

Persistent Systems Limited - Analyst Conference Call

Q1 FY14 Results

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MODERATORS

Dr. Anand Deshpande

Chairman & Managing Director, Persistent Systems Ltd.

Mr. Hari Haran

President, Persistent Systems Inc.

Mr. Rohit Kamat

Chief Financial Officer, Persistent Systems Ltd.

Mr. Nitin Kulkarni

Executive Director, Persistent Systems Ltd.

Mritunjay Singh

Chief Operating Officer

Mr. Vilas Kate

Chief Planning Officer, Persistent Systems Ltd.

Mr. Amit Atre

Company Secretary

Moderator

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

Anand Deshpande:

Thank you very much. I am delighted to share with you the financial highlights for the quarter that ended on June 30th, 2013. We have clocked a revenue of Rs. 3572.88 million representing a YoY growth of 18.8% and QoQ growth of 7%. In US dollar terms the revenue was 63.03 million representing a YoY increase of 14.8% and QoQ growth of 1.5%. The profit before tax was 803.12 million representing a YoY growth of 39.6% and QoQ growth of 11.3% and then profit after tax was 570.95 million representing a YoY growth of 37.3% and QoQ growth of 10%. We will share more details about this and some of this is already there in the fact sheet. Let me also share with you some other highlights that we had for the quarter. . So as you are aware we had acquired from Hewlett Packard a product called Client Automation which used to be called a Radia Client Automation Product. We launched this product at HP Discover as a Persistent product in the conference last month in June and we were named the finalist for IDG Computerworld's Honors Program in the emerging technology category for Big Data Innovation. We announced ShareInsights, which is actually a very cool site. You could go to www.shareinsights.org where we are taking unique problems to solve using our Big Data platform. We announced an end to end public, private and hybrid enterprise cloud lifecycle solution at the OpenStack Conference. We have extended our presence in Africa, especially North Africa through a partnership with SysCare Technology in Morocco and then we have announced a strategic collaborative initiative to promote inclusive innovations through a conference that is being held in December 2013. We also had a board meeting today, followed with an Annual General Meeting and all the resolutions that we had, have been approved unanimously. The shareholders have approved a final dividend of Rs. 3 per share for the financial year 2012-13 and the company had paid an interim dividend of Rs. 6 per share. The total dividend for the Financial Year 2012-13 was Rs 9 per share. I would like to also mention that Mr. P B Kulkarni who has been a board member of the company for a very long time since 2001 onwards, has retired by rotation and he has not been replaced but he has retired. Dr. Dinesh Keskar who is from Boeing has been given much more responsibility as Senior Vice President Sales for Asia which includes India and most of Asia Pacific countries. So he has decided to resign from our board with effect from today. So with these announcements, I am going to hand it to Hari for introductory remarks on what we see on the sales side and then I am going to have Rohit give you a little bit of financial overview of the numbers and then I will follow up with some very specific things which we think you might ask, so trying to anticipate a little bit of the questions. So let me now request Hari to share with us what quarterly commentary is from the US side.

Hari Haran

Thank you very much Anand. As always it is a pleasure to have the opportunity to speak with you about our quarterly results along with updates on key front end activities and the market trends. As Anand indicated we registered an overall quarter over quarter growth in US dollar terms of 1.5%. I want to highlight that we had set out to do much higher than this in Q1. Let me add some color here on the less than expected growth. A good portion of the IP revenue coming from the HP Client Automation, the Radia product, it shifted to future quarters due to delay in on-boarding customers. Basically the contract papers that were in place with HP they have to be transferred to our papers and there was a delay in that process. Our top-line growth would have been much larger had we on-boarded the clients as per our forecast. I want to reassure that we do not see any structural weakness in the flow of the HPCA IP revenue. All we are seeing is a shift of these revenue stream by about three months or so. Factoring this into our analysis, we still see a good year ahead. From the last quarter, we are beginning to see good traction in the accounts that we have acquired through NovaQuest. We are systematically mining some of the NovaQuest enterprise accounts. In Q1 we saw a growth of 4.5% on our engineering and platform side. During the quarter we opened about 16 new accounts out of which two are large multibillion dollar accounts. Our investment into the platform business is beginning to give us dividends through good growth. We are continuing to see growth in our pipeline quarter over quarter. Given some of our recent wins as well as the pipeline, we expect to grow well on our engineering and platform sides as well. Now coming to the market front, we are seeing enterprises and independent software vendors beginning to increase their spend budgets. The industry is experiencing a shift in the software landscape due to trends in Cloud Computing, Big Data and Mobility. Enterprises are looking at bringing next generation products to market which have a dominant software component. This presents a tremendous opportunity for engineering services company such as Persistent Systems, where we have a strong product DNA. We see the product engineering budgets for these enterprises to grow over time. We also see opportunities for developing various platforms for independent software vendors and in that note we will continue to expand our sell with strategy for these platforms. Cloud Computing, Big Data Analytics and Mobility continue to be the areas where we are seeing a lot of traction with respect to opportunities. We saw a double digit growth in revenue Q-o-Q coming out of these areas. We have invested at least 20 more headcounts in sales and marketing and I would like to add that we expect to invest more in this quarter in this area. Our partnership with SysCare in Morocco is beginning to contribute to our global pipeline. We are in the final stages of our plans with respect to investing in a near shore development center in the USA; stay tuned to that space more to come onto this in the future. Enclosing we continue to see our vibrant and exciting market. We remain optimistic about our ability to capitalize and execute on the opportunities presented by the market. Thank you.

