Persistent Systems

Analyst Call

Persistent Systems Limited - Analyst Conference Call

Q2 FY13 Results

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MODERATORS

Dr. Anand Deshpande
Chairman & Managing Director

Mr. Hari Haran
President, Persistent Systems Inc.

Mr. Rohit Kamat
Chief Financial Officer

Mr. Nitin Kulkarni
Executive Director & Chief Operating Officer

Mr. Vilas Kate
Chief Planning Officer

Mr. Vivek Sadhale
Company Secretary and Head – Legal & Investor Relations

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Moderator

Ladies and gentlemen, good evening and welcome to the Persistent Systems Q2FY13 Analysts Conference Call. As a reminder, 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. Should you need any assistance during this conference call 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 & Managing Director, Persistent Systems. We also have with him Mr. Hari Haran, President, Persistent Systems, Inc, joining from the U.S. Mr. Rohit Kamat, Chief Financial Officer, Mr. Nitin Kulkarni, Chief Operating Officer, Mr. Vilas Kate, 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

Let me give you a very quick overview of the financial highlights, which are also l available on the website. The revenue for the quarter was USD 60.05 million. This represents a Y-o-Y growth of 16.5% and a Q-o-Q growth of 9.4%. In Rupee terms the revenue was ₹3268.64 million representing a Y-o-Y growth of 37.2% and a Q-o-Q growth of 8.7%. The major contributor to this quarter's revenue was the IP-led revenue for the quarter, which was $11.36 million, which is a growth of 48.5% Q-o-Q. The EBITDA was ₹890.20 million, which represents a Y-o-Y growth of 96.3% and a Q-o-Q growth of 10.3%. The PAT was ₹446.47 million representing a Y-o-Y growth of 37.8% and a Q-o-Q growth of 7.4%.

If you look at the consolidated financial highlights for the first half of the year, the revenue is ₹6275.68 million representing a growth of 35.8% over the previous year. The EBITDA during the period is ₹1696.93 million representing a growth of 98.6% and PAT was ₹ 862.25 million representing a growth of 43.8%. With the end of this basic financial highlight I would like to spend a little bit of time trying to share with you a commentary of what is going on in the quarter. After my short introduction I am going to hand it to Hari who will share with you the customer side perspective of what is going on. After that I am going to request our CFO, Rohit Kamat, to share with you the financial details and the way the numbers panned out this quarter. We will then open it out for Q&A and I would like to actually end this call by about 6 o'clock.

Let me start by giving you a little bit about what the business has been. We have had a strategy for the last few years, which we have explained to you and the next generation of product engineering business, which essentially involves the following pillars:

1. We want to provide end-to-end product development services for our customers and become a trusted partner for them. We have moved beyond just outsourcing, off shoring, and low cost India centric delivery shop and we are seeing new business coming in, which requires us to do end-to-end product development work.
2. The second pillar has been around tracking technology. We believe that it is important for a company like Persistent to track what is new in the technology market and invest ahead in the disruptive technology trends. Our investments from the last three years in Cloud Computing and Analytics, specifically with focus on big data, enterprise collaboration and mobility are examples of how we have achieved this, and we have made good progress in all these core areas. We continue to invest on newer technologies and we are working on some new things as well.
3. The third pillar has been to work with partners who are leaders from technology stand point. We have achieved this and we have partnered with some of the leading companies in all these four areas like Cloud, Analytics, Collaboration, and mobility and we work with them building products for market leaders and have picked partners that constitute our "sell- with" strategy. As the market starts to gather momentum, we are well poised to ride the wave. To help us enhance our service offerings, we will hire and acquire companies and appropriate talent across the world including geographies close to our customer. We bolstered our Cloud business this year with the acquisition of Doyenz, which has an innovative Cloud platform business from a company called Doyenz, Inc. Doyenz's rCloud is an innovative business continuity Cloud platform that provides backup and disaster recovery for physical and virtual servers under the Cloud for SMBs. Persistent will continue to serve rCloud's customers, about 3500 of them under the Doyenz brand and Persistent will develop and enhance the rCloud Services maintaining all the employees, channel partnerships instrumental to its business and this acquisition comes with a seasoned team of 17 Cloud experts, who will enable Persistent Systems, Cloud expertise, and provide complete end-to-end solutions to existing and new customers delivered through the channel. Doyenz will contribute to our revenue from this month and they are currently operating at a run rate of 4 million dollars per annual run rate. Doyenz is a privately held company headquartered in Bellevue, Washington, which is one of the suburbs of Seattle with additional facilities in Boston, Massachusetts and in London, England. For more information please visit Doyenz.com.
4. The fourth pillar of our product engineering strategy is to focus on IP, which means Intellectual Property. This would be a major differentiator and will provide us margin advantage. We have been exploring wide spaces with our customers and have done strategic acquisitions to build our IP portfolio. We have announced that Nara

