Persistent Systems

Analyst Call

Persistent Systems Limited - Analyst Conference Call

Q2 FY14 Results

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MODERATORS

Dr. Anand Deshpande
Chairman & Managing Director, Persistent Systems Ltd.

Mr. Hari Haran
President, Persistent Systems Inc.

Mritunjay Singh
Chief Operating Officer, Persistent Systems Ltd.

Mr. Rohit Kamat
Chief Financial Officer, Persistent Systems Ltd.

Mr. Vilas Kate
Chief Planning Officer, Persistent Systems Ltd.

Mr. Amit Atre
Company Secretary, Persistent Systems Ltd.

www.persistentsys.com

Moderator : Ladies and gentlemen, good day and welcome to Persistent System's Analyst Call. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' 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 US, Mr. Mritunjay Singh – Chief Operating Officer, Mr. Rohit Kamat – Chief Financial Officer, Mr. Vilas Kate – Chief Planning Officer and Mr. Amit Atre – Company Secretary. I now hand the conference over to Dr. Anand Deshpande. Thank you and over to you Dr. Deshpande.

Dr. Anand Deshpande Thank you very much and for all the participants welcome on this call. We are delighted to share our quarterly results with you.

Let me first walk you through very quick headlines and then I am going to hand it to Hari to give us little bit more detailed commentary from the market side and then I am going to request Rohit Kamat – our CFO to give a little bit of a detailed overview on the nuances of the numbers and then I will follow-up with some closing remarks and then we will open it out for questions.

So just to give you very quick highlights:

The revenue for the quarter was $68.45 million. This represents a Y-o-Y growth of 14% and a Q-o-Q growth of 8.6% Q-o-Q. Revenue in rupee terms is Rs. 432 crores, which represents a growth of 21% quarter-on-quarter and 32.3% year-on-year. The major contributor for our 8.6% Q-o-Q growth was the IP led revenue which grew by 38%. Our EBITDA was 112 crores presenting a year-on-year growth of 26% and a Q-o-Q growth of 44.4% and the PAT was 607 million on 60 crores representing a year-on-year growth of 36.1% and a Q-o-Q growth of 6.5%. For the half year again we have numbers that have been published.

I do not want to go through all the numbers right now but I would like to read a few of the business highlights:

So we set up a center in Dublin, Ohio which is near Columbus, Ohio and this has been set up with an intention to deliver next generation services such as Cloud Computing, Analytics, Mobility, and Social Collaboration Services out of that. The center has been specifically designed to take into account agile development and rapid prototyping needs of next generation applications and we believe that this will help us with some of the enterprise customers in the US and this is a big effort for us during the quarter. We have released rCloud 4 Universal Architecture which is an innovative cloud platform. This is the next version of the product that we had acquired from Doyenz. We have extended our partnership with Oracle.

Another important milestone that was achieved was the ISO 13485 Certification that allows the quality management systems required for medical device software. We have expanded our presence in the sales side in India and Asia Pacific during the year and during this quarter as well and we hosted a very successful innovation day and launched the company’s innovation center for employees during this quarter. We also hosted a PLM Summit in Chicago.

In terms of the awards we won we were recognized with a “Golden Peacock Award in Corporate Governance” in the National Category for the second consecutive year. We were ranked “Top Service Providers in the Enterprise Software Segment” by Zinnov, recognized by Computer World as” 2013 Computer World Honors Laureate” in the Emerging Technologies category. We were ranked in the best “Under a Billion Companies in Asia Pacific” by Forbes India and also we made the “Dataquest Top 20” issue as a Top 100 company. We won an award for “Virtual Learning Program by Tata Institute of Social Sciences” and also the Economic Times – ET Now channel’s “World CSR Day Award” for “Best Employee Engagement Strategy”.

With this quick overview, let me now hand it over to Hari to give you an overview of the quarter in terms of the market scenario.

Hari Haran Thank you very much Anand. Good evening ladies and gentlemen. It is a pleasure to have the opportunity to speak with you about our quarterly results and some of the key market trends. As Anand indicated we registered an overall quarter over quarter growth in US dollars of 8.6%. If you recall I had indicated during our previous earnings call three months ago that we remain optimistic and confident about our future.

To that end, I am happy to report to you that we delivered a stellar quarter with respect to both our revenue and our general progress with respect to our business.

Let me add some color here on the drivers of our revenue growth – Now Anand said that our IP and products revenue grew by 38% Q-o-Q. Now this IP revenue growth came from our client automation product and also from our location based services product. Those two were a key fuel to the growth of our IP business. I would like to reiterate that this revenue component tends to be lumpy and less predictable. So we have to factor that quarter over quarter. Our services revenue looks very good and also grew quite well. We are seeing substantial tractions in the Social, Cloud, Mobility and Analytics area. Further, we are systematically able to mine services business from the client automation and the Nova Quest enterprise accounts.