Anand Deshpande

Thank you Hari, Let me now request Rohit to give a little bit of a financial overview of the numbers and charts.

Rohit Kamat

Good evening everyone. While Hari has explained the growth dynamics of the business I would like to give you some more details of revenue in terms of volumes and billing rates. The overall increase in the revenue from products engineering and platforms was 4.5% comprising 3% volume growth and 1.5% growth in billing rates. Our onsite revenue for the quarter increased by 14.6% comprising 10.5% volume growth and 3.9% growth in billing rates. The offshore revenue for the quarter grew by 1.6% comprising 2.3% volume growth and a drop of 0.8% in the billing rates. You are aware that our IP revenue is volatile Q-o-Q and provides better visibility on yearly basis. IP revenue recorded an increase of 24% Y-o-Y while it dipped by 12.9% on a sequential basis. During the quarter we ramped up our headcount by about 174 resources net. We

applied for 260 H1-B visas out of which 184 were selected for processing. We effected a pay hike in USA of around 3.5% effective 1st April. We hired some key employees from the R&D team of HP and incurred cost associated with HP knowledge transfer. As a result of this initiative our direct cost increased by 150 basis points net. We strengthened our sales team in the US by adding 20 resources. This along with a provision for doubtful debt of 29 million, caused an increase in SG&A expenses of 160 basis points. Due to these two factors that increase in direct cost and increase in SG&A expenses our EBITDA margin was at 21.8% as against 24.9% in Q4. Capitalization of licensing rights acquired in connection with HPCA deal led to 60 basis points increase in amortization charge. Our investments generated a treasury income of 80 million in this quarter. Due to sharp depreciation of rupee against US dollar there was a net exchange gain of 183 million. As a result our profit before tax increased to 803 million as compared to 722 million in the previous quarter. The profit before tax margin improved to 22.5% from 21.6%. Effective tax rate for the quarter was 29%. Profit after tax went up to 571 million as compared to 519 million in the previous quarter. PAT margin improved to 16% from 15.5% in the previous quarter. The diluted EPS for the quarter amounted to 14.27 recording a growth of 37.3% Y-o-Y and 10% Q-o-Q. Additions to fixed assets amounted to 1022 million comprising tangible assets of 127 million and intangibles of 895 million, which included HPCA which was under capital work in progress in the previous quarter. Actual outflow towards Capex was 201 million as payment towards HPCA acquisition will be made over next two years. Our cash and investments stood at 4571 million as on 30th June. The Forex cover in terms of forward contracts was at 106 million at an average rate of 58.17. With these updates I hand it back to Anand.

Anand Deshpande

Let me also throw a little additional color to highlight two specific points which I think are worth noting. One is that yes, we have a 1.5% Q-o-Q growth in US dollar terms, but when you split that into two parts, this is how we would look at the numbers in how we are reporting them. So products and services part of the business grew by 4.5% and the IP business dipped by 12.9% Q-o-Q. So we are very happy that these products and services business has grown 4.5% which is an important thing to note and the fact that we have a 12.9% dip on the IP led business, it is not really something that we are concerned about for two reasons. One is if you look at the numbers for IP led business, we have a 24% Y-o-Y growth in US dollar terms and we have known this for a while that the IP led business and the way the deals are structured with our largest customers, we get much bigger IP led royalty and other business in the last quarter of their financial year which is say calendar quarter, so Q3 and Q4 is when you see benefits in the IP led business. We also know that the Radia business, which is the HPCA business has just started to contribute to our revenue lines and we have a significant upside planned towards the second half of the year on the Radia business. So even though there is a 12.9% dip on the IP led business Q-o-Q, overall I think it is a fairly healthy IP led business for this quarter and moving forward we think for the rest of the year this should look by and large pretty good. So that is regarding the 1.5% growth.

