Persistent Systems

Analyst Call

PERSISTENT

Persistent Systems Limited - Analyst Conference Call

Q2 FY18 Results

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MODERATORS

Dr. Anand Deshpande
Chairman & Managing Director

Mr. Mritunjay Singh
Executive Director & President - Services

Mr. Sudhir Kulkarni
President - Digital

Mr. Atul Khadilkar
President – Corporate Operations

Mr. Sunil Sapre
Chief Financial Officer

Mr. Mukesh Agarwal
Chief Planning Officer

Mr. Amit Atre
Company Secretary

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Moderator: Ladies and Gentlemen, good day and welcome to Persistent Systems Earnings Conference Call for the Second Quarter and Half Year ended September 30, 2017. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. In case you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. We have with us today on the call, Dr. Anand Deshpande – Chairman and Managing Director, Persistent Systems; we also with him Mr. Sudhir Kulkarni – President, Digital; Mr. Mritunjay Singh – Executive Director and President, Services; Mr. Atul Khadilkar – President, Corporate Operations; Mr. Sunil Sapre – Chief Financial Officer; Mr. Mukesh Agarwal – Chief Planning Officer and Mr. Amit Atre – Company Secretary. I would now like to hand the conference over to Dr. Anand Deshpande. Thank you and over to you, Dr. Deshpande.

Dr. Anand Deshpande: Thank you, Aman, and good evening to all of you for joining the call.

I am really delighted to announce this "Quarter's Results" and also share with you "Half Yearly Update for the Half Year ended September 30, 2017." During the quarter, revenue was $118.10 million which is 4.5% QoQ growth and 12.3% YoY growth; the revenue in Indian rupee terms was Rs.7,612 million which is a 4.6% QoQ growth and 8.1% YoY growth. The PAT was Rs.826 million which is a 10% QoQ growth and yearly growth of 12.4%.

On the half yearly basis, the revenue for the first half is Rs.231.07 million, revenue in rupee terms is Rs.14,892.67 million and PAT in Indian rupees for the first half is Rs.1,577.12 million.

We are pleased with the performance this quarter; we have seen continued and steady growth in our revenues supported by improved margins. We see strong demand in Data, Digital and IoT, specifically in Healthcare and Financial Services. Our methodology around Software 4.0 is helping our customers accelerate their journey towards becoming a software-driven business. This is regarding this quarter. I am also very delighted to announce that we launched the Smart India Hackathon this afternoon with the press conference which was led by the Hon'ble HRD Minister, Shri Prakash Javadekar. Encouraged by the splendid response to the inaugural edition, we are delighted to launch Smart India Hackathon 2018, which started as a simple idea sparked at Persistent Systems has now evolved into a nationwide movement." So we announced this recently.

I am going to hand this over to Mritunjay Singh – President from the Services side, then I let Sudhir who is visiting us in India and is at the airport in Mumbai and then finally Sunil and then I will take any other open questions you might have at the end, and then we will open it out for Q&A.

Mritunjay Singh: Thank you, Anand. If you see the numbers for the quarter I think we have done fairly well; Services business has grown by 2.7%. Some of these things are a result of our focus on the specific accounts and specific work that we have been undertaking and overall we see this trend in terms of customer trying to do a lot more what industry calls as "Digital Tie Business"… I think last quarter we did talk about some of these things and we continue to see this kind of traction where customers are looking at custom built development on the newer technology and those are the kind of projects that we are winning. Our Enterprise business is expanding but at the same time we have a challenge in ISV business which continues to shrink. So, broadly, I think we look like we are on the right track and we do not expect this to change dramatically in the next two quarters. Thank you, Anand. Over to you.

Dr. Anand Deshpande: Sudhir, can you comment on what you see in your business?