Rajagopalan who joined us last week, will lead this initiative as we continue on this path. IP revenues have played a significant role in our good performance this quarter and will continue to do so in future quarters as well. Some of the business highlights, we are very proud to have been associated with Aamir Khan's pioneering show "*Satyamev Jayate*", where our Big Data team and our Big Data platform was used for capturing impressions across various web and social channels. This was one example of our innovative work applied for a problem of importance.

We have celebrations for Alan Turing Centenary going on through the year across all our locations. I just want to list three awards that we won this quarter. We were awarded the Golden Peacock Award for excellence in Corporate Governance for 2012. We were named in the 2012 Global Services 100 list for the second consecutive year and we were recognized as a leading global outsource product development vendor and a specialty Application Development and Management Vendor. We were also recognized by Zinnov as a leading playing in the Software ISP and Consumer Software Segments in the breakout zone, as in the telecom R&D Service Provider area. The nurture zone in the Healthcare area and in the execution zone for our deep expertise in Cloud Computing and enterprise mobility. With this short introduction let me now hand it to Hari, who will give you the overview from the U.S. side.

Hari Haran Thank you Anand. As Anand indicated Q2 was a remarkable quarter for us. We saw 9.4% Q-o-Q growth in US Dollar revenue terms. We saw a phenomenal growth in the telecom and ISV that we sometimes refer to as Infrastructure and System Vertical. A good part of the growth as Anand alluded came from IP and products. While this component tends to be lumpy from quarter to quarter, we are definitely seeing increased traction with customers in this area. I might add that we are able to have a much richer and a solution oriented conversation with our customers because of IP led services. Currently our IP consists of various royalties from connector products, location products, LIMS, laboratory information management system products, drivers and finally network performance products. We expect this portfolio to grow both organically as well as inorganically and I think Anand made a mention of that. In order to accelerate and reinforce our IP product strategy we have hired a senior leader, Nara Rajagopalan as the Chief Product Officer. This is to further show our commitment and to put the emphasis there. Just a couple of days ago we successfully completed the acquisition of the Doyenz, rCloud product. Anand mentioned a few words about it. Doyenz provides an innovative Cloud platform that meets the business continuity needs of small and medium size businesses. The rCloud platform provides backup and disaster recovery for VMW. VMW are environments allowing IT professionals to restore virtual environments in under 15 minutes providing quick access to business critical applications.

With the acquisition of Doyenz we will substantially increase our presence in Bellevue, Washington, a suburb of Seattle. Now this acquisition not only adds a Cloud product in our portfolio, but also greatly augments our high-end Cloud consulting capability in the company. We continue to see more customers wanting to balance their product portfolio and this represents a tremendous product takeover opportunity for us. I am sure you will be hearing more on our product success as we progress through the next quarters. Regarding customer growth we added 48 new logos in the quarter. Out of these six customers are multi-billion dollar large accounts. One was a very large global telecommunications carrier, another was a large multinational conglomerate. We added a prominent claim management solutions company.

We added one of the very large media company, a large studio, a large sports retailer, and a large utilities company, just to give some color about the type of new multibillion dollar logos that we have been opening. Our pipeline is growing in all geographies, North America, Europe, and Asia-Pacific. We also recently closed some new accounts in Europe and Australia. The revenue contribution from our top 10 client continued to climb Q-o-Q, thus assuring their confidence in Persistence Systems. While we saw good growth in our traditional product engineering services, we saw a very good uptake as well in Cloud and Mobility. We also saw some growth in BI and Analytics. Our sell-with initiative is progressing very well with IBM, Salesforce.com, and Oracle. We have signed up a few more partners, one that we announced recently is Rage Frameworks, which is a business process automation company. We expect our partnership initiatives to continue and grow. From a headcount perspective we are growing the sales and marketing in the organization, we are adding a few senior sales and innovation leaders in the front end. We recently hired the executive leadership for Europe and placed him in the UK. We have put some sales folks in Australia to grow in Asia-Pacific. In any event you will be hearing a few more announcements in the coming days. I would like to add that we have increased our sales and marketing spend by more than 7% from previous quarter and we expect to continue to invest aggressively in the field sales force.