The second point that I think is worth noting is regarding investments. We are seeing a lot of activity in terms of our platform related business. There is a buzzword around SMAC which everyone is talking about. We are extremely well-positioned in these four areas including having the right partnerships, discussion with customers and real people who have done work in these areas. Considering the excitement and the opportunity and the pipeline that we have seen, we have gone ahead and invested both in sales and creating capacity. That capacity creation has caused the utilization numbers to look like they have gone down but this is deliberate because we wanted to invest in platforms because we see growth for the next few quarters in these areas. We have also upgraded the sales team in terms of hiring senior people who are in a position to

sell solutions around the SMAC platforms and that has caused an increased investment in our sales expenses. So thankfully we have had the benefit of a depreciated rupee and while that has been going on we chose that being the first quarter the fact that we have a depreciated rupee opportunity and the fact that we are seeing the pipeline and healthy activity, we chose to make some investments both in sales and in creating capacity which I am sure you will agree the right thing to do at this time. So with this I am going to stop here and take questions.

Moderator:

Thank you very much Sir . Ladies and gentlemen we will now begin the question and answer session. We have the first question from the line of Kunal Tayal from Merrill Lynch. Please go ahead.

Kunal Tayal

Anand my first question is on the IP side of the business, while we do understand that it is volatile and the Y-o-Y growth rate is still 24%, I just want to understand that if with any of your particular products there is an issue with because like you yourself highlighted that Q4 otherwise is a seasonally strong quarter so last quarter was weak for IP followed by this quarter's weakness again. And then second question is this 24% growth in IP, could you just split that into what is the organic growth rate there, so just to get to a better sense as to what the existing products are doing?

Anand Deshpande

The new business that we acquired during the last quarter was the HPCA part of the business and that has contributed a very miniscule amount to this quarter's number. So a lot of the business that we are showing here is from business that we have from the TNPM products that we own, royalties that we have from one of our largest customers, the location business and the rCloud business, if I want to call them organic now we had them for more than three quarters. So that is sort of how most of the business is, so it is pretty much an increment on the existing business that we had last quarter. So there is nothing that was new that was acquired and has come into this quarter's IP revenue. So I am not trying to read a whole lot into the fact that there is a little bit of an up and down on the Q3-Q4 part of the business. Overall we see a significant growth in all the four areas, TNPM, location, rCloud and Radius. Also we will have the new Radia business starting to kick in from the next quarter onwards. And just to explain how the Radia business is set up, the arrangement is that we have acquired the product from HP. We now own that product. We started to spend on the products in the sense that the team is entirely ours now and we are investing in the roadmap for the products which we announced during the conference in June. So the costs have already started to come into our books starting this quarter and you see an impact on that in the profitability of the business. So the way revenue starts to come to us is that whenever a customer comes to the end of their license – so these are all annual maintenance contracts which are renewed yearly. At the time of renewal they come to us. So till then HP continues to get the revenue that they have already accrued in their books when they got the AMC contract renewed. So there is a stepped function every month, you will add more and more customers to the list as they come up for renewal, so this is by design in terms of how this is going to look. In the first year we will see a ramp up as we go along.

Kunal Tayal

On the product engineering side if you could talk a little more as to what is the cost uptake, is it more of the SMAC tag related projects or is it like you were mentioning that your R&D budgets itself are going up, so was that the bigger driver here?

Anand Deshpande

So overall as we had mentioned in the last few calls, there is definitely the trend that when you work on a newer technology you require far less people to do the project. So that trend has not changed and I am

convinced that this is for here to stay. That said, we have seen growth in our services business predominantly driven by the SMAC tag, both because these platforms where we are doing sell with technology and some of our existing accounts where customers for whom we may have been doing other things now are starting to add in addition to their current work, some work in the SMAC areas. And the fact that we already worked in that area has helped us get that business. I think it is a healthy growth both in terms of what we expect and it is a fact that we have to go find your deals with either existing customers or new customers because in general our deal sizes and the fact that it requires less people to do the job, both those trends will continue to be trends as we go along.

Moderator

We have the next question from the line of Sandip from Edelweiss. Please go ahead.

