the Q1 of the calendar year for us and Q4 of the last financial year. And that number typically is down during this quarter and we expect that this is the reason why this quarter's IP revenue is lower than what it was during the last year.

Kunal Tayal For the full year how much could IP be as ...

Anand Deshpande So we are projecting about \$25 million for IP led revenues for the year.

Kunal Tayal Secondly, I wanted to clarify again I missed your point on the guidance, \$220 million on the top line and are you still seeing flat EBITDA and PBT margins for the year? And if you could explain the ramp up, we should see on the operating margin side, given that you also have a wage hike now?

Anand Deshpande See, it is a little complex in the following way. What we want to achieve is to really get our PAT which is Profit after Tax. Last year, we ended the year at 139 crores. All our efforts are based on trying to make sure that we make more than 139 crores in this financial year. Now that requires us to grow our top line, grow our bottom line, grow all the margins and all these numbers are a lot, of work for us for the next three quarters.

Kunal Tayal If you would have the quarterly annualized attrition rates handy?

Anand Deshpande Yes, it is about 3.2%. It has been a very low quarter.

Nitin Kulkarni What has happened is that the trailing 12 month has, as you can see has reduced significantly and that is because of the low attrition that has happened in this quarter.

Kunal Tayal Lastly any changes in the hiring targets for the year? I believe earlier you mentioned some 2300 gross hires?

- Anand Deshpande** That remains the same. There were 1000 fresh recruits and about 1200 to 1300 in the lateral recruitment, a net addition of about 1500 is what we are expecting.
- Kunal Tayal** Utilization rates 72%, do you think you can raise that on a more sustainable basis, maybe like 75% - 77%?
- Anand Deshpande** Yes, Absolutely. And the other thing is again this will happen over a period. So, we have some fragmentation in our business because of SEZ and other things, by which it has an impact on the utilization and it is very hard to squeeze it immediately but yes, absolutely there is enough room to improve the utilization and that is one of the factors we are working on.
- Moderator** Thank you. The next question is from Priya Rohira from Enam Securities. Please go ahead.
- Priya Rohira** Just wanted an update more on the performance of the four focus areas and how do you see pricing in those areas enabling your overall top line growth? The second thing is more to do with the American geography performance. Is it more to do with the seasonality of Q1 or do you see the product pipeline building up especially from your top 10 accounts?
- Anand Deshpande** For the four technology areas, we continue seeing a good growth and this is like we mentioned earlier, we had about 40% revenue which came from the four technology areas and that is the trend that we are seeing right now.
- Priya Rohira** If I am not wrong, Q4 was 42%, is that right?
- Anand Deshpande** Right, it varies in that range but it is about 40-41% right now and there is a little bit of plus minus that happens because some of the sell-with deals that we are doing are project based activities. But overall the activity level that we have in these four areas is actually very good. Some of the IP's that we had built out last year; we have announced them earlier this year. We were unsure in the last couple of quarters about the market for these IP's but now we have them in active consideration with some of the key customers. So overall we are very upbeat on what we see here. In terms of the US geography, why the percentage looks lower is more to do with the fact because of the IIPL and other business that we acquired in Europe and in Asia/India, those numbers have gone up relative to the US geography but the US geography in absolute numbers has gone up.
- Hari Haran** Yes. As we look at the pipeline in North America and actually in general global, the pipeline is strong. So the product pipeline and the sentiment from the customers have not slowed down by any sort and we are seeing this in the spending in their R&D. In fact we are seeing growth with some of the IPOs and various exuberance in the market. We continue to see that the technology

players are spending on R&D. So our pipeline continues to look good. Of course, we need to have the right rate of closure etc. which is more executing on our sell side, but the market itself looks quite good. Now, we understand that we have got to change the game and which we are into selling more of solution based and also selling at the higher end and that is why we have put together some of the transformational initiatives, such as high end technology consulting etc. that will help us have the type of conversations that we need to close the bigger deals. So as we see the tractions increasing that we are, I think we should be able to take advantage of the opportunities presented to us in the market. Certainly the market is looking good in North America and we do see the momentum.

Priya Rohira Just an update on the salary hikes. The onsite salary hikes and both offshore are effective July, right?

Anand Deshpande Yes. The onsite salaries are with respect to April 1, because we had not done a wage hike for them in January this year.

Priya Rohira A part of the impact would have come in the current quarter's margins, is that right?