In summary, our overall 4x4 x4 strategy as Anand indicated is paying off. We had taken a very calculated bet on IP and platform investments. This has paid off very handsomely for us. We had aggressively gone after telecom, ISV, life sciences, and banking vertical. We were rewarded this quarter quite well from telecom and ISV. Our sell-with partnership technology and solutions consulting and our investments in the various horizontal focus area are all showing results. Our bread and butter product engineering business is showing good promise.

We are also happy to report that we are not seeing any pricing pressures and are able to maintain flat to slightly higher rates. This is definitely a testimonial to the confidence that our customers are having on us. Regarding the market we see tremendous opportunities in the future, in the core product development market. Several enterprises are designing the next-generation products and software and for many of these next-generation products, software is the dominant component. Be it the beverage industry, the automotive industry, medical device, or airlines, several new products are being contemplated by our customers in the market. This represents a copious opportunity for us. Further, more and more enterprises are adopting Cloud and Mobility in their IT Infrastructure and this is giving rise to opportunities in product development as well as professional services. Overall, we are very pleased, excited and confident about our results. We remain optimistic about the future and are marching forward strongly towards our goals.

Anand Deshpande Let me now hand it over to Rohit to provide you some more details about the financial numbers and how to read the charts that are on the website.

Rohit Kamat Let me share with you more details regarding revenue growth of 9.4% in this quarter, which was primarily fuelled by growth in IP led revenues. Out of the 9.4% growth 6.4% is attributable to IP led business and 3% is attributable to product engineering business. If we divide our product engineering business into two buckets, that is offshore and onsite, then our off shore revenue increased by 4% comprising volume growth of 1.8% and growth in billing rates of 1.2% Q-o-Q. On-site revenue declined by 0.4% due to combined effect of increasing billing rates of 0.6% and decline in volume by around 1%. You will appreciate that IP led revenue, which grew by 48.5% Q-o-Q, cannot be split into volumes and billing rate by its very nature.

Now I will come to the margin movements. Our gross margin improved to 44.1% in Q2 as compared to 44% in Q1, this is in spite of 9.9% average salary increase for India-based employees with effect from 1st July 2012. The revenue growth of 9.4% enabled us to offset adverse impact of salary increase, which was 360 basis points and impact of currency, which was 60 points on gross margins. EBITDA margin for the quarter improved to 27.3% as compared to 26.9% in Q1, S&M expenses grew in actual terms 18:26 by 7.3% in line with our strategy to invest more in S&M initiatives. The admin expenses dropped to 8% of revenue in Q2 as compared to 8.5% in Q1, this was on account of improved efficiency and better utilization of resources. Our other income, which comprises of interest and dividend increased to ₹82.25 million as compared to ₹74.57 million in the previous quarter. FOREX loss was at ₹160.6 million as against ₹121.3 million in the previous quarter due to sharp appreciation of Rupee against the Dollar towards the end of the quarter. Effective rate for the quarter was 28.3% as against 27.8% in the previous quarter. Profit before tax was ₹622.79 million, which is 19.1% of revenue and PAT was ₹446.47 million, which is 13.7% of the revenue in this quarter. The CAPEX for the first half year was ₹249 million. We follow the policy of taking forward contracts to cover 50% to 60% of our net projected FOREX earnings on a 12-month rolling basis. The value of our open forward contracts outstanding as on

30th September amounted to ₹91 million and the average rate of the forward was 54.79 per dollar. Total cash and investment as on 30th September stood at ₹3,872 million as compared to ₹3,596 million as on 30th June. The surplus funds are invested in liquid and debt mutual funds, and bank deposits. Average return from this investment was in the region of 9.45% before tax and 7.23% post tax. So that is my update. I will now hand it over to Anand.

Anand Deshpande Thank you Rohit. We will now open it up for questions.

Moderator Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from Kunal Tayal from Bank of America. Please go ahead.

Kunal Tayal My first question is on IP revenue. IP definitely has grown very well; I wanted to understand the outlook on traditional OPD business because traditional OPD has also shown a good increase in momentum this quarter.

Anand Deshpande We are very upbeat on the traditional OPD business both from our existing customers and also from new accounts that we have in the sales pipeline. Hari, do you want to comment on this?