Sandip

Couple of questions – first on the business side. I agree to your point that we cannot see the IP part of the business in every quarterly manner but if you can throw some light on the North America part, but I think Hari has given a good description but if you can add some more value whether you are really seeing a good pickup on the discretionary side of it. And then second question with Rohit, he actually gave a very good description of the numbers but I think he was a bit fast when he was giving the breakup of volume and pricing on the services part of the business and product part of the business. And also if Rohit can provide some more data on why we lost some part of the margins in spite of such a huge movement in the rupee part?

Anand Deshpande

Correct, so let me first comment on the fact that yes we are seeing lot more activity in North America and we think that as we look at the rest of the year we are going to see more and more US driven activity. So while we are looking at Europe and all the other areas I do expect that the North America or American part of our business should dominate at the expense of potentially European and other business. Just because there are so many opportunities in the US that it just makes sense for us to be there. And a lot of the senior sales guys that we have hired are all in North America. So our dependence on North America may seem like it is growing but this is how it is at the moment.

Rohit Kamat

In terms of volumes and rate split, onsite revenues for the quarter increased by 14.6% comprising 10.5% volume growth and 3.9% growth in billing rates. The offshore revenue grew by 1.6% comprising 2.3% volume growth and a dip of 0.8% in terms of billing rates. So overall business from product engineering and platforms grew by 4.5% with 3% volume growth and 1.5% growth in billing rates. On the expense side, we had a number of things which have happened. Some of them are a sort of one time for this quarter. For example, we opted to apply for an additional number of H1B visas in view of the Immigration Bill. So the additional visa cost that has impacted margins by about 140 basis points. Secondly, the utilization of resources, the 250 basis points drop in utilization. As Anand explained we had invested in terms of platforms and that had an impact on utilization. So that has impacted overall margins by a 80 basis points. HPCA additions of resources and knowledge transfer expenses have impacted by 40 basis points. On the S&M side we have added senior resources, which has led to 110 basis points increase in S&M cost and in terms of doubtful debt provisions you will see this quarter we had made a provision of 29 million as against last quarter we had reversals, so the impact of that is 120 basis points. Now this has been compensated by currency gain at an EBITDA level of about 180 basis points. So overall you are seeing a drop of 310 basis points at an EBITDA level net of currency gain.

Moderator

We have the next question from the line of Rahul Jain from Dolat Capital. Please go ahead.

- Rahul Jain** The Europe revenue in the quarter is at \$3 million which has reduced dramatically over what we used to do in FY12 and FY13 and it has reached a run rate as low as 9-quarter low. So is there any specific reason to reach demand in that aspect?
- Anand Deshpande** I think this is regarding the European business that we have. See as you are aware we do not have a whole lot of European business in our portfolio. The European business is dominated by a small number of customers and in one case we have completed a project and in another case the customer is not doing well at all. While it is hard to say, if it has anything to do with them being in Europe, it is just that the product has been around for a while. They have not invested; they are running out of cash. So our teams have gone down on that particular project in Europe. So that is the situation. So I do not think it is anything that I would read this as being indicative for the market or trend wise. It is a fact that we had a few customers and two of them have not done well for us. Looking forward, we do have a small team in Europe. We are trying to add there but just looking opportunistically I am seeing lot better growth opportunities in the North American market, so we are just going after it. Let me be very candid here.
- Rahul Jain** Just some reconciliation on the margin front. As you have given various reasons of this impact of close to 310 bps on various factors, so if you could explain in anticipation of what are the likely expenses that could come on Q2 on a like for like basis and what should be the margin gain considering the same level of currency rate?
- Anand Deshpande** So Q2 the major impact would come from offshore salary hike. Typically our offshore wages increased from 1st of July. On the visa side actually we would have no additional costs coming in during Q2. Then another factor is we would have campus people joining. So there would be some pressure on margins due to these factors. So we are expecting incremental revenues from HP. Currency actually is difficult to predict but as the revenues grow from Q2 onwards we will see margin impact receding.
- Rahul Jain** Q2 ideally should be lower and then Q3 onwards it should come back, is it?
- Anand Deshpande** Yes, that is correct.
- Rahul Jain** So, any count number of people joining in Q2 on the fresher side?
- Rohit Kamat** Yes, through campus actually we are expecting about 500 people to join, they will be distributed in Q2 and partly in Q3 and lateral recruitment will be based on business needs.
- Moderator** We have the next question from the line of Nitin Jain from Ambit Capital. Please go ahead.
- Nitin Jain** The first question was on IP led revenues. Sir, last quarter you had mentioned about decreasing seasonality in the business due to diversification of your product portfolio. So just wanted to reconcile this with this quarter's performance, means this seasonality has decreased so why there was such a large decline. And second was on the proportion of SMAC revenues for your product and platform engineering business. So what was it this quarter and what was the number last quarter?
- Anand Deshpande** So let me answer the first part regarding the IP revenue, yes our intention is to see how to create other businesses or some products that do not have that level of seasonality that we currently have and that was