Our traction in new geographies in Europe and Asia is quite encouraging. We have opened some new business in these regions. During the quarter we opened about 36 new accounts out of which 5 are large multibillion dollar accounts. We are continuing to see growth in our pipeline quarter over quarter. We also opened a new development center in Dublin, Ohio and Anand alluded to that and this is also expected to help us grow our product engineering business further. At the current rate we see ourselves trending positively throughout the fiscal year. We see a vibrant market in front of us. Both enterprises and independent software vendors are increasing their spend budgets. Software had become more than an enabler for enterprise. Enterprises are reinventing their business models, thus the role of software has become core in their business. On top of this, trends in Cloud, Devices, Mobility etc. has prompted the software companies to create more products. Finally some of the product consolidations and private equity activity will generate more opportunity for rebalancing their product portfolios and product takeovers. Companies with strong product DNA such as Persistent Systems are well positioned to help plan and partners in this regard.

Our new account acquisitions continue to be fueled through platform partnerships and IP. So we will continue to invest in both these areas. In closing I want to say that we see an exciting market, a growth oriented market and a market with a sense of urgency to take actions and move. The name of the game is to move swiftly in focused areas and execute with precision. We are very excited and very optimistic about our ability to take advantage of the opportunities presented by the market.

Thank you very much. Back to you Anand.

Dr. Anand Deshpande Yes, let me now request Rohit to provide further detail on the balance sheet and the P&L that we have presented.

Rohit Kamat Thank you Anand and good evening to everyone. While Anand and Hari have given a good overview of main drivers contributing to an excellent growth of 8.6% in the quarter, I would like to give you some more details in terms of growth of volumes and billing rates.

If we broadly divide our revenues in two categories i.e. services revenue and IP revenues, the services recorded 3.4% growth in a quarter and IP recorded 38% rise. Within services the onsite revenue increased by 5.7% comprising 7.6% volume growth and a small drop of 1.9% in billing rates. The offshore revenue in the quarter grew by 2.6% driven mainly by the volume growth. Now coming to margins, our gross margin expanded by 280 basis points to 43.9% from 41.1% in the previous quarter. The growth of IP revenue, better utilization and currency gain helped to boost margins despite 9% wage hike for India based employees effective July 1, 2013. Currency contributed around 270 basis points to margin improvement while the impact of wage hike was around 310 basis points. As a result of volume growth and operational efficiencies our sales and marketing expenses as a percentage of revenue declined by 10 basis points and general admin expense had declined by 160 basis points during the quarter. As a result of EBITDA margin increased by 420 basis points to 26%.

Our treasury income declined by 5.4% as we recognized MTM loss of 12.8 million on our debt funds. As we are aware during the quarter rupee was extremely volatile against US dollar. We incurred a Forex loss of 99.5 million during the quarter as against the gain of 183.4 million in the previous quarter. Our PBT for the quarter was at 834 million as compared to 803 million in the previous quarter and the PBT margin was at 19.3%. We received a tax refund during the quarter flowing from a favorable tax billing which lowered our effective tax rate for the quarter. Profit after tax for the quarter was 607 million as compared to 570 million in the previous quarter and the PAT margin was 14%.

The EPS for the quarter was Rs. 15.20 recording a jump of 36.1% year-on-year and 6.5% Q-o-Q. Our cash and investment stood at 5241 million as on quarter end. The Forex cover on 12 months rolling basis amounted to 93 million at an average rate of 59.57 to a dollar.

With these updates I hand it over to Anand.

Dr. Anand Deshpande Thank you Rohit. I just want to point out one item here. When we submitted our results yesterday we had also made a request if someone had questions to post them in Twitter in line with all the new media stuff that we have been working on. So we have received some questions on Twitter as well and we will take them in between and if you have further questions as well fell free to tweet with @persistentresults. And let me now hand it back to Inba for taking Q&A right now.

Moderator Thank you very much Sir. Ladies and gentlemen we will now begin the question and answer session. First question is from Srivathsan Ramachandran of Spark Capital. Please go ahead.

Srivathsan Ramachandran Just wanted to be helpful if you can run through as to what led to such a sharp spike in IP revenues. Is it more license bookings and some of the newer product offerings or what kind of contribution did HP CA have? And the second question is slightly related – how should we look at IP revenues on a whole for the whole year at this point of time? Should this kind of numbers, there will be volatility so how should we look at it from a FY14-15 perspective?