Anand Deshpande That is correct. But the percentage of people who we have onsite is relatively low as compared to numbers.

Priya Rohira Just an update more on the Agilent acquisition of the software and marketing and development business which helps you in France. How many people would you have taken on board?

Anand Deshpande About 27 to 28 people.

Priya Rohira For the full year, we continue to maintain a 30% tax rate?

Anand Deshpande Yes, it will be in excess of 30%.

Moderator Thank you. The next question is from Rahul Jain from Dolat Capital. Please go ahead.

Rahul Jain If you can share growth in the respective four focus areas during the quarter?

Hemant Pande We have had about 9% to 10% growth in the respective technology areas, we can give you the details offline but overall I can tell you that the percentages as we had said of the business that we have this quarter in collaboration, in cloud we have about 12% of the business happening in those, and in mobility and analytics we have about 7% to 8% each.

Rahul Jain Just to understand the full year guidance and the possible growth in this particular portion, if you can disintegrate the overall growth into these two pieces?

Anand Deshpande I am not sure we quite follow the detail on your question. Overall growth rate, yes, we are looking at 220 million as our top line that we have indicated.

Rahul Jain I am trying to understand how much this 40% business will grow and how much the 60% business will grow?

Anand Deshpande When you look at large numbers, it is pretty hard to make a real impact on the immediate term but hopefully when you look at the end of the year, our thrust for these four areas should contribute to more than 40% of our business. Will it be 45, probably not, but it should be more than 40, and the rest of it comparatively speaking even though it will grow, it will then as a proportion of the 100 will come down from 60 to maybe 59 or 58 or whatever.

Rahul Jain I was just trying to understand from the growth because the growth in that particular space in general is much higher than the overall IT services. So I am trying to link the sort of outperformance or the higher growth we can deliver in that segment, where the industry itself is growing much faster.

Anand Deshpande Yes.

Rahul Jain Apart from that is there any further increment on the sales-with initiative in terms of when we can possibly monetize some effort there?

Anand Deshpande We have already started to monetize our sell-with efforts. So what we have done, as I mentioned earlier, is that in each of these four areas, cloud, analytics, collaboration and mobility, we have identified certain kinds of areas that we want to specialize in and we have identified leaders in each of them and we are working with the sales team to sell together with them. So for example, on the sell-with site in cloud, we are very closely working with some of the leaders in this area and we are working with their sales team to sell together in those areas. And in say, collaboration, I already mentioned to you CISCO and Microsoft are the two partners we are working with. We also have a partnership with Google on the search appliance and that together it helps us with the collaboration side. In the analytics space, we are focusing quite a bit on text and text analytics and we are also trying to do some work around Hadoop and Big Data, which is actually a new area that is getting very popular in terms of addressing some hard questions that cannot be answered by a standard dataware.

Rahul Jain If you can share more light on the co-investment on the Life Technology, in terms of what could be the investment cycle and when we can expect start monetizing on that?

Anand Deshpande That is a fairly long-term project. It will take about two years for the product to get released in the market. But while that is going on revenue stream for us, where we are responsible and partnering with them is for building out what are known as assay, they will start in another six months' time. We have already started to get customers together and that helps us open out a new set of customers, who are building assays on this equipment and we are already partnering with them to build out these products and those should start to come out in six months. See, this is more of a strategic initiative as well. One of the things that we have observed and I am sure all of you have tracked this as well, companies in India today are going to continue to have margin pressures. If we continue to do the same kinds of things our ability to charge more is very limited. So we have to find new methods of charging with customers, find new methods of convincing the customers that we are thought leaders, we understand the business and the domain and that is the only way you can charge more money in a long-term basis and we have to make these kinds of strategic partnerships and investments to allow us to be counted as thought leaders. So this is going to be work in progress all through the year. We will see more of these during the year and they will start to give results in the next year and the year after that. Not doing this, is not an option. So we have to do this and that is the strategy and we are planning to do it.

Rahul Jain So just as to understand what could be the investment, is it the number of people who will be working on it and what could be that number?

Anand Deshpande Actually the number is not quite disclosed right now but it is 25 to 30 people who are working on this project, some of them are at our cost.

Rahul Jain So this is the combined team size, some of them are on our rolls and that will be the kind of investment we will be putting forth?

Anand Deshpande At least to get started, yes.