one of the reasons where we thought we would have the HP Radia product, that will give us that benefit. There is a one quarter delay in terms of how the accounting is going to happen on that in the sense that one our costs have already started to come into the picture, starting 1st April. However revenues have a ramp and the ramp has been slower because there were deals in the pipeline that belonged to HP and did not belong to us. So the first quarter contribution of revenues from Radia which is the HPCA product has been very low. We expect that once we get past the hump of getting most of the customers converted to Persistent Paper then we should see a fairly steady revenue in terms of what we will get from the HPCA business.

Nitin Jain

So this decline was more related to the connector business or it was more related to the acquired products?

Anand Deshpande

No, it is not acquired products. It is the same kind of products like connectors and other products that we have had in the past, where we have royalty streams that give us a good benefit in January. So that helps in the first quarter and the Q3 last year we had a specific deal that happened in locations where we got a good boost in the Q3 numbers. There are similar such deals in the pipeline but what we have realized in the IP business is that till you actually sign it and there is a PO, lot of deals can keep moving for a while in some of these cases. So we just have to have more of them. But overall they are not going to go away. We will get them and overall there is a 24% Y-o-Y growth on the IP led revenue. So I think we can continue to get that kind of momentum for the rest of the year. And we are quite optimistic that with HPCA that is just starting out we should have some revenues in the pipeline that will help out. Now regarding the contribution of the whole of around SMAC stack that we have been talking about, the total contribution this year was about 49.5%, which has gone up from about 46-47% that we had in the previous quarter. So overall Q-o-Q more and more of our business from the product engineering side is moving into the SMAC stack.

Nitin Jain

Okay, so this 49.5% is proportion of product and platform engineering business?

Anand Deshpande

Yes. See again you know we are going to keep these two as sort of very separate things. So we are going to give you the product business as a product business where I think the utilization numbers all of those numbers for products do not make sense. We should look at staffing on product business, we should look at the revenues on the product business and that is what it is. And all the other numbers that we are referring to are relating to the services business which is a linear part of our business.

Moderator

We have the next question from the line of Vasudev Banerjee from Quant Capital. Please go ahead.

Vasudev Banerjee

Just wanted to know as you said that the Radia revenue got delayed by one quarter, but on the cost side as you said that 40 bps margin impact because of knowledge transfer so ideally what the level of revenue you are expecting this quarter which got delayed to the next quarter. So can you quantify?

Anand Deshpande

No it is hard for me to give you any real numbers at this stage. Let me just say it is hard, we are deliberately not giving them is what I was trying to tell you here. See eventually this product will make money in this year. So whatever our extra costs are by the end of the year, we should see this being a green product. So that should give you a little bit of a hint of what the costs are and we will make up that in terms of the revenues for the year.