Dr. Anand Deshpande Let me give you some more color on this one. So as we had mentioned in the last call or even before that call, we had done an acquisition for a client automation product from HP towards the end of last financial year and moving into the first quarter of the year and we had mentioned that the way the contract was set up we get incremental revenues as and when clients come up for renewals. So what we have seen as an improvement in revenues has been new clients that have renewed their contract with us for that particular product which is a client automation product and we expect that trend to continue for the rest of the year as well. So we should see good uptake in terms of the revenues that come from the client automation product which did not exist in the previous quarter at all. So this is like starting this quarter onwards you will see incremental growth on that piece. The second part of the IP revenue was a discussion that has been going on for a long time with our customer in a new geography in South Africa and this is around the location product that we have which we acquired from open wave a few years back. So there was a new contract that we signed there. Some of the revenues have come into this quarter and some will come into subsequent quarters as we go along. So yes we had a few good deals that happened during the quarter for making this revenue happen but these were not entirely unexpected in a way and as was mentioned by Hari and others we have and will continue to have some volatility in terms of the IP revenue but by and large we feel pretty good about the situation that we are in with respect to the client automation product and also with respect to the new launch that we have done for the Doyenz product and some of the others that we have. So overall these are trending correctly. So that was one part of your question I think and the second question I forgot but –

Srivathsan Ramachandran Outlook for how should we look at it on a yearly basis given that quarterly there will be high volatility, you have to take per month of a 24-month view.

Dr. Anand Deshpande So if you take a long term view and you sort of trend the graph around the IP revenues you should see an upward trend and both in two ways. One is of course you will see an upward growth in terms of revenue numbers but you should also see slow but steady improvement on a percentage basis across the business. So the percentage of IP contribution in the whole business should also see a small but steady growth as you look along for the rest of the year and for next year as well.

Moderator Thank you. Our next question is from Basudeb Banerjee of Quant Capital Investments. Please go ahead.

Basudeb Banerjee Just wanted to know as splendid set of numbers in the IP led segment and 3.4% QoQ in the services segment that too led by the platforms. So if you see other similar mid-cap peers delivering somewhere around 5% plus QoQ, so where do you see your services segment revenue down the line from these limits?

Dr. Anand Deshpande I think overall as Hari pointed out we have had a very good sales pipeline in the sense 36 new accounts were opened this quarter. Some of these are very large companies. 5 of them are multibillion dollar companies as was pointed out by Hari and you have to look at last quarter we had a 4.5% growth on the services line. This quarter it is a little less at 3.4 but overall I think we are trending in the right direction. We see a lot of action from customers both our current customers, new ISVs and also enterprises where we have had not enough presence in the past who are looking to us for leadership and technology directions in the context of some of the newer products such as social, mobile and all this SMAC stack that people are talking about. And we have pointed out for the last 3 to 4 years we have deliberately and systematically made investments in these areas and we believe that in the next few quarters to years you will see us taking benefit of some of the investments that we have made in the past. So we are extremely optimistic about where we are in that context and I am quite upbeat about what the rest of the quarter should look like.

Basudeb Banerjee And secondly sir with utilization at 71.7, do you see volume growth down the line led by improvement of utilization or do you expect manpower addition to be increasing at that rate?

Dr. Anand Deshpande No, one of the important things to note here is that a lot of the utilization – utilization as we have calculated of course shows what is billed versus total capacity and the intention of having lower utilization numbers and potentially that can be done are driven by the fact that we are seeing a lot of requirements for investments in some of these newer technologies, so while theoretically it is possible to improve the utilization by at least 5 to 7 percent points. We are not that concerned about the utilization number right now and we are very anxious in continuing to invest in some of these newer technologies in terms of building IP, building capabilities and also building frameworks. That will allow us to be more aggressive in trying to close these kinds of deals that are coming up in the pipeline. In terms of the number of people to be recruited I am going to request Mritunjay Singh who is our COO to give a little bit of a description on this.

Mritunjay Singh We have added last quarter roughly around 300 people and for the remaining half we are looking at adding 626 new people to our headcount. Like Anand was saying, we continue to invest into area which is relevant to us and we will continue to see wherever we can get efficiency.

Moderator Thank you. The next question is from Pranav Tendulkar of Canara Robeco Asset Management. Please go ahead.

Pranav Tendulkar I had just two questions; one is, is there any seasonality like we have in Connector business, in HPCA business also, and how is the HPCA business because HPCA revenue that comes, I understand that majority of it will be IP, so going forward will it all the 6 million or 7 million of revenue be classified as IP and how is that seasonality in that business, that is first? And second question is we faced challenge say one year back to break into enterprise customers and now there are some signs that come through the commentary that we have been able to break into those multi-billion dollar clients. So how is that going and is the sell is helping or is the sales force concentrated brick?

Dr. Anand Deshpande So regarding your first question seasonality on the HPCA business or the 'Client Automation business' as we call it now, it is pretty early to say whether there is seasonality, we will know this more as we complete four quarters on this one, but overall the trend is good that we should get improvement in revenues on Q-o-Q basis for 3 more quarters we will see the first full year for our business and then we will know what is the level of seasonality in this one. So it is early to predict but right now we are just trying to close Q-o-Q on that one. That should be fine. The second part of it regarding enterprise customers as we had pointed out a lot of our new enterprise customers are coming to us through platform as an entry strategy that we had deliberately planned. Many of our partners in Cloud and Analytics are taking us into new deals and many of these are going through line of business executives on the client side for enterprises and those are actually giving us new accounts which are pretty big and it is up to us to see how to translate those projects into long-term revenues and relationships.