Rahul Jain And gradually these number of people will increase?

Anand Deshpande It depends on the way it will work out. But, yes, it is not unreasonable, the amount of investments we are looking at.

Rahul Jain And the revenue would lack cost for some time?

Anand Deshpande Yes.

- Moderator** Thank you. The next question is from Sandeep Agarwal from Antique Stock Broking. Please go ahead.
- Sandeep Agarwal** I am observing your improvement in onsite and offsite pricing that is part of IP related revenue decline. And secondly if you can again please tell me the gross addition and net addition numbers, which you are expecting for FY12, that will be great?
- Anand Deshpande** Regarding the rates that you asked, we had an onsite billing rate of 13,033 which has gone up from 12,746 and the offshore rates have also gone up marginally. As we have mentioned to you, that we are trying to do these new kinds of business arrangements with our customers around technology consulting and sell-with. In these two kinds of business models, we are able to get better revenue per person and part of the rate increase that you will see from us, will not just be a rate increase because of charging more for a same services or by changing the service mix of what we are selling to our customer at higher rates, you will see a gradual improvement in our rate.
- Sandeep Agarwal** The second question was on gross additions, the fresher's plus lateral and net addition.
- Nitin Kulkarni** Fresher addition is about 1000 and the lateral addition is about 1200-1300. So that is why we said our gross addition is going to be about 2300. Net addition again, it's the function of the attrition and so now we are looking at about 1200-1300.
- Anand Deshpande** It's about 1400-1500 people of net addition to 2300 people in terms of gross addition, of those 2300 people gross, 1000 are coming on campus, fresh graduates and of that 1200 or so that we take during the year, they would vary depending on what happens. And again these are all numbers which we are giving you at this stage as we go along, we are tracking these numbers very closely and they are monitored and controlled on a weekly basis.
- Sandeep Agarwal** Two last questions, one is on the tax rate, what is the tax which you are expecting for the next year, that is FY13 and how are you seeing growth traction in the European region particularly?
- Anand Deshpande** Let me take the growth on the European region first. We are seeing good growth in the European market, but as you may appreciate we had very little market in Europe. So it will take some while for us to get that to be a very significant percentage of our business. We would like to see that number go upward of 10% but we are still quite far from that. But we are seeing growth in the European market. Just to give you a little bit more colour on that, what we have done is the Info spectrum group has a very good expertise in shipping, aeronautics and some other related areas. They have a good presence of customers in UK and also in Norway and the Scandinavian Nordic region and in addition to that, we have a partner in France through this

Grenoble deal now and one of the three employees from that company is moving into Grenoble and he will work with pharma and life sciences customers in Europe. And then we have a partner that we are working with in Germany as well. So, our strategy is to grow European business, is again a very specialized business that we are going after; there is shipping and other things in the Nordic Region, life sciences in France to Grenoble and for manufacturing and other business to UK and Germany.

Rajesh Ghonasgi

The second question you have asked about is the tax rate, I will just talk about FY12 first before I talk about FY13. You see our current quarter tax is 31.1, this is just one quarter. Over the next three quarters depending upon how well we push up traction, we make a traction easily, we would see a rate which will range between slightly more than 30% to somewhere near 32%, and I will just give that range as the rate for this year FY12. Going forward in next year a new DTC should hopefully having been passed and if it goes through as it is written currently, we should have a tax rate of 30% including SEZ, etc. somewhere between 27% to 28.5%. I am just looking into the crystal ball, which was again the amount of SEZ revenue profits to come in. The other thing I am hoping for is that there are no adverse changes in the tax law as it gets passed.

Moderator

Thank you. The next question is from Amar Mourya from Indianivesh Securities, please go ahead.

Amar Mourya

First thing I want to ask here is, what was the gross addition in the current quarter and if you can share the split of freshers and laterals with us?

Anand Deshpande

We will write that down and get back to you before the end of the call.

Amar Mourya

Second thing, if you can share the margin of these four new verticals, I mean what is the margin, we are seeing in this particular quarter?

Anand Deshpande

I think it's a little premature for me to talk about specific margins on these four areas. At the moment, they are still early in the business and they are comparable to the rest of the margins. We do not want to sort of break them down into smaller groups at the moment because it just becomes too complicated to maintain and continuously track these numbers.