Hari Haran Yes, absolutely. Thank you very much. Yes, we are definitely upbeat on the overall product development business and our traditional OPD. Again, the reason is twofold. One is, as evidenced by the pipeline, we are seeing a lot of opportunities there, so the opportunities in the marketplace is certainly as the next generation products are being thought about by all industries be it the next generation vending machine or the next generation plane that has all kinds of fancy electronics and entertainment systems. For all of these, the dominant portion is software, so we keep seeing opportunities. That is one point. The second point is, our approach into addressing these opportunities are slightly innovative, which is, it is not just people related offshore services, it is that and more, which is coming with IP, coming with some thought leadership, and some framework that accelerates product development and shows much higher value to the customer and that makes them engage us proactively in this thinking process, so IPPs, the solution piece, the consulting Piece, all of that goes very well with the services Piece, and thus gives us a differentiation and so we continue to remain optimistic in that area.

Kunal Tayal Thank you, that's very helpful. If you could just give some thoughts as to going forward, should we expect a balanced growth between IP and traditional OPD or should it still be skewed in favour of IP.

Anand Deshpande We do expect steady growth on the product engineering business. IP inherently by the nature of the business will be lumpy, so you will see some quarters where the growth may be even better than this and some quarters it may not be as high. But, that is just the nature of the IP business.

Kunal Tayal Two data points I wanted, one is, your quarterly attrition rate, and in your old definition if you should share the onsite-offsite mix.

Nitin Kulkarni On a rolling 12-month basis, our attrition rate is currently at 16.8%. The second question was regarding onsite and offshore mix.

Kunal Tayal On the old definition.

Rohit Kamat We had done a restatement here in terms of offshore-onsite revenue mix because the last time there was some confusion about this IP-led portion in terms of volumes and growth. So, the numbers which I shared with you are the restated numbers and split of onsite and offshore. Old definition, it will be 21% onsite and about 79% offshore.

Moderator Thank you. The next question is from Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal One question on utilization, if you see, utilization has come to 77.7%, so if you can throw some light on the outlook there and also one question on attrition rate, there is a very good job on that part. It was quite high and now it is at a very reasonable level, but what is your view going forward on that, and also if you can throw some light, if you see this quarter, the onsite efforts have come down drastically, so what will be the trend going forward. I am not asking any specific numbers, just the trend.

Nitin Kulkarni Let me take the first one on the utilization, currently we are at 77.7% and we have opened up hiring. Obviously it is a healthy level, but we want to maintain utilization level between 75% and 77%. So, that is our goal. On the attrition, yes it has come down, and again we expect that the kind of maintained attrition between the 15% to 17% levels, and that is what we are working towards, and thirdly on the onsite offshore mix, yes, it has been low this side, but over the remaining part of the year, we will expect that we have more stuff happening onsite.

Anand Deshpande One last comment relating to that, I think it is important that for the last two years we have been trying very hard to change our business mix and you are starting to see some of that value here and onsite and offshore and some of these questions on utilization, actually look very different in our charts now, but we will continue to provide to you the numbers as they look, but in IP led business or some of the other businesses the onsite and offshore and other mix are very different. Again onsite, do you include Malaysia as offshore or onsite, it is a little more complicated now.

Sandeep Agarwal Correct.

Sandeep Agarwal If you can throw some light on the tax rates going forward, because that is something which keeps on moving every quarter.

Rohit Kamat We have exposure in multiple geographies, so that is why you see some variation in the rates, but it will remain in the range of 28% to 29%, that is our expectation.

Moderator Thank you, the next question is from Shashi Bhushan from Prabhudas Lilladher. Please go ahead.

Shashi Bhushan For the last quarter in the conference call you said that there is little seasonality in IP, where you except growth to be more backend loaded, now with this quarter growth do we see that trend changing or we are still expecting the same.

Anand Deshpande IP is a lumpy business and we do expect to get good growth in the next few quarters, we are loading quite a bit into our IP portfolio, so you will see an overall increase in general, but it's very hard to draw a straight line across that. It is very difficult to correlate it with utilization IT, number of people, etc. So this is just the nature of the business and we may have to shift that, but that is just the way it is going to be.

Shashi Bhushan We acquired Openwave, I think last to last quarter, so is the growth coming in telecom because of Openwave, and what was the incremental contribution from the IBM facility.

Anand Deshpande The IBM part was also in the telecom area, but yes, significant growth this quarter came in the telecom area because of Openwave location and also the IBM contributed to a full quarter rather than the half quarter or so we had in the last one, so you have seen that uptick. The business pipeline on both these areas is pretty good and we don't have a clear handle to give you very predictable answers in terms of what the future would look like and all I can say is that the pipeline is good.

Moderator Thank you. The next question is from Abhiram Eleswarapu, from BNP Paribas. Please go ahead.

Abhiram Eleswarapu What do you think is your new IP as a percentage of total revenue target? I assume a couple of years ago you said 20% is a reasonable target, you are already there so what is the next stage?