Sudhir Kulkarni: Absolutely, Anand. Thank you so much. One of the major initiatives at Persistent Digital is building next-generation transformative platforms and solutions in Healthcare and Financial Services. I spoke about this last quarter about launching risk-based authentication solutions based on technology that we bagged in our deal with USAA. I am happy to announce that we have not only built NEURO, the product but also have a first few customers on the solution including some major names in the financial world. The build-out of the open source healthcare platform with Partners HealthCare which we announced earlier is also coming along nicely and you will hear of applications built on the platform very soon.

Digital Health is a major opportunity for us and we will be focusing on it in coming quarters in a significant way. While we have begun by working closely with healthcare providers, this is a vast area of opportunity for us that encompasses use of Artificial Intelligence for drug design, Internet of Things for innovative solutions again as a platform and other innovative uses of technologies like blockchain for universal EMR or Electronic Medical Record, etc., So our approach of co-creation with major institutions in the health space is working well and will yield results over the long-term. During Q2, we added 19 new Enterprise customers, of which at least half are engaged in major digital initiatives and we plan to grow them into multi-million dollar accounts for us in coming quarters. Some of the major ones include a large payment processor, a large investment management firm, a major healthcare provider and many others. In many of these, our teams are opening up interesting digital program even as they continue to grow the ones already launched at existing customers in Healthcare and Financial Services.

On our acquisition of PARX, the platinum partner for Salesforce in the DACH region in Europe, I am happy to let you know that the on boarding of the PARX seamless move and I look forward to growth in our Salesforce business in Europe as well as our overall business in that geography. Far too long our dependence on our US business has seen disproportionate and we will now be investing in ramping up our European presence and our business there. The Digital OU grew to 24.67 million, a growth of 21% QoQ and 60% YoY. Though some of the deals pushed over into the next quarter at the last minute, based on the consultative sales team that has now been brought onboard and is being enabled, I am confident that we will see healthy growth in Q3 and also going into Q4. But what is revenue without profitability? I am happy that the team that we have built was consciously able to control cost to improve gross margins for the unit as well while maintaining the revenue growth.

I am handing it over back to Anand and happy to take any questions. Thank you.

Dr. Anand Deshpande: Let me have Sunil give his "Commentary on the Financial Data" and then we will open it out for questions from the group.

Sunil Sapre: Thank you, Anand and good evening to all of you. You have heard the business updates from Anand, Sudhir and Munjay. I will give you some updates on the margin movement, CAPEX and liquidity position as on 30th September. So revenue for the quarter was Rs.118.10 million, recording a growth of 4.5% QoQ and 12.3% YoY. This revenue includes $1.9 million from PARX, the recently acquired business in the DACH region. In rupee terms, the revenue was Rs.7613 million with a growth of 4.6% QoQ and 8.1% YoY and the first half revenue was Rs.231.07 million with YoY growth of 10.1%. The composition of revenue in terms of linear revenue, it grew by 6.2% QoQ mainly with the increase in volume by 5.4% and increase in billing rate by 0.8%. The onsite linear revenue grew by 11.4% driven by volume growth of 11.5% and decline in billing rate by 0.1%. The offshore linear revenue grew by 2.7% QoQ driven by volume growth of 4.2% and decline in billing rate by 1.5%.

Coming to the Margins: EBITDA margin was 15.2% as against 14.3% in the previous quarter primarily due to the improved operational efficiency, the utilization for the quarter was 78.6% as against 77.2% in the previous quarter. Growth in EBITDA was 10.9% QoQ and 4.5% YoY, the YoY growth is mainly impacted by the exchange rate movement.

So far as depreciation and amortization is concerned, it was at 5% as against 5.4% of revenue in the previous quarter. The EBIT was 10.2% as against 9% in the previous quarter.