Amar Mourya

Secondly, what I want to ask here is if we see the four verticals, they are so called the high end verticals and where we will need lot of lateral base. So do you see the pyramid going somewhere, the shift, and the things which we had spoken that on the pyramid is going to be aligned between the lateral and fresher that is going to be somewhere skewed because of this?

Anand Deshpande

So two points, I think that is a good point that you have made, but what we are trying to do is that we have a technology consulting group, which is predominantly a US based group. So some

of the high end or the laterals or senior people that we are likely to require for executing on both sell-with and on some of these technology groups or even for these kinds of projects that I pointed out, the senior requirements are more on the US side rather than on the India side. So it does not affect the India pyramid at all. It does affect the requirement of having onsite people, who have technology and hands on capabilities in delivering on these projects. But the good news is that you are able to charge higher rates for these people onsite in the US as compared to the normal rates of people that you put in and most of the people we are recruiting out there, they are being recruited locally in the US. So they do not have any visa related issues for sending people from India. So that factor is not really an issue for us at this time.

Anand Deshpande

One minute we got a numbers you were asking for, so Nitin will give them.

Nitin Kulkarni

The gross addition was about 545 people and we had an attrition of 211, so that will give you the net as well, the net was 384.

Moderator

Thank you. The next question is from Rishi K. from India Research. Please go ahead.

Rishi K.

I wanted to learn about this cloud transform business of yours. What kind of revenues you guys are projecting in the next quarters?

Anand Deshpande

See again, these are long term investments and it's hard to project a specific number in a specific technology area in our business because we work with a large number of customers. Deals are pretty small and they take a long time to incubate and grow. Overall on the trends side, I can suggest that the cloud computing is a happening area. We have partnered with pretty much the leaders in the cloud area. We are working with all the leaders and helping them build their products and we are also partnering with them in the sell-with side. So we feel like we are very well covered at least to get started and we are seeing good growth both in terms of growth on our existing projects with these companies and also in number of discussions we have had in terms of the sales.

Rishi K.

But acceptability from small and medium enterprises or from a big profit how is that acceptability right now because we have spoken to a lot of corporates recently, who do not want to shift from CapEx model to the OPEX model right now?

Anand Deshpande

I do not know who you are talking to but what we find is overall the deployment of virtualization cloud, sales force deployments, and all product companies that we are working with, small and medium and large, all of them are trying to find ways to make their products multi tenancy ready and also ready for the cloud. So at the moment most of our customers definitely are IACs and that market is definitely moving to the cloud. There is no question about it. Everyone is looking

for finding ways to do fine grain billing, how do you bill, how do you do license models that are appropriate for the cloud, how do you move infrastructure to the clouds, so all of this is happening in a big way. So I am not sure, where your data comes from, but we do not see any holding back from our customers in this area.

Hari Haran

I just want to add something to that. What you may be hearing is some of the large banks etc. are not necessarily moving their infrastructure hosting to a cloud model, but that is not the area where we operate, first of all we do not operate in the infrastructure layer, we operate in the platform in the software stage but more importantly many of these large institutions, they are moving certain very specific applications to the cloud and that is where the opportunity resides and large or medium size corporations, they have already started doing it because those applications would make sense to operate it out of a cloud. They are already doing it.

Rishi K.

I just wanted to learn if there was an independent Director called Prabhakar Bhagwant Kulkarni, who was holding around 11% stake as per the June 2010 shareholding background BSE. He is the Director in KNP Capital Services right now? Do you have any cross holding transfers in the last year from the same party?

Anand Deshpande

Let me clarify on that particular item. The way it works is, we are operating an ESOP Trust which is the Employee Stock Option Plan. The way the trust rules are set up and the way the Demat accounts for that trust have to be salvaged, they cannot be held by a trust, so there is an individual who is responsible for his name being on the trust. So these shares that you see 11% are actually Persistent' employee stock option trust and P B Kulkarni, who is a Director in the company, it's in his name because he is the Chairman of the trust and he is managing the trust as such. And that is all there is to it and there is no cross holding of any kind.

Moderator

Thank you. The next question is from Dipesh Mehta from SBI Securities. Please go ahead.

Dipesh Mehta

I have couple of questions, first about wage hike. I just want to understand promotion is done in Q1 or it would be part of Q2 cost? Second is about our bad debt. I just wanted to understand because this time, we have provided for bad debt as well as provision for bad debt. So just want to understand, how we are seeing that thing moving in next coming quarter? And one more question is about guidance, whether we are maintaining our operating profit margins like we earlier said it would be at the level of FY11. Thanks.