Anand Deshpande We will up the target next year. We are pretty healthy about the Product Engineering business also growing, so I think for the year we will continue to retain it to 20%. There will be ups and downs and we will see where it goes.

Abhiram Eleswarapu My second question is on the business development and sales team, so last year you undertook the change to move this mode to make it in line with your strategy, so how far are we on that and are there anymore hires planed on this front?

Anand Deshpande There are several hires in the pipeline, we should make some announcements within a few weeks as well for another senior person that we have recruited. Overall, as I said, we are moving our business in terms of how and what we sell and to align with our sales and the business mix that we are changing, we have been changing the mix of the sales team as well, but overall we will continue to invest more in sales and marketing. We will continue to invest in resources across different geographies where customers are located. The Doyenz team comes with a 17-people team in Seattle and we will look at more such local hirers as well. So again we are moving up this whole business of offshore outsource moving people to the US, but we are looking at what the product would require and do what it takes?

Moderator Thank you. The next question is from Hitesh Shah from IDFC. Please go ahead.

Hitesh Shah If there was any one-off in the IP business or we should take this IP business as on ongoing revenue and did you say that we should expect a decline in IP business next quarter?

Anand Deshpande No, IP is going to be always collection of many one-offs. That is just the nature of the IP business. When you sell a license you sell a deal and you get some money and you will get that again after a year or when it renews. So that is just the nature of the business. It will be lumpy and it will stay like that. The way we are doing this, we have a portfolio of IP that we have accumulated over the last years and we have been sharing with you one or two every quarter. We believe that the diversification of the portfolio, different kinds of deals coming in, and different kinds of situations will give us some consistency on that business, but it is a collection of many one-offs. That is just the nature of the business.

Hitesh Shah The MoU that we signed with HP some time back, has there been any more incremental work that has come through and how do we look at that?

Anand Deshpande We have a project going on with some of the large companies and that has been continuing. We do not have any MoU with HP that we have signed.

Moderator Thank you. The next question is from Nitin Padmanabhan from Espirito Santo Securities. Please go ahead.

Nitin Padmanabhan Just a couple of quick one's on rCloud, if you could give me just a sense in terms of what are the historic growth rate there for that product ? What is the scalability you see for the product in terms of an opportunity? What is the kind of cost we paid, what is payback that we look at for this investment? And finally just one last thing to ask was, I think you did answer a couple of times in terms of IP led lumpiness, but I just wanted to understand relative to our historic portfolio within the IP business, considering the portfolio has grown, shouldn't it be relatively less lumpier than historic?

Anand Deshpande Let me start first with a Doyenz question and then we will answer the other one. Just to give you a little bit of colour of what Doyenz does, Doyenz has been a startup company started by a team which is ex-Microsoft and some very senior people, and if you go to the management team on Doyenz.com you will be able to see the people who have created this company. This company has been in business for the last few years and they have built a product called rCloud. rCloud essential is a DR, Disaster Recovery Product targeted to small and medium businesses. They have 3500 customers and as Hari pointed out, you can backup your environment including a virtual environment in the Cloud and if there is a disaster, within 15 minutes they are able to restore your environment as it is on the Cloud, so that you don't have to worry about your business suffering at all. So this is a business where the market is extremely large and it will grow. This is still the first year revenues for them and the total revenue is at $4 million per year run rate. We have not disclosed how much we have paid on this as yet for various reasons and maybe some other time once we get some clearances, we may be able to announce that number. Regarding your other question on lumpiness see the way the license revenue has happened. This is pretty much how they happen and yes because of the portfolio we will be able to get some streamlining in terms of what it might look like; however, from our point of view also this is new to us and we don't have enough data and lot of the business that we have acquired is all new, so to add up and to give you a straight line or a curve that is going to be for the next few quarters is very difficult for us at the moment, but once we get some more data over the next 2-3 quarters, we will be able to predict better.

Nitin Padmanabhan On the payback of rCloud, how quickly do you think we will be able to payback?

Anand Deshpande One and a half to two years expected payback on the investment that we have made and the revenue start from this month onwards.

Moderator Thank you. The next question is from Priya Rohira from Enam Securities. Please go ahead.

Priya Rohira Anand it will be useful if you could help us on an update on this "sell with" strategy, how does it work for IP business and what have been the recent deals you have been pursuing in terms of the four initiatives?