Pranav Tendulkar So basically the previous references are working and we have attained the kind of scale where you can see a next level of growth or the building block has been built that is how we should see?

Dr. Anand Deshpande The market is very large and we have started to scratch the surface and starting to see that, yes, this is doable and there is a lot to go here, it is very early in the game, there are a lot of opportunities.

Moderator Thank you. The next question is from Nitin Mohta of Macquarie. Please go ahead.

Nitin Mohta Anand, my question was more on the longer-term trajectory for IP revenues, I understand quarterly this is lumpy, but if I look at last two years is kind of driven by acquisitions that we have done. So is that the mantra for getting success on IP side, just your thoughts over there would be much appreciated?

Dr. Anand Deshpande The third process on the IP-led revenues have been to go to our existing customers and seek products that are potentially not strategic from them and see if we can partner with them on the revenue side of the equation rather than just on the cost side of the equation. So that has been the deliberate strategy that we have had for growing our IP-led business and that is what the results are right now. In addition to these we have a few that we have invested where we are building out early stage projects or activity but to build a product and to build substantial IP revenues in that is going to take some time. The cute thing we did during the quarter was we were responsible through our eMee platform for doing the Social Media work for Red Chillies and for Chennai Express. So if you see Chennai Express was usually a successful product in terms of the number of I guess they did 200 crores in the first few weeks, and while Shahrukh Khan of course believe that it was because of him, a lot of people saw the movie because everyone else was talking about it and that sort of our contribution of making social media happens. So these are kinds of products that we have built, but to convert them into revenues that will have impact on our numbers is going to take a long time. So our strategy continues to be in acquiring products that are not strategic and partnering with customers who already have an ecosystem and existing customers.

Pranav Tendulkar And if I can just follow up in terms of what that means for profitability, is there an investment target that you have in mind?

Dr. Anand Deshpande It is not like we have a specific target in that sense, but when the revenues are at steady-state by and large most of them are I would say more profitable as compared to the other services type of business. However, there is an investment that is required upfront. So it depends on the stage of the product that you are in. But by and large they are profitable. So they are not profit-eroding in any way.

Moderator Thank you. The next question is from Abhishek Shindarkar of ICICI Securities. Please go ahead.

Abhishek Shindarkar My first question is regarding the revenue mix across verticals. How do we reconcile the sharp decline in the Telecom contribution and the increase in the Life Sciences contribution?

Dr. Anand Deshpande Munjay is going to answer that question.

Mritunjay Singh If you look at the numbers in the Telecom sector we had a couple of project delays from one quarter to the other. So that is the reason. If we look at in revenue terms it is not a significant size. And Life Sciences growth has been good, that is pretty much broadly little higher than what the company average is.

Abhishek Shindarkar My second is a book-keeping question, if I understand the growth in the Services business was 3.4% which was driven by 3.1% volume, how do we reconcile the other 0.3 or 0.4 because if I look at the billing rate both the onsite and the offshore billing rates were either flat or have declined? So how do we reconcile the maths there?

Dr. Anand Deshpande I think some of it is happening because the ratio is on the blending side in terms of how the onsite and offshore ratios have changed. So if you see the offshore component has gone down. That sort of improves a little bit on that number as well.

Moderator Thank you. Our next question is from Dipesh Mehta of SBICAP Securities, please go ahead.

Dipesh Mehta Yes, I have two questions. One, I expected addition of around 600 odd employees, so can you give us breakup between freshers expected and lateral? And second question is just want to understand top client growth, whether it will be largely driven by IP or we have seen growth in services side also in top clients?

Dr. Anand Deshpande I will give you a description of the breakdown. So out of 626 that we are going to hire roughly around 366 will be like fresher's and the rest will be laterals from the market. Q-o-Q if you look at number it was largely driven by the IP, I mean that is where the significant growth has come. But I think there is a services component. It is not just a one-off IP upgrade. There is overall growth in the whole activities around that client.

Dipesh Mehta And that too was because we have done one transaction with that client in earlier years so that business is tracking up or other IPs are doing well?

Dr. Anand Deshpande No, no that business is also tracking which is showing up here in this. See actually all the acquisitions that we have done, by and large are doing quite well. So overall again all the 3-4 of them that we have talked about, all of them have tracked well this quarter.

Dipesh Mehta Okay, and about location business – can you share the number of what is one-off kind of what we book in Q2 and expected in remaining quarter of the year?

Dr. Anand Deshpande Actually we do not want to give a very specific number on that one. All I can say is that we were able to make a new deal in an existing customer on location in South Africa as I mentioned and that has helped in terms of this quarter's revenues. I do not want to disclose very specifically what that number is at the moment but you could probably figure it out by looking at further analysis but yes it was a good number.

Dipesh Mehta And still some revenue is expected in Q3-Q4, right?