- Vasudev Banerjee** Secondly on the cost front a couple of things, what is the current scenario for the wage hike with the pay having affected the numbers or in the coming quarter and the second thing is can you again explain the doubtful debt provision change per se?
- Anand Deshpande** Let me say that salary hikes for offshore employees have been announced and they have been distributed. They start being effective from 1st of July, so there is no contribution to the extra salaries in the balance sheet and the numbers, P&L that we are presenting today. In the Q2 numbers they will come in. This is what Rohit also pointed out.
- Rohit Kamat** As a matter of prudential policy we make provision for all doubtful debt above 180 days, all outstanding invoices above 180 days. So depending on how the collection happens in quarter, there could be some ups and downs. Since these provisions are made on a prudential basis at times we happen to collect also from the amounts which are already provided, so last quarter the amount collected was more than provisions so we saw a negative impact in terms of the provision. This quarter, couple of debtors the amounts crossed the 180 days period, we have made a provision.
- Vasudev Banerjee** And as you said that the visa cost incurred this quarter for that preemptive measure of immigration bill, so this incremental expense will continue for a few quarters more or this is just a one quarter phenomenon?
- Anand Deshpande** No, it is a one quarter thing.
- Moderator** We have the next question from the line of Dipesh Mehta from SBI Cap Securities. Please go ahead.
- Dipesh Mehta** Sir, I just want to understand a quantum of offshore salary hikes announced. Second question about margin, if we say our margin remains very volatile so can you provide some color about in medium to long term what kind of margin stability, what then would you suggest excluding currency movement. And third about onsite price uptick, it remained a very good uptick for the last couple of quarters. So can you provide excluding NovaQuest the like to like hike how much we have got?
- Anand Deshpande** It will be less than 10%. Between 8% and 9% in terms of wage hike. Regarding the rates in the US onsite rates, they will remain in that range, I do not see them going up or down a whole lot. There may be some minor adjustments depending on what geography we staff the requirements in the US, so we might see some of that. And then the third question you had was regarding volatility on the margins. See as we have said in the past, overall the way we look at our business on a Q-o-Q basis is we try to look at our earnings in dollars as top-line and the profit PAT or PBT in terms of profit before tax in rupee numbers. And we think that to some extent the Forex cover and rupee depreciation and other things allows us to make investments that allow us for growth in the future. So if I am able to get better margins then we want to invest in the business. So that is sort of how we have been running the company overall and our overall objective has been to ensure that our profit before tax is in the 18% range on an annual basis. So that is how we have been thinking about it and as you would notice here we realized that there was an opportunity to make some additional investments because of the rupee depreciation and we have made those investments in sales and in training people which in the long term should be useful for the business.
- Dipesh Mehta** So, one should look at PBT when you say about stability in margin around 18%?

- Anand Deshpande** That is our overall target for the year, meaning usually first quarter, second quarter you might see an up and down. By third-fourth they should stabilize. We definitely want to be at 18% PBT on a Y-o-Y basis and we have been achieving that and we feel quite confident to do that.
- Moderator** We have the next question from the line of Nitin Padmanabhan from Espirito Santo. Please go ahead.
- Nitin Padmanabhan** Just wanted to check in terms of the product engineering and platform business has done pretty well this quarter. I would like to understand your perspective in terms of how did you look at this business possibly may be a quarter or two back and are you surprised by the growth that you have seen now? Is there an uptick in demand and do you see the environment materially improving here? Any sort of color you could add qualitatively for the business?
- Anand Deshpande** Overall I think we are definitely optimistic about where the market is moving. But basically the SMAC technologies that people are talking about are going to start to help and people are going to deploy cloud and mobility and also start to push analytics. We have also seen that our existing customers for whom we were doing may be not necessarily this kind of work. We may have been building products doing QA. All of the companies are asking what is their SMAC strategy and how are you going to deal with it. So we are seeing growth in both existing customers and new customers generated through platforms in this whole SMAC area and which has contributed to our business going to 49%-50%. So I would not say we were surprised – we are kind of surprised that it has not happened fast enough to some extent but we think as we move along in quarter-on-quarter, we are seeing growth on this. And again one last thing I would like to mention and this is something I have mentioned earlier as well. See in general in this market for these kinds of technologies these deals are not going to be huge. They are going to be small-to-medium size deals, where people are going to implement using cloud. You do not require as many people to do the project, so there will be much smaller teams in this generation as compared to a similar product being built, say 3-5 years back. So that is the fact and that has not changed. We are seeing lot more activity because we are getting more customers and our existing customers realize that we have the expertise in SMAC areas.
- Hari Haran** To address a couple of these questions – first on the environment, yes the environment itself is definitely improving and as I indicated enterprises be it banks or pharmaceutical companies or any enterprise they are looking at bringing next generation products to market. And these products have a dominant software component. So finally they are releasing their purses and we are meeting numerous customers and we are seeing this trend. The demand also is increasing in the area of SMAC, so we see an overall uptake in the market growth this year. We see it both in the environment as well as the enterprise and independent software vendor spending.
- Nitin Padmanabhan** So, this is definitely better than last year from the OPD business perspective. That is a clear takeaway, right?
- Anand Deshpande** Yes.
- Moderator** We have the next question from the line of Srivathsan Ramachandran from Spark Capital. Please go ahead.

Srivathsan Ramachandran I just wanted to understand how the renewal rates for the HPCA business would be? Would it be safe to assume that entire business will get renewed when it is due for renewal or would there be some 70% -80% conversion risk that we should look at?

Anand Deshpande Yes there is a conversion risk for sure, meaning sometimes customers may choose not to renew with us.