Anand Deshpande Let me explain a little bit on this one, yes we have had a strategy of having a "sell with" partnership, so what we have done is for these four areas: Cloud, analytics, collaboration and mobility, we have identified leaders who we think are going to disrupt the market, like for example on Cloud we have partnership with Microsoft, we have a partnership with IBM and also with Salesforce, we were very active at Dreamforce and we are seeing very good growth and out of the 48 logos that we have announced have come to us through the "sell with" partnerships, the same is true on mobility and also on Cloud and Analytics and in Collaboration and Analytics. The analytics activity is more and more around Big Data where we have invested a lot and have created very good expertise. The business pipeline on that, I think will happen more in the second half of the next calendar year, so it is going to take some time for us to see the real volumes, but we are seeing lot of interest and lot of POCs that we are doing for Big Data base products and this product was used for the "Satyameva Jayate" show that we were involved in. So overall, very upbeat about the "sell with" partnerships, the way they are growing in all the four areas.

Priya Rohira My second questions relates to the pipeline in the traditional business, how would you classify it as better than last quarter and any glimpse on how the R&D spends may look in FY 13 interactions you had recently with your clients?

Anand Deshpande Let me have Hari comment on that in a moment, but let me just say the following. This is something that I must point out. For the last several quarters, we have seen business being slow in terms of growth and people have been saying that it is slow growth and but let me point out that we have observed and we have said this for the last two quarters and we do not think that this is a seasonal problem. There is a structural change in the market in terms of how people are buying, deals are very different, and they are smaller in some sense because they are on a platform that is very different. Customers are expecting end-to-end product development services and a whole bunch of things which are very different from what we were selling two years back. Over the last two years, systematically we have been retooling the company in terms of the revenue mix, in terms of what we sell, how we sell, and who we approach and who from our side is selling. So we have made significant changes in the company in the last two years, which have contributed to some of the changes that you see and we are very upbeat about where we think that some of the changes in the bets that we had made, the partnerships we had signed up were all good and there is a good potential for growth in all of these areas. This is a systematic plan that we have had for the last two years and we are not saying that market is easy or anything like that, market continues to be difficult, customers continue to have issues all the same. They have to make some decision and they are looking at the market in a certain way and we have aligned ourselves to look at that in that way, so that is why we are very upbeat about where the market is. Let me now hand it to Hari who can give you a more specific colour on what exactly is happening.

Hari Haran What I wanted to give you some colour on piggybacking on what Anand said, regarding the pipeline itself, if you look at the pipeline and just compare the pipeline this quarter from last quarter, there has been a substantial growth of the pipeline, in the order of more than 20% to 25% and you expect that to happen because certain deals from the pipeline that gets translated into actual revenues, so there has been a decent growth, but keeping here is the change in the buying behaviour and thus causing structural changes in the market place. Just going to the customer with resources and competence, and a low cost model is an approach that it is not growing. That is not the way the market is taking it. The market is looking at it more from a perspective of "*can you help me solve my problem and build this entire product*" and that confidence can only be delivered to the customer by putting your best and brightest in front of the customer, showing them thought leadership and proactively giving them an opinion of what you think about how their product can be done and they are willing to pay big bucks for it. So it is not the traditional rate model, number of people model it is about going out there and saying *"I can get this whole thing done and putting a price tag for it and sometimes the margins were much, much better there"* and so this actually is a change going on and also people are wanting to reuse platforms that are out there, so it is not building everything from scratch, it is using your thought leadership but leveraging the platforms that the big guys are putting out, so there is a fundamental change that is happening in the market place and we are riding that change, because we are pioneering that change, partnering with platform companies. Pipeline is good, changes are good and you have to be ahead of this change in order to capitalize the opportunity and that is what we are trying to do constantly.

Priya Rohira So all in all you seem to be more optimistic for FY13 is what looks directionally?

Hari Haran Yes.

Moderator The next question is from Ravi Menon from Equirus Securities. Please go ahead.

Ravi Menon Two questions one is about the IP, just wanted to get some colour on what kind of IP, you did speak about that being one upfront payment and then renewals, so would like to get some color about what is your upfront payment versus what is the percentage of annual renewal fees?