Dr. Anand Deshpande That is correct. Since we said we are going to look at Twitter, we have a few questions on Twitter. So there is a question from Hitesh Shah of IDFC about what is the revenue and IP growth around some of the recent acquisitions and this is again the same kind of question that we just answered?

So overall Hitesh we have had a good growth on all the IP numbers that we have acquired and the client automation product that we have talked about again as we said in the first quarter we had mostly expenses and no revenues on that one but as we go to the second quarter and third we starting to close new accounts there, so you will see improvement on that.

There is another question here about looking at a weak Q3, what is your guidance on the next quarter?

Again, we are not giving very specific guidance as such but we will have to factor in slightly fewer number of days on the Q3 part but the market and the opportunities are good so I am not really ready to write off the quarter at all. We think it could be a pretty good quarter but I do not want to give a specific guidance at this time. Let us go back to the questions from you.

Moderator We will take our next question from Ashish Agarwal of Tata Securities. Please go ahead.

Ashish Agarwal Just wanted to understand on the margins front what are the levers you are working on and what do you see how the margins will pan out going forward?

Rohit Kamat We have a number of levers. If you look at our utilization which is currently at 71%, in third and fourth quarter it is definitely going to improve. In terms of physical capacity we have a very large capacity which is available. We can add around 2000 people without any additional infrastructure cost. So that is another lever and IP revenues is definitely great lever for us because when IP gets added to top line large part of it flows through the margins. So these three levers I can readily identify and we can do definitely better in terms of operational efficiencies and cost controls also.

Dr. Anand Deshpande I would like to add a caution here in the sense that while theoretically it is possible to improve margins, we are in a market at this time where we are seeing opportunities and investing. We believe that it is prudent for us to invest in building on IP and technologies for these newer technology areas. So again we have to think long term rather than just on Q-o-Q numbers what our objective is.

Dipesh Mehta And secondly I think one of the participants also asked this question but just wanted to reiterate, if we look at our IP revenues in the first half of FY14 and may be second half of FY13 they are almost flat and given the fact that we also have HPCA revenues coming in the second quarter, are you concerned that organically our IP revenues have not been growing at least for the last four quarters?

Rohit Kamat Actually you should look at this question in a slightly different way. If you look at the H1 revenues this quarter as this half as compared to H1 revenues for the previous half of last year you will see the growth. And the second half has been actually a better half for us for IP revenues traditionally so actually I am pretty happy that it is flat and we made as much as we made in the second half because the second half of this year is yet to come.

Moderator Our question is from Nitin Jain of Ambit Capital. Please go ahead.

Nitin Jain The first question is on the services business, the first half it has grown at 13.5% and in media there was an interview that you are seeing improved traction and you might do it around 20%. I do not know how true that was but do you expect the second half better than first half, growth greater than 30.5% on a YoY basis?

Dr. Anand Deshpande Again, we do not want to split this thing into too many parts. Overall if you look at our numbers for the whole year, we are trending at about 14.5% to 15% year-on-year growth. That includes IP and services. We expect the second half to be better than the first half and that should give us decent growth on the total overall for the business. In terms of the services part of the business it is hard to say exactly how much it is but again we are trending at about 14-15% and we expect the second half to be better than the previous half. That is where I would like to leave it.

Nitin Jain And sir second on the EBITDA margins since the margins expanded by 420 basis points and as Rohit mentioned the wage cost impact was to a large extent offset by currency tailwind. So I just wanted to understand what was the contribution of IP led business through this margin expansion?

Rohit Kamat I do not have exact number right now because we compute them on an overall basis but I will work it out and get back to you.

Nitin Jain And lastly again on margins do you have any long term range in your mind?

Rohit Kamat If you look at FY13 as a whole we were at 26% EBITDA. First quarter of this year we were at 21.8% and now we are back to 26% but as Anand already explained we are investing in the new competencies and new technologies and you understand in the context of our business all these investments get charged off to P&L. We cannot capitalize them as long term investments. So while with a growth we will expect improvement of margins the fact that we are going to invest back in our business, we may not see substantial improvement. So I expect margins to be in the range of 24% to 25% on a long term basis at EBITDA level.

Moderator Thank you. Our next question is from Soumitra Chatterjee of Espirito Santo. Please go ahead.

Soumitra Chatterjee I had three questions basically. First one is Dr. Deshpande talked about urgency why clients took close deal. Just wanted to understand what is driving that. Second is your client's number seems to have declined by around 5%. We need some more color on that as to what is driving this and third one is more of like in the last year you have acquired quite a few IPs. Which one do you think have surprised positively in terms of potential?

Dr. Anand Deshpande We will have Hari comment on the customer side first and then Hari, if you can address that because I think that was something that you had mentioned as well.