Anand Deshpande

Let me take the first question, which was regarding promotions. So the way we have it is that, we have a promotion policy that essentially allows promotions all through the year. A large number of promotions happened in the 1st Quarter, but the raise that happens through the promotion is not really very significant and it's very marginal. Promotions do not cause change in

the salary by much. Salary changes happened because of wage changes, which in our context is a little different from promotion. So it's a little more complicated than that. But promotion as such is kind of different from them and they are decoupled from the salary increment cycle. The salary increment cycle will happen in the month of July and that has already been announced before 30th of June and they know what their salaries are from 1st July. They will get paid from this quarter onwards. Promotions were announced for the junior levels in the month of June and another round of promotions for the senior people was announced in the month of July, effective 1st of July. We anticipate more promotions to happen during the year depending on the nature of the project and nature of requirements on the products. Promotion essentially means that, you are now responsible for taking a different responsibility. You are a group leader or whatever else, but that does not affect the salaries at all. Regarding your second question, let me have Rajesh, comment a bit on the bad debts question that you had asked.

Rajesh Ghonasgi

We provide bad debts on a certain formula and that formula is anything greater than 180 days gets provided for or if less than 180 days, if there is an issue with the quality of debt. The write-off that we have done is a separate entry, basically to recognize that some of these debts may not be collected. Since much of this is in the foreign currency, there is a FEMA, Foreign Exchange Management Act process, we have to get authorized and get the approval, etc., which we got this quarter. Now this entry does not lead to an additional cost because in effective we pass this entry and we reverse the earlier provision. So net off, there is no additional cost that we incurred this quarter. It is just an accounting entry, where a provision made earlier gets settlement as a write-off. Before it gets recognized as a write-off and issue separately, the earlier provision is also reversed. So in P&L terms this particular entry does not lead to an additional charge. I hope I explained it because it is more to do with the way FEMA works and the approvals that we require more than anything else.

Anand Deshpande

The last question that you had let me mention to you about the guidance. I will just reiterate that we had given guidance at the beginning of the year of \$220 million top line. We hold that same guidance for this year. We have also given a guidance, that we will make sure that our EPS is positive growth, which means that we had done 139 crores profit during the last financial year. So we have to make more than that, which would be at least 140 crores of net profit despite increase in our tax rate.

Dipesh Mehta

My basic question was about the margin perspective because if I take Q1, despite salary hike coming in July, we have seen a dip in growth margin, that is salary and software professional charges which have moved up significantly. So I just want to understand what sectors have led to the decline in the growth margin and what will drive our growth margin even after the Q2 salary hike?

Rajesh Ghonasgi Dipesh, I will just clarify this, you are talking about reduction in growth margin. If I see the growth margin and that is on Slide 8 of our presentation on the sequential numbers, our growth margin has moved by 0.1%, that is 10 basis points. The 37.4 to 37.3 and I think that is the ratio you are talking about, is that so?

Dipesh Mehta Rajesh, you are considering the Forex item, if I exclude other income and other Forex item then your gross margin has dipped.

Rajesh Ghonasgi The Forex is not included in the gross margins. So I am not sure where that comes in.

Dipesh Mehta In your presentation, I believe it is because otherwise if I simply do a calculation your EBITDA.

Rajesh Ghonasgi What you are looking at, is the schedule fixed balance sheet and P&L and we have given a separate working in our presentation which is on our website on Slide 8, which strips out the Forex into Other Income and it does not get considered in the gross margin or EBITDA anywhere. So I think that would give a better picture because this is a functional write up of cost and if I use this, our growth margins were at 37.3% for the quarter against 37.4 for the earlier quarter. Now we are flat in a sense but we also had additional revenues and we had a good volume growth. The reason why this is flat is, in fact if I take your point, this should have actually increased, is because one of our components which is the IP revenue has dipped from the earlier number, the last quarter's number by over 1.5 million and from our top client. Now the IP revenues are made to be variable and we actually want to have that variability come in because there will be ups and downs but this sum total is far higher than what we would earn on a cost basis. But these revenues, the IP revenues give us a much higher gross margin and hence that dip is what is listed here. If we had maintained that ratio or it had not dipped as much as it has right now from the IP end, our margins would have been higher as you are looking at it.