Anand Deshpande Let me explain a little bit about the second part of the question first and then give you the first one. We are doing license deals with customers and they are of different sizes and these one off payments because they are up and they will be once a year or there is annual maintenance or some of these kinds of things. There is nothing unusual as such, but that is essentially the nature of the business. Let me give you a little bit of overview of some of the IPs that we are selling and we have made pretty much and one announcement every quarter about the IPs that we have acquired, so this quarter we are announcing Doyenz which we will include in our IP portfolio, previous quarter we acquired TNPM, which was acquisition under the network performance monitoring product, we acquired from IBM, the previous quarter we announced the Openwave product which is the location product from Openwave and then we had LIMS product and we have some drivers and a whole bunch of things in our portfolio. In addition to these acquired products, we have also been working with our customers to identify white spaces to identify what things they would like us to build for them and then we sell, so we have loaded enough IP in the portfolio that we have invested in building connectors, we have built out tools and various other things, which our partners are selling and the way this whole business happens in the IP business is that there is a slow crank, you have to invest a lot, you see some revenues in one quarter and then there is more revenues in the next quarter and that builds on. So it is a very different equation from investment to returns, so in contracting business your investment in people and your returns are in the same quarter, here you are investing up front for several quarters and then you start to see returns which are not related to the number of people, that is just the nature of the business and you will see that happening for us as well and we continue to make investments in internally building new IP and also trying to acquire new IP.

Ravi Menon Just one more follow up on that, you said that you may continue the investments with same number of people on the personnel front there in the IP business go down very slightly. Is it because some of these products are now little immature and no longer require any investment.

Anand Deshpande That is one place also and it is slightly different way of how these get counted. Certain IP we have an opportunity where some of those people move to billing projects because the investments that we are making in some of these IPs do not necessarily reflect in IP, so sometimes we are investing in a new technology solution, we have identified a new technology, we go and invest upfront and when a billing project comes, we might move these people on to that project. Just like Hari said, when you have to go to a company and say we are going to do end-to-end product development, we are going to a certain customer, we go with some tools and goodies in our bags and when those get transferred, different things happen, so this is a minor shift in terms of the dip that you see and I would not read too much into it, next quarter hopefully we will add to that.

Moderator Thank you. The next question is from Anurag Purohit from Systematix Shares & Stocks. Please go ahead.

Anurag Purohit My question is to Hari, you mentioned that deal pipeline has grown quite well in the quarter and more importantly new software development is picking up, I wanted to understand whether this initiative is limited to some of your top 50 clients or it's also across to some of your smaller clients that are financed by Venture Capital in US.

Hari Haran Actually, it is a combination and when I say combination it is combination of both existing accounts as well as new accounts. By and large, a lot of these is not from small venture funded companies, as I indicated a lot of these next generation product initiatives are coming from large enterprises, but what that does is that tends to create a ripple and creates the need for different small types of products that will plug into that and that could come from venture funded companies, but at least this quarter, our most of the revenue continued to come from larger clients, but is not to say that hard to predict exactly a trend on how much asset would come from the venture funded community versus the big companies, but overall I can say with conviction that number of these companies are rolling out next generation products and I am meaning product from a broader sense, a new screen that comes up in a car, I call it a product and that is very germane to our analysis because 70%-80% of that screen is of software and hence that directly translates the opportunity for us and then I am just throwing one example out there, but there are numerous examples out there, be the healthcare, be the hospital, be life sciences, medical devices, be the robotic surgeon all of these are next generation products that are not just being contemplated and that's real and people are rolling these types of products out.

Anand Deshpande I will add one more thing to Hari's comment and that's a useful to know, as he mentioned a lot of our customers where we are doing new products or product development for the first time are fairly large companies meaning billion of dollars plus and the reason we are getting an entry into these customers is that the line of business executives in these companies are making lot of these new product decisions and enterprises are thinking like products and they are building products rather than doing ID services. Business has shifted, market has shifted, we are very differently positioned and selling very differently to a new set of people beyond our traditional IFC product development work, so lot of the products that we are building may not come for traditional software IFCs, but they are coming from large enterprises, media companies whatever else you might think of and they are all following a product development in a product engineering strategy that we have always said is what we have described in the past, so nothing for us has changed. We have changed in terms of how we sell, what we sell and who we sell to and that is the reason why you see these differences and why we are so upbeat about where the market is on the product engineering side, so we do not want you to think like what has been in the past, what is going to be the future is very different and its different it is not better or worse, but it is definitely different.

Anurag Purohit Just a follow up to that question, you also mentioned that in some of this newer deals it is more end-to-end product development that Persistent would be taking up. How does your risk profile change in those projects, especially because product itself has some inherent risk compared to your normal traditional services, does the risk profile change quite substantially in those deals?

Anand Deshpande It does change some, I do not know about substantially, but at the moment we are not taking risks on the success or rather as much on the market or the channel success of the product, but on the engineering success of the product, so we are taking some limited risks, but yes we are taking greater risks on our pricing is outcome based in some cases we are responsible for end-to-end products and yes we are sharing risks with our customers.