Hari Haran Okay, so when I was talking about the urgency in the market I was not necessarily talking about an urgency from the customer's closed deals. I was talking more from a perspective of urgency of our customers to move to the next generation architecture, urgency from the part of the customer to apply their new business models quickly in the market, so in general an urgency in the transformation of the market and that obviously translates to increased set of activities and the velocity of activities with their partners and vendors such as Persistent Systems. So that is what I really meant in terms of urgency. So it is more from a temperature reading of the market and how customers are behaving with their partners in their discussions for their long term road map.

Soumitra Chatterjee If I could just ask one more question – on this urgency point is this resulting in the time required to closed deals getting reduced?

Hari Haran In some cases yes and that happens when our customers need to respond to their market situation quicker and that we are critically involved in creating some software product or some software roadmap that is going to cause that change and yes in those cases the customer wants to do the deal quickly so they can take into market quicker.

Dr. Anand Deshpande Absolutely I mean that is very consistent with that Hari is mentioning is really true and the consequence of that is that if we have to close deals very quickly we need to be really ready to be in a position to respond to these requirements which requires us to have both capacity, capabilities and also IP or tools and frameworks that we have to be ready with so that we can respond very quickly. And we have seen that whenever we are able to respond rapidly to customer requirements by showing them what can be done POC (Proof of Concept) or a demo or some of those things, those deals actually work out really well and have moved very fast. So yes, speed in the market is very crucial and that causes us to have to do a lot more work to keep up with it. So that is absolutely that is what we see in the market. But it is a good fun market to be in. When you get into a discussion and you are able to show something and quickly close on it, because you have some new story. It is very relaxing, refreshing, and it is a very satisfying experience.

Soumitra Chatterjee And the client's fixed turn around time has declined by about 5-odd percent sequentially.

Dr. Anand Deshpande No, I do not think you should worry too much on that point. There are 2-3 ways and let me explain to you how that happens. So what we are doing is when we show a client number we are showing the number of unique client invoices that we have done during the quarter. There was no invoice on it during this quarter but it comes back next quarter you might see some uptick and when we aggregate it over a year you will see that the unique number automatically goes up because if a client did one thing in first quarter and then someone else did it in fourth quarter we will do the union of those by the end of the year. In general, I think the client quality has improved quite a bit and if you look at the distribution of clients the number of clients in the 'more than 3 million' bucket and all those numbers, I think they are all trending positively. We see good market conditions, so I would not worry too much about the raw numbers. As it is 240 customers for a company like us it is a fairly large number.

Soumitra Chatterjee And just one more question, of all the IPs that you acquired last year, which one has surprised you positively in terms of the potential that you were anticipating when you were just trying to make that acquisition?

Dr. Anand Deshpande I think the location business has done very well for us in the last few years.

Soumitra Chatterjee And on the TNPM side sir, if I could do some calculations I think that the annual revenue run rate from that product has basically moved up. Will it be fair to conclude that?

Dr. Anand Deshpande Yes.

Moderator Thank you. Our next question is from Vibhor Singhal of PhillipCapital. Please go ahead.

Vibhor Singhal Can you just give us a breakup of the 420 basis points expansion of EBITDA margins, how much of it is due to rupee depreciation and how much of it got translated into wage hikes and all?

Rohit Kamat Around 270 basis points is due to currency and there are number of other factors in terms of utilization, in terms of visa cost which we had last quarter which did not repeat this quarter and also there was some gain in terms of gratuity. So it is a culmination of a number of different factors. I have given you two important things. The wage hike was 310 basis points and the currency contribution was 270 basis points, so overall impact was 420 basis points.

Vibhor Singhal So sir that would mean that, wage hike would have been (-310) basis points and rupee would have been (+270) basis points so that means with the impact of visa, utilization and other gratuity that you mentioned would have been around 450 basis points?

Rohit Kamat You are looking at EBITDA level, yes that is correct.

Vibhor Singhal And sir as you mentioned going forward we are looking at margins in the range of around 25-26%?

Rohit Kamat 24-25% basically because of the investments which will flow back.

Dr. Anand Deshpande See again it is a very tricky situation in this. We have to think of about this as a long term business rather than as a Q-o-Q business. So from one side of it we are really anxious to see that we are in a very nice spot. There is a lot of activity in the market. So I am actually encouraging the businesses to focus on building investments and focusing a lot more on being ready for the market as Hari pointed out, the speed of execution is crucial. So trying to sort of optimize profits by not being ready for responding to requests would not be the right thing to do at this stage of the business. So if we were in a slow steady business and focusing on margins would be the right thing to do. I am not trying to say that we cannot do it, it is just a call that we have to make in terms of how much leeway do we provide on the sales and marketing side? Should we make the investments or should we focus on margins? It is hard to do both at the same time, so right now our focus is on growing the business. And we will not compromise the margins badly but we are pushing him a little back.

Moderator Thank you. Our next question is from Abdul Karim of Narnolia Securities. Please go ahead.