The treasury income was lower at Rs.133 million as against Rs.183 million in the previous quarter. In the last quarter we had some gain on sale of long-term investments which is why the other income was higher. The gain on foreign exchange was Rs.203 million as against Rs.184 million in the previous quarter. PBT was Rs.1115 million at a margin of 14.6% as against 14% in the previous quarter. The growth in PBT was 9.3% QoQ and 13.2% YoY. ETR was 25.9% for the quarter. PAT for the quarter was Rs.826 million at 10.9% as against 10.3% in the previous quarter and the growth in PAT was 10% QoQ and 12.4% YoY. The operational CAPEX for the quarter was Rs.46 million. The cash and current investments on the books amounted to Rs.9992 million at the end of September 30th as compared to Rs.8745 million at the end of June. The value of forward contracts outstanding at the quarter end was $100 million with an average forward rate of 67.99.

Thank you all. I Wish You All a Very Happy Diwali and I hand it back to Anand.

Dr. Anand Deshpande: Thanks a lot, Sunil. As I have mentioned in the past, we are on a transformational journey and I think this quarter was an example of a steady quarter with good progress, both the top line numbers and bottom line numbers have gone up and especially the profit number was better than the growth number on the top line. So I think overall fairly a good quarter.

I am going to open this out for question-and-answers and answer any specific questions you might have as you look at the numbers in more detail.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: Anand, one, on the headcount of the IP-led business, there is a kind of decline there. So what is the key reason – is it mostly due to seasonality and you see some kind of some other reason there? Secondly, on the enterprise side, we are seeing huge addition of clients. Is it all Digital Enterprise-led or it is also across? Finally, Europe already Sudhir commented but just wanted to understand in Europe what we are getting into more are those Digital Enterprise clients or what is our approach there or we are looking for traditional services side?

Dr. Anand Deshpande: You have three questions. I should try to remember them one-by-one. So first point was regarding the IP-led headcount reduction that you see in terms of APM for the personnel allocated to IP is lower this quarter. So this is part of the standard things that are going on with respect to our existing products where we are trying to optimize the headcount on an ongoing basis and especially for some of the projects that we do in Accelerite there is an ongoing effort to improve the team size and also the same thing is happening on our IBM IoT business. This is a natural progression as we get more and more stable revenue products, R&D efforts come down and this is really what is happening. So there is no seasonality but this should be an ongoing trend for the same products overall every quarter we should require fewer people on that. Regarding your second question about what is happening in terms of the customer numbers going up very sharply, I would like to point out that one of the reasons why that number has gone up very sharply is because we added the customers count that we got from PARX. So, we have about 100 plus customers that we added from PARX customer portfolio. These are all in Europe and mainly in the DACH region which would be the German speaking European region. Most of these customers are a mix of various things. Typically, they have been in the Salesforce implementation space. So lot of the work would get classified as enterprise type projects. This is part of our Digital story as well. When Sudhir mentioned that he is trying to enhance Europe because he is running Digital and PARX is part of the Digital team and other things going on, we are really pushing new generation digital work out of Europe and other parts of the world as well. We will continue to do services in Europe, we do have a decent footprint and we are going to try to increase that as well. But I think the large numbers that you see that has gone up from previous quarter to this quarter is because of PARX. The acquisition we announced in the month of July, we actually completed the work at the end of July. So this quarter we are showing the revenue for only two months and a lot of the details that we have are sort of still the analysis and exactly which accounts can be formed further and all that has not been done yet. So we will tell you more about PARX in the next quarter's meeting.

Sandeep Agarwal: Alliance shows some weakness this quarter. Is it one-time or if you can give some comment there?

Dr. Anand Deshpande: That comment again I will share this because this is probably something that you will see from other people as well. There is a large percentage of our revenues that is coming from the IBM CE/CLM product that we work with where we get revenue share. In general in IBM's way of how they operate, revenues tend to be better in their calendar Q4 as compared to calendar Q3. So their third quarter seem to be weaker than their stronger quarters. But by and large I think we are on track and there is nothing unusual in the alliance number looking as what it is. If you look at and compare it with last year this should look consistent in terms of the growth that you would see here.