Srivathsan Ramachandran And what is the experience so far been?

Anand Deshpande No, there is a little bit of an attrition on that but it is not as high. So we have modeled that into our business calculation.

Srivathsan Ramachandran My second question is if you see the services business growth it has been slightly more onsite heavy, just wanted to understand if the nature of the growth is changing from our traditional engineering kind of offerings more to the platform or professional services kind of an area?

Anand Deshpande You have observed it right. Yes, there is a higher incidence of frontend requirements. It may have two reasons for that, one is yes the business is changing where we are doing more solutions, we are selling at a higher level and we are commanding premium plus customer demands that we have to have more people onsite. So that is definitely one reason. There could be another reason is that when you start some of these projects you need to have more people onsite and eventually when the project grows and stabilizes there may be opportunities to move or add additional people offshore as well. So both these things are likely to happen, but yes you are right the onsite mix has gone up.

Srivathsan Ramachandran: How many years can we see this HPCA payment amortized?

Rohit Kamat It is to be amortized over six years.

Moderator We will take the next question from the line of Abdul Khanani from Narnolia Securities Ltd. Please go ahead.

Abdul Khanani As on 30th June, 2013 cash and cash equivalents increased from Rs. 362 crores to Rs. 457 crores. Is there any merger or acquisition related things that you are looking at in any of the segment that you are focused on and if yes, on which location and which segment you are looking for?

Anand Deshpande So let me explain a little bit about what we are trying to do in terms of the M&A or the acquisition strategy that we have with products. So essentially we are talking to our major customers, the large ones that we work because we believe and they also agree with us that there are many products that they have in their portfolio which for various reasons are not considered strategic by them. And if we see an opportunity to acquire any of them where one, we know what the area is, we know how to deal with it. They are aligned with our current portfolio in some way or gives us long term benefits we will go ahead and acquire them. Now we have observed that some of these deals can take a very long time to happen because it is not that there is an urgency that the people in the management team who have to make a decision and this has to go down to the organization and sometimes this can take couple of years even to get these kind of deals to happen. So we are in active conversations with many companies about looking at their portfolio on an ongoing basis. So yes we

are looking for other deals. That said, we do not have anything that is eminent that we can even suggest that it might happen in this quarter.

Abdul Khanani

Sir, my second question is during the month of June the company has announced a partnership with SysCare Technology. Please throw some light on this partnership?

Hari Haran

So we announced a partnership with SysCare in Morocco and that partnership was to primarily fuel two things – one is to capitalize on the opportunity presented in French speaking European and African nations as well as Arabic speaking nations. And the second was to use Morocco as a potential for providing resourcing and staffing and creating some capabilities around that for serving French speaking countries. This was our motivation and the partnership has started yielding some deals into the pipeline already although for natural reasons it is at a very early stage as the others are in the process of providing proposals and taking it through the normal deal cycle. But we see some results coming out of this partnership during this year.

Moderator

We have the next question from the line of Urmil Shah from Kim Eng Securities. Please go ahead.

Urmil Shah

I just needed a bit of more clarity on the outlook for margins for the second quarter, we said that it would continue to remain under pressure but 150 basis points impact of visa cost would not be there. The impact of knowledge transfer of HPCA at least should reduce and also doubtful debt should ideally not been there. So still why are we factoring or why are we expecting pressure on the profitability?

Rohit Kamat

The offshore wage hike would make a significant impact. That is one obvious thing which will happen. On currency side you are not sure, currency has already started showing a receding trend. So I can send you separately the exact calculations.

Urmil Shah

Anand you mentioned about potentially going forward in future we could have a higher proportion of offshoring of product engineering services which we are doing more onsite but given that we know you are seeing more traction in the US, would it be safe to assume that at least for this year and quite a bit of next year it would be more on the onsite front?

Anand Deshpande

No, I would not say that. The onsite proportion has gone up but I think a lot of the projects are getting executed from offshore as well. So I do not see this just as an onsite activity.

Moderator

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

Ankit Pandey

I just had a question on the growth outlook for the company, we had earlier stated I think a couple of quarters ago that we expect some serious momentum on the top-line in the second half of the financial year and may be the first half of the next financial year. So Anand, do we still maintain that?

Anand Deshpande

Yes, we do. And some of it you are already seeing here. You will see more numbers in the second half. As we have explained to you what the components of them are, it should be quite clear that the IP part of the business has definitely things that will happen in the second half. They are already in motion. If we can keep the momentum going on the rest of the business where we can keep the growth rates at better than the rates that we have right now. I think overall we should have a good year.