Abdul Karim I wanted to check in terms of Product Engineering & Platform business has done quite well this quarter. I would like to understand your perspectives in terms of how did you look at this business possibly may be quarter or two back and are you surprised by the growth that you have seen now? Is there any uptick in demand and do you see the environment materially improving here? Any sort of color you could add qualitatively for the business?

Dr. Anand Deshpande I will give you some opinions and then I will let Hari close out on this discussion because he can give you more on the US side. But see overall the Product Engineering & Services business has been our bread and butter businesses for the last many years. Now if you segment that business there are existing customers who are by and large stable. There is some growth in most of them but they are not going to create dramatic effect but they are growing steadily. There are no major complexities at the moment in that part of the business. The second part is new acquisitions and new business acquisition strategy. So we have deliberately focused our new acquisition strategy around the SMAC areas which are the new technologies around Social, Mobile, Analytics and Cloud. And in those areas our strategy has been to partner with platform players who are the best known companies in these areas and we are working with them to get some new business to happen in these areas. So yes that part is moving well. We had anticipated that for a while. In fact I would say we had anticipated that that should have come even earlier than what it has come right now but we are quite happy to see that and we see this across the press and everywhere else if you read the press and trade journals you will see that everyone is talking about Mobility, Cloud and Analytics and we have been very well positioned in that area. So we are quite optimistic about our current positioning, the investments we have made, the partnerships we have, the market branding that we have in this area, and overall we are fairly well known for these areas. So if growth happens in the world in these areas it will benefit us. That is what we are trying to focus on. Let me ask Hari to say if he has anything more.

Abdul Karim Sir one more question – during the quarter company's attrition stands at almost all time low at 14%, so I just want to understand what your thoughts in terms of retaining the talent especially in the SMAC area or other related areas.

Hari Haran Let me give you an example, sometimes this growth that you see in the market is best explained through concrete examples. So as you know lot of the banks are going through a major automation project in US, which is how do you take the thousands of branches that you have and automate and streamline the processes, for example, why not have these tablets that the customers when they come into the bank can interface with the tablet and do banking as opposed to do banking with agents that sit in the branches. So this initiative has just started quite a bit in number of banks in the new banks and this is quite well documented in the industry. Now in an opportunity like that one of the first things that happens is that how do you automate the interface with the various tablets. This is the type of thing that Persistent does with the client automation product. So as we start working with the client in this particular area that brings us an uptick in the product revenue. Now naturally what happens right after that is there will be customization, integration and other engineering opportunities that come about in the bank in this whole automation project and that brings about more Engineering revenue in interfacing with these banks.

Now the third piece which is interesting and even more exciting is that as that trend begins to kick in some of the software products that are developed by our independent software vendors. We see more roadmaps and more products coming out of those set of clients, that market segment and that again translates to Persistent doing work for that. So this is how the entire ecosystem works where you start with the fundamental business trend that happens and I gave you one specific example of branch and client automation and how that kind of fuels the whole system in terms of both the independent software vendors as well as enterprises engaging both in the product area with us as well as the Platform and Engineering, and Customization area.

Mritunjay Singh Attrition if we look at in the last few quarters it has been actually trending down and that is a result of a lot of things that we are doing internally, so we are not worried about attrition. We work in some of the newer technology areas and so this is fairly common in that kind of a space that we are operating.

Moderator Thank you. Our next question is from Manju Bhashini of Sundaram Mutual Fund. Please go ahead.

Manju Bhashini This is more to understand the IP part of our business. Let us assume that with constant currency basis, if the IP led, I think earlier we had mentioned about the mix being more optimal around 20:80 – 20 towards the IP led part. Now that we have already reached there, where do you think the target is going to be? We would still like to maintain the target at these levels suggesting that the services will also grow much faster or is there a change in the strategy there?

Dr. Anand Deshpande I think we are very positive with what we see in the IP side as well so we are not going to restrict it to 20. We think we can definitely float into 25% in the next few years. And we are looking to aggressively cease if there are opportunities in the IP acquisition or product rationalization areas with some of our customers and there has been a lot of PE activity in this area as Hari mentioned and whenever private equity players come into companies. They look at product rationalization roadmaps and there are certain products that will become non-strategic from their point of view which could be good opportunities for us. So we will continue to look at those for sure. But that is another growth engine for us and the Platform and Product Engineering work is another growth engine and we think both of them should grow. So I am not going to worry too much about the percentages between these two as long as both are growing independently and profitably.

Manju Bhashini What I am trying to understand is, is it a correct reading if we say that IP led will grow faster than the rest of the business and there is a possibility say over the next 2 to 3 years that one third of the overall business can come from IP led. Is there a possibility for that? Is the market so vibrant now as you see?

Dr. Anand Deshpande Actually both markets are vibrant but yes, in terms of a possibility that can definitely happen. But we are not deliberately trying to make one or the other.

Manju Bhashini And in case of the IP led revenues what is the kind of upfront investments that we need to make? Are these capitalized in the quarter we acquire the products from the clients or they are more written-off or the P&L takes the hit whenever the new product comes?