Moderator: Thank you. The next question is from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: Just a couple of questions; first on margins, how do you see that really progressing considering we have got wage headwinds coming up in second half of the year? Secondly, you have partially answered it, but the seasonality in 3Q for the alliance business, should that be similar to last year?

Dr. Anand Deshpande: The answer to the second question is yes, we expect somewhat similar at least on the IoT side, I cannot tell you for the whole alliance but if you looked at what we did in those kinds of quarters we expect a similar run rate…of course, run rate this year has been better than last year, so we will continue to see that kind of a run rate on the IoT business that we have. So that is one point. Regarding wage hikes and margins and all of that stuff, yes, of course, we have announced that we are going to increase the salaries for those people who are in the junior category, about 75% of the staff starting 1st of October, so we do see an impact of between 1.5 and 2% extra in terms of the cost of salary hikes but we also see growth in revenues and other operational efficiency. So we think we can maintain and improve margins. I am quite confident that by the end of the year we will have margins that are comparable to better than what we had last year.

Apurva Prasad: I missed out contribution of PARX revenue for the quarter.

Dr. Anand Deshpande: $1.9 million.

Moderator: Thank you. The next question is from the line of Nitin Padmanabhan from Investec. Please go ahead.

Nitin Padmanabhan: This is on the Services business specifically. Over the last couple of quarters, I think there is a lot of work that has gone into post the reorg, we seem to have consecutive quarters of growth. Do you think that this segment is sort of poised for versus what we normally expected was the flattish kind of growth going forward… do you think it is back to some growth that we can see for the segment going forward?

Mritunjay Singh: Services business as you know is a business with a lot of headwind, right. Last time we talked about is that while the business has a headwind we are chasing lot of deals and when the deal closes and a couple of customers when they start to spend money on some of the things which is riding our suite, then we go after that and we are able to win that. So while we are focused on making sure that we grow that. I would not paint any big rosy picture around this because this business will continue to have headwind. We are trying to do well in this business, but I do not see there is any structural shift in the market. So we will continue going after deals, we will continue trying to mine the accounts. It is very difficult to forecast what will happen in this business because of the market forces that I just described. But I think based on the client and what we see, we definitely think that we will be flattish and we will see if we can do better than that.

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

Mohit Jain: First is on IP-led revenue. It has been almost six quarters where there are flattish revenue, close to 30 million. You have mentioned some deal wins in the press release this time as well. So is there any outlook over the next 12-months on IP-led revenue, how are they going to perform?

Dr. Anand Deshpande: I do not want to give an outlook but as such I think it will be much better to say this after the next quarter’s numbers. The IP revenue is growing slowly but steadily and there is seasonality as you are aware of. So let us talk about this more after the calendar Q4 number. I think if we get the numbers that we are expecting in Q4, then things should be okay.

Mohit Jain: On PARX why was the contribution zero this time, you have mentioned it is 10% margin business, but nothing contributed to profitability this quarter, so any upswing we can see in third quarter because of PARX?

Dr. Anand Deshpande: Part of it has to do with the way the adjustments were made and also some payouts that had to be made. So it ends up being kind of like that but it will maintain what we had said, it is just that it was half quarter and we have provided for certain payouts, so some of that has happened but there is nothing unusual there right now.

Mohit Jain: Next quarter it should come back to 10?

Dr. Anand Deshpande: Again, what happened this quarter is that the PARX thing came on line with respect to joining the company only in the month of August. While we have August and September revenue the accounting systems for both teams have not been fully integrated as yet. We expect that to happen during this quarter. We will be able to give you far better information on the profitability and the provisions and other things potentially in next quarter. That is sort of where it is. I think they have done well in this quarter and the pipeline that they are showing actually looks healthier than we had projected. So I think it should be fine.

Mohit Jain: Last is on utilization. Now as the people number is going down. Like how much scope do you see in the utilization overall?

Dr. Anand Deshpande: Clearly, the utilization has gone up as you can notice but it cannot keep growing up infinitely. I think we are aspiring to get offshore linear utilization in excess of 80% and onsite in excess of 90%. So we have a few percent points there. It is not like we are going to have huge numbers than other places.