Moderator Thank you. The next question is from Madhu Babu from HDFC Securities. Please go ahead.

Madhu Babu What is the outlook on headcount, would it continue to fall?

Anand Deshpande No, we are expecting to add another 600 people net during the next 6 months.

Madhu Babu Could you talk about the CAPEX for this year?

Rohit Kamat CAPEX for first half was ₹249 million, second half in line with the additions to the headcount numbers, there will be some purchase of hardware, software plus some spending on facilities, so we are estimating around ₹60 crores to ₹70 crores of CAPEX in the second quarter.

Moderator Thank you, the next question is from Rohit Gajare from UTI Portfolio Management. Please go ahead.

Rohit Gajare Can you tell me what was the organic growth for the quarter? I think some amount of IP has been inorganic, so if you can just tell me the growth may be on a Y-o-Y basis, which is clearly organic and whether inorganic that will be great.

Anand Deshpande Yes, it is still a little complicated to say what is organic once we have the acquired the IP, things that we have built on our own, they are all organically built IPs, so a little more complicated, but let me separate it out the following way: 3% was on the non-IP led business, 6.4% was relating to IP led business.

Rohit Gajare Whatever inorganic would have been there, would have been within IPs?

Anand Deshpande Correct.

Rohit Gajare The employee count has reduced again this quarter, so when do we see this settling, the employment meaning the technical employees?

Anand Deshpande No it will not settle, it will keep growing now, I think we are going to add 600 people for the rest of the year.

Moderator Thank you, the next question is from Vimal Gohil from UTI Portfolio Management, please go ahead

Vimal Gohil Looking at your discretionary spent under pressure, do you see that affecting our Enterprise Product Engineering Services that is our non-ISV services?

Anand Deshpande No I somehow don't subscribe to this model that Product Engineering is nondiscretionary It is fundamental to their line of business executives who are making business and money and they need certain products for their own product and they need to spend that money to do it. Yes, it may not continue for a very long time, we might complete the product and move on, but these are all changes that we know are happening in the business, that is what we are saying that these are structural changes and not seasonal changes.

Vimal Gohil Second question is regarding the 600 additions that are going to happen in the next two quarters, would that include additions from the IP buyouts as well?

Anand Deshpande No, these are fresh recruits, IP buyouts whatever are there, they are already factored into the current situation, these are new people that we will hire in all our locations in India.

Moderator Thank you, the next question is from Rahul Viswanathan from PUG Securities. Please go ahead.

Rahul Viswanathan Just a question on hedge position, what is the current scenario of that.

Anand Deshpande As mentioned, we have $91 million at an average rate of 54.79.

Moderator Thank you, the next question is from Ravindra Agarwal from Capital Markets. Please go ahead.

Ravindra Agarwal I missed on the tax rate that is expected for FY13 and another question is earlier we had mentioned that we are confident of beating NASSCOM guidance, so like considering our upbeat outlook, so could we expect like considering that we are already around 13% for the first half, would it be fair to assume in the high-teens for the whole year?

Rohit Kamat Sure you can assume, we will beat the NASSCOM guidance and regarding the tax rate, as I explained earlier it will remain between 28% to 29% in that range.

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

Rahul Jain From which date is the acquisition effective?

Anand Deshpande October 12, 2012.

Rahul Jain What is the salary hike impact on the margin or what could be the difference provided if you would have a normal IP led growth, what would have been the impact on the margin otherwise?

Rohit Kamat The salary hike which happened offshore from 1st of July was 9.9% and impact of that on margins was 360 basis points.

Rahul Jain We had 360 covered plus 80 basis points improvement, so is it largely attributable to the growth in the IP or it could be mix of the entire business?

Rohit Kamat It is attributed to better utilization and overall revenue growth.

Anand Deshpande Rates also have gone up, volume growth is there, utilization has gone up and so has IP led which is actually coming at better margins as compared to normal business, so all of these together essentially allow us to maintain our margins and grow slightly despite FOREX and salary hike.

Moderator Thank you, Ladies and gentlemen due to time constraints that was the last question. I now hand the conference back to Dr. Anand Deshpande for closing comments.

Anand Deshpande Thanks a lot for being on this call. Wish you all a very Happy Holiday Season and Happy Diwali. If you have any further questions, by all means reach out to Vivek Rohit and me and we will be happy to send you an email or set up a special call for you. Thank you all for being on this call and wish you all the best.

Moderator Thank you gentlemen of the management team. On behalf of Persistent Systems Limited that concludes this conference call. Thank you for joining us.