- Moderator** We have the next question from the line of Mohit Jain from Trust Group. Please go ahead.
- Mohit Jain** Two questions sir, one is on utilization. Have you stopped disclosing this number from this quarter?
- Anand Deshpande** No, no it is disclosed actually.
- Mohit Jain** It is part of your presentation, is it?
- Anand Deshpande** No, it is in the factsheet that we have given. Now the way we have disclosed this is actually far more transparent. What it does is it shows you what percentage of people are allocated to product related activities, so you remove that from the total. For the rest of the people it shows you how many are billed and how many are not billed. So considering that very cleanly, so you should be able to find out exactly all the utilization numbers, but if you are looking for the real number it was 70% utilization this quarter as compared to 72% from the previous quarter and the reason is we think that this is the right time to invest both in sales and also in training people.
- Mohit Jain** So for investment you mean these guys are basically allocated to new research areas?
- Anand Deshpande** No, they are doing training for cloud, we are training more people on what is analytics, so we have to do Hadoop things which are all the Big Data stuff, so we have a big team training on that. We have a large team being trained for sales force. We have a large team on OpenStack. So these are just standard technology skills. So that is why we are not calling them a lot of R&D stuff, it is just that utilization has gone down.
- Mohit Jain** So should we expect this number to remain at this level given that the currency is behaving favorably?
- Anand Deshpande** Yes, that is a hard question to answer. That is a lever that we have to play along with and it has to do with what kind of pipeline we see as well.
- Mohit Jain** Second is on effective tax rate that has probably gone down. So any guidance for FY14 ETR?
- Anand Deshpande** No, because our SEZ earnings have gone up a bit and I think you just leave it where it is right now.
- Mohit Jain** 29%?
- Rohit Kamat** Yes, it will be around 29% to 29.5% that range.
- Mohit Jain** Can you repeat why the amortization has gone up because of the HP deal and how should we take that number going forward?
- Rohit Kamat** Yes, so HPCA software which we acquired last year actually it was lying in work in progress, we had not capitalized it because the knowledge transfer process was not completed. This year we capitalized it and amortization will happen over its expected life, i.e. 6 years.
- Mohit Jain** So this is a cash payment which has gone out?

- Rohit Kamat:** In terms of payment actually it is a minimum royalty commitment over a period of three years. Out of that one-third we have already paid and two-third is to be paid over the next two years. So cash outflow is different but because of the nature of minimum guaranteed sort of a payment we have recognized it as a liability and we are capitalizing based on the valuation of intangible.
- Mohit Jain** So we have capitalized the minimum royalty payment that was supposed to be made as part of the contract and now we are amortizing it at this rate. So your cash flow will happen over three years and we will amortize over six years. Is that understanding correct?
- Rohit Kamat** Yes, that is correct.
- Moderator** We have the next follow-up question from the line of Srivathsan Ramachandran from Spark Capital. Please go ahead.
- Srivathsan Ramachandran** Hi Anand, just wanted to get your sense in terms of the supply side or the attrition numbers, because given the way rupee is going and some of the capitals will also be substantially stepping up. So just wanted to understand what your thoughts are in terms of retaining talent especially in the SMAC areas and other related areas?
- Anand Deshpande** Yes it is going to be a continued challenge but overall the attrition numbers are 14.2% right now, which are okay. And it is hard to say right now. I have not seen that local capitals have jumped up a whole lot yet. But you are right, your observation is as good as ours and we should be watching that.
- Srivathsan Ramachandran** Sure, and in terms of the overall IP portfolio that you are looking. just wanted to see if it is possible to get some idea of the pipeline you are looking at from an IP business point of view, more from the what kind of new products that you are looking at either internally or are there any more products that you are in conversation with some of your customers anything that we could see in the next 3-6 months?
- Anand Deshpande** It is a big question and let me suggest the following. Let us do an offline conversation on this. We will share with you what we have. Right now we are nearly at the top of the hour.
- Moderator:** Thank you. Participants, that would be the last question. I would now like to hand the floor back to Dr. Anand Deshpande for closing comments. Over to you Sir.
- Anand Deshpande** I would like to just thank all the participants for being here on the call. I am sure there are more questions and other clarification that you might need. Please send us an email and we will be able to answer them. I look forward to talking to you again next quarter.
- Moderator:** Thank you Sir . Participants on behalf of Persistent Systems that concludes this conference