Mohit Jain: 80% is something you can run after?

Dr. Anand Deshpande: I think 80% is doable but too much beyond that may not be easy. There will be some ongoing fluctuations partly because you have fresh graduates that come in and a whole bunch of things like that and you cannot run exactly on a number, but by and large right now we are aspiring to see how to move it to 80% on offshore and 90% on the onsite side.

Mohit Jain: Can you share the quantum of wage hikes for this quarter?

Dr. Anand Deshpande: 6-8% is what we have announced for those people who are in the junior category. Junior category in our thing would be those who are let us say between zero to say 7-years of experience and that is about 75% of the population of the company. For the senior people in the company we have said that we will review this at the end of November/early December and we have provisionally been planning to see how to increase the salary for the next group starting 1st of January, so that is really the plan.

Mohit Jain: That will come in the fourth quarter, right?

Dr. Anand Deshpande: Yes, I hope we are able to make decent numbers and we should be able to pay that number in Q4 for the rest of the company. That is the goal and I feel we can do it.

Mohit Jain: Lastly, this 200 bps margin improvement guidance you gave at the beginning of the year. Does that hold true from 4Q perspective, do you think could slip to next year?

Dr. Anand Deshpande: I do not want to say exactly but we are aware of that and we are trying to track to it. But of course this is hard especially because the rupee also changed quite dramatically and the fluctuations that we saw in this quarter for rupee were fairly high, so lot of that has to do with it as well but I think the operational efficiency numbers as you see on the next level of detail you will find that they have done quite well this quarter and we are on a path which I think should show better numbers next quarter as well. I think we are on the right track at the moment to improve margins.

Moderator: Thank you. The next question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: Hey, Anand, just two questions; firstly on the CE/CLM product profitability, is it tracking as per your expectations and by when do you think it should break even? The second question, just wanted to correct my understanding that despite the impact of wage hikes in second half, do you expect the full year margins in fiscal '18 to be better than fiscal '17?

Dr. Anand Deshpande: The answer to the second question is 'yes', we do expect to be able to improve our margins this year as long as the rupee does not do anything crazy. On the first part of it, regarding the profitability margin, as I have mentioned before, there are six months cycle that they have for product releases. So we are going to release a version of the product in the December quarter. The next cycle is definitely profitable cycle. This cycle is by and large even to small profit when you look at the six months product cycle that we are running right now. Again, in a lot of these cases, the top line has a huge impact on what the profitability is going to be. So we have projected a certain number for this year in terms of what the revenue is going to be now. We have to watch this fourth quarter number if that is in line or exceeds it, then that will have an impact on the profitability. Next quarter's number is very critical to tell you more about the entire profitability of the company as well in some sense.

Moderator: Thank you. The next question is from the line of Mayur Parkeria from Wealth Managers. Please go ahead.

Mayur Parkeria: One observation was though the profit after tax has grown higher than the growth in the sales. If we look at the operating EBITDA that has grown only 5% when you look at the rupee growth which is also in the region of around 8%. So at an operating level, we still have the margins which have been lower. So would you like to highlight how do we see that in the light of the fact that we expect the margins to improve by the year-end?

Dr. Anand Deshpande: I think operating margins this quarter have improved as compared to the previous quarter. If you look both at EBITDA level and EBIT level, they have gone up in terms of percentages. I do expect that we will have better revenues especially because of the way the seasonality is on some of the IP revenue that we have for next quarter. So I think we are tracking fine as far as I can see at the moment. Operational efficiency during this quarter again lot of these things take time for it to be visible. So I can actually already see the fact that some of the changes that we made mid-quarter last quarter starting to have had some impact which was in the profitability numbers for this quarter. But you will see some of that in the next quarter as well.

Mayur Parkeria: We are getting the benefit of the removal of the restrictions for the IBM people and deploying them more on the services side. We are able to leverage more on that and that is playing it out in the cost structure?