Dr. Anand Deshpande Correct, so we have an amortization line on the P&L right now below the EBIT number if you see there and that number is what we are paying for some of the acquisitions that we have made. Now many of these acquisitions have been made on a royalty kind of an agreement where we pay certain part of the revenues or only a percentage of revenue comes to us. So in that case the upfront consideration is usually not that high. So it depends on per deal basis how that comes up but that number shows up when we have made an upfront consideration we are distributing that over the life of the product typically three to five years.

Manju Bhashini Sure. And over the full life of the product is it fair to assume that the revenues will form more like a sign pattern the first half of the signed curve rather than a linear pattern. What I am trying to understand is maybe it will take a few quarters for you to stabilize at a particular level and then gradually it will trend down.

Dr. Anand Deshpande No, absolutely I think that is a good way but I do not like the sinusoidal part that you mentioned because the zero does not stay long enough but if you were to extend to a trapezoidal thing that would be more like it, yes. There is enough margin to make in the middle. Sinusoidal as soon as you hit the max it will start to hit down, that is not the case.

Manju Bhashini And generally the life of these deals are they more into three years kind of a band or are they larger tenure deals, say 10 years or so?

Dr. Anand Deshpande Well, it depends on the product. Yes it is 3 to 5 years is what we are anticipating.

Manju Bhashini And is it correct to say that at a steady state level, say you reach a steady state may be one year from the time you acquire the product can the margins over there be assumed much higher than the company level margins? Is that a fair assumption?

Dr. Anand Deshpande Yes.

Manju Bhashini But if that is the case say for example we have I think started disclosing the IP led revenues from 2Q FY12 or so when it was around 5 odd million dollars per quarter. Since then to now if you just track the margins and the contribution of IP to the overall mix and also see where the currency was during the same timeframe the margin it seems like more a function of currency rather than more a function of IP contribution increasing. I can give with valid data points. See gross margins in 2Q FY12 was around 31 odd percent versus 2Q FY14 was at 38% and the rupee movement during the same timeframe was 46 to 62.86-odd and the IP contribution has also increased from around $5-odd million to around $13 million now. But I am unable to reconcile this. In that sense the margins should have been much higher, right during the timeframe.

Dr. Anand Deshpande Yes, you are right. But the main thing is that we are continuing to invest in some of these products so they are on the early stage of US sinusoidal curve so that is the reason why you see that. We can give you more specific details. Actually we are coming at the end of this hour, so we really want to take the last two questions. We can follow up on this afterwards.

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

Sandeep Agarwal Just a couple of questions, I know Hari mentioned already we are now focusing on Europe, Asia and also wanted to have some detail on that side. Also along with that I wanted some more light on this recovery which we are seeing in US, how it is going to impact positively but how big is that for us or is it like not uptick in significant delta?

Dr. Anand Deshpande Actually, we are at the last minute on our call so we will say that both these things we have a good opportunity in markets. Yes we are looking at diversification across the market and sometimes the challenges are not because of the market it is about our ability to execute so that is sort of where I think the focus is right now. Let me just be sort of brief here.

Moderator Next question is from Ashish Chopra of Motilal Oswal Securities. Please go ahead.

Ashish Chopra Given the way the market environment is as you are witnessing and considering your own investments into the business, so I just wanted to know do you feel the need to continue adding in the range of 10 to 20 sales personnel in ever quarter or would you feel that you are fairly adequately resourced on that front?

Dr. Anand Deshpande See in our business we will never be adequately resourced per sales. We need to keep adding as we go along. So that is how I will leave it right now.

Moderator We will take our last question from Abhinav Ganesham of Canara Bank. Please go ahead.

Abhinav Ganesham Can you just throw a little light on your medical devices software business for the next two years?

Dr. Anand Deshpande No, I think it is still early to say much on it. We have some business going on and I think in general that market is going to grow. So we are very excited about that plus the variable computing devices and a bunch of things. So we are very optimistic and we have some customers, so that is why we did this whole thing. Two years is too long to project in any part of our business.

Abhinav Ganesham A small caveat here, like with Obama Care if it comes up with restrictions with that then you will have a Plan B in this case?

Dr. Anand Deshpande No I think Obama Care is all about getting wellness to happen. So a lot of the devices we are looking at are wellness devices as well. So I think we can have an offline conversation on this. Let me end at this point

Moderator Thank you. I would now like to hand the floor back to Dr. Deshpande for closing comments.

Dr. Anand Deshpande Thank you very much. I think we are at the top of the hour so I would like to end this call at this time. We are happy to take any further questions you might have on Twitter or by sending us email. I would like to take this opportunity for thanking you all for being on this call and I would like to also wish all of you a very happy healthy and good Diwali and Happy New Year for those who are celebrating New Year in the next few weeks. Thank you very much.

Moderator Thank you members of the management. Ladies and gentlemen on behalf of Persistent Systems Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.