Dipesh Mehta I just want to understand the difference between the presentation slide number and the provided financial. I believe it is on account of what I just want to understand it because your EBITDA showed is around 401 and otherwise it is around 389 million.

Rajesh Ghonasgi Yes 401 is the EBITDA while 381 is the EBITDA for the earlier quarter.

Dipesh Mehta So the difference is coming from the provision written with?

Rajesh Ghonasgi No, it's not just from provision written-back, there is a whole slew of numbers. So you have difference of employee related expenses, purchases, travel etc. that is the reason why I looked at the ratios on the right. If you see the EBITDA ratio on the extreme right column, you will find that the EBITDA ratio is 17.9% for Q1 and 17.9% for Q2.

- Dipesh Mehta** So on a continuing basis, we should monitor which number? The presentation slide where you present it, or the reported?
- Rajesh Ghonasgi** Dipesh, I think maybe we should take this offline because I do not know which number you are looking at. There are two sets of papers. Number one is this presentation slide, where financial information, where expenses are split up into functional basis and another is the normal signed balance sheet which is in the Schedule VI format. So, I would suggest you look at this sequential growth because the behaviour of expenses is reflected here and this gives a better picture. The other part is the office report Forex, the Forex does not come and add up to the EBITDA margins or gross margins.
- Moderator** Thank you. The next question is from Anamika Sharma from IDFC Securities, please go ahead.
- Hitesh Shah** This is Hitesh Shah from IDFC Securities. Anand, you mentioned that US\$ 25 million is what is expected in IP revenues for the full year, with us having done just about \$3 million in Q1. I wanted to understand, are we looking at a step jump in next couple of quarters as well or most of it would be back ended?
- Anand Deshpande** I see quite a bit of it is back ended but we still think that we will make those numbers.
- Hitesh Shah** Like almost half of it should come towards the end of the year, is that a fair assumption?
- Anand Deshpande** Again to be very honest some of the IP led revenue will have some variability. There is a portfolio of multiple projects that we are working with and there are certain investments that we have made during this quarter, for which we know we will get some additional revenues towards the end of the year will it come in the last quarter of the last two quarters, it is hard for me say at this time.
- Hitesh Shah** I just want to understand what kind of visibility do we have? Do we get to know the next quarters IP revenue from the very beginning of the quarter because we kind of recognize it with a lag or how does it happen? I just wanted to understand the treatment of the same?
- Anand Deshpande** No we are not holding anything back, whenever we know, we are announcing it the same quarter and there is a little bit of a variability that we have unfortunately. I do not have as much visibility of it as I would like to see.
- Hitesh Shah** Secondly on the margin front, with about \$220 million of revenue and we having seen a margin of about 12.3% on an EBIT line against close to 15% last full year and also further guiding to about 200 basis point decline in margin are we looking for significantly higher margins towards, as a second half and what would be the key levers for that?

Anand Deshpande

We have to do better margins in the second half to make the numbers that I am telling you, that is quite obvious. And the two or three margin levers that we have, one of them is that the utilization numbers to go up. Second margin lever we have is the fact that we are selling different kinds of services such as sell-with, technology consulting and some of these other models which potentially allow us to get better revenue per person and some sense as compared to the current revenue model that we have. The third lever we have is, of course, the IP led stuff where we have made investments in this quarter and we are making investments in this quarter as well, which we think will give us much better returns in the second half of the year without having to invest in additional revenues for that and then finally we are hiring 1000 fresh graduates this quarter and those will start to feed into the system by the end of the year and that will also help us in improving our model. So those are the four margins levers that we have got. See overall it is a tough business to run all these kinds of things. There are many moving parts, but we feel quite comfortable that the market conditions are good. We are in the right spot and we are seeing a lot of activity and action. So yes, we think we can run this and manage our expectations that we are defining.

Moderator

Thank you very much. Ladies and gentleman that was the last question and I would now like to handover the conference back to Dr. Anand Deshpande for closing comments.

Anand Deshpande

I would like to thank all of you for staying and joining on this call. Thank you very much for asking insightful questions. We have all the data that we shared with you already on our website and if there is something more that you need, feel free to write to Vivek Sadhale, who is our IR Chief and we will be happy to send you any further questions you might have.

Moderator

Thank you Dr. Anand Deshpande and the management. On behalf of Persistent Systems that concludes this conference call.