Dr. Anand Deshpande: That is not yet. We have been managing our team sizes on development on that product on a six month cycle. The product has to ship in December and then we can reduce the team and move people around. That will happen post-December. Right now, this quarter there was no change from previous quarter.

Mayur Parkeria: Last question which is not related to quarter but just on a slightly broader understanding of the Digital revenue segment. We have broadly three major platforms partner with Salesforce, Appian, Oracle. Firstly, how would the revenue broadly be if one has to look at that and within that are the revenues more in light of their own platform deployments or are they more on the solutions which we have due to the deployments which happen?

Sudhir Kulkarni: A large part of our engagements with these three partners as well as the work that we do directly with some enterprises on the Enterprise Digital side are solutions. We traditionally grew our business let us say with Salesforce as a partner that is working on the Force.com platform and building solutions on top of it rather than implementing CRM Systems, Services, Cloud, etc., So I would say that our mix is more in favor of the solution side as you ask rather than on just the implementation side.

Mayur Parkeria: Migration to Cloud -- That will be part of the solutions?

Sudhir Kulkarni: Yes, migration to cloud is also not like just lift and shift basic business, it also has not been a core piece of our work. We have always had the DNA of building product as an OPD player for a long time. So we have actually leveraged that strength and built lot of solutions with these partners like NEURO for example, risk-based authentication product is actually born out of our deep understanding of the identity in access management scope So that is what we have been doing.

Moderator: Thank you. The next question is from the line of Madhu Babu from Prabhudas Lilladher. Please go ahead.

Madhu Babu: Sir, regarding NEURO, what is the kind of deal sizes we can expect and how would be the margin trajectory like initially would we have a lower margin because of higher sales cost, etc.?

Sudhir Kulkarni: This product was built and the first version was kind of released in end of May and we have now got a couple of customers that have signed up for this. We do not know the price point that we would add, but I would say that the price point would be anywhere between 100 to 250k at a specificity but right now until such time as I have at least 5 to 10 customers that have really bought into it and we have implemented and understood the entire product roadmap, I do not think that we could take that as a norm.

Madhu Babu: These are mid-size banks or smaller banks who are buying the product?

Sudhir Kulkarni: This product falls right in the risk-based authentication space and these are all kinds of financial institutions, the one that we have signed are not bank per se but they are financial institution that do a lot of payment processing kind of transactions.

Madhu Babu: Just the other question, in release we have mentioned for the insurance case there is a reversal of around Rs.4 crores. Can you explain more on that?

Sunil Sapre: This refers to the insurance claim that we had for one of the IP infringement cases in the fourth quarter. You would find that we had made a settlement on this particular claim and there was an insurance claim lodged with this insurance carrier and you would have found in the Q4 financials we had made an expense provision and that was reported as an exceptional item which was net of insurance claim receivable. So, what has happened in this quarter is that we have received more amount from the insurance company than what initially we thought we would receive and this Rs.4 crores is that excess amount that is credited into the P&L.

Madhu Babu: So the EBITDA we have to adjust for this Rs.4 crores if my reading is right?

Sunil Sapre: There are other items, for example, last quarter we had a benefit out of actuarial valuation. So if you balance off these, that benefit was also of the order of similar Rs.3 crores kind of order. The impact on EBITDA is actually not really arising out of this.

Madhu Babu: Another thing is strong traction in the non-top client in 2 to 5 and 6 to 10 and even non-top 10. I think the buckets are showing good traction. Any particular reason on that front?

Dr. Anand Deshpande: I would not read too much into it. Clearly, we are trying to grow our business across the board and this quarter was a soft quarter for our top one customer because of the seasonality of IP revenue that we talked about already. So, I do not think I would read too much into it beyond that at this moment.

Madhu Babu: Sir, the headcount if you see even on YoY we have declined. I think we have extracted the operational efficiencies well. So do we see further headroom in terms of able to drive non-linearity in the headcount side or are we reaching the peak?

Dr. Anand Deshpande: No, I think there is still some room, but clearly we are operating at 77% utilization, in India that can go up a bit, we have also reduced the number of fresh graduates we have hired. There will be some room but we are near the bottom now in terms of reduction of headcount. I would expect next quarter to see at least some positive growth QoQ at least on this quarter for headcount adjustment. But again there is going to be continuous efficiency adjustments on an ongoing basis. The fact that we have dropped by about 200 and the headcount I would not worry about that necessary. I think it was a desirable effect that we were looking for.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBI CAP Securities. Please go ahead.

Dipesh Mehta: Just two things; if I look our subcontracting cost, it is inching up every quarter, now it is almost 18% of our salary cost. Can you help us understand how we plan headcount and how we deploy resources and how one should look this line item going forward? Second thing is about I think a couple of quarters back we indicated about new product launches Concert, Sentient and all those things which can help us drive our IP revenues. So if you can help us where we are in that journey?

Dr. Anand Deshpande: In terms of the contractors, the reason we have contractors is lot of them are also onsite in the US, broadly where we find that there are new projects or other staffing requirements we have resorted to hiring contractors on the projects, some of that is coming in from there. There is no specific plan to either increase it or make that really a big thing but I do expect it to retain at that level or go down slightly but it will stay at that point is how I see this. In terms of some of the new product launches specifically around Sentient, ShareInsights and others, this quarter we did have revenue in some of them, so if you saw the Accelerite business it has gone up a bit and we are sitting on a product that is declining revenue, but the reason we are able to retain the revenue trajectory at that point and see some growth. I do see some more growth over the next few quarters is because of revenues that we are able to get against new products. We are getting good traction, sales are happening, but these things take time and they are not going to become huge numbers very quickly. So we are not quite at this stage of the hockey stick as yet, but we are seeing steady improvement QoQ in terms of the numbers for both Sentient and ShareInsights.

Dipesh Mehta: Is it possible to share some numbers because if I look IP number of customers, I think we are lowest for last few quarters kind of thing. So if you can help us understand new IPs which we are investing into and where we see future potential how the traction is into new versus the legacy where we are seeing some decline?

Dr. Anand Deshpande: By design right now what we are doing on end point client management which is where Sentient sits and also Rovius which is the cloud platform. We are definitely focused on existing customers and adding more revenues to them by selling new offerings because when we are selling something new it is easier to go to the existing customers first. That is what is happening. On the IoT side, which is the Concert product, we are definitely going after new customers and investing in new R&D work there. So that is really what I can say at the moment on that one but I think these are doing quite well at the moment and I am quite pleased with where we are at the moment. On the investor day, again this year we will be able to show you the exact product and the demos and exactly what is going on and perhaps share with you some customers for whom we are working with those products. It is hard to do these kinds of technical discussions or tell you exactly more on this particular call but we can take this call offline and we can show you what exactly is going on, you can also talk to Nara, who heads that group.

Moderator: Thank you. The next question is from the line of Abhishek S from Equirus Securities. Please go ahead.

Abhishek S: Sir, the sequential growth in Europe has been really strong excluding the contribution from PARX. Can you highlight what are you seeing there?

Dr. Anand Deshpande: Actually, one other thing that happened in Europe was we actually closed a nice deal as part of the Accelerite portfolio. So one of the IP revenues came in from Europe, so that made that happen. Now the fact that we have a team from PARX and some other people we have roughly 200 people in Europe, that helps in sort of creating a critical mass of people in the Germanic and the German-speaking region. So we are hoping that the momentum that we can get and gather from there will help us increase our European position. This is by design we would like to see that go up but we are not doing it at the expense of our US numbers. We want the US numbers to keep growing as well and European numbers to grow but as a percentage of total we think we would like to see higher growth in Europe and hence increase in the percentage out of Europe.

Abhishek S: The second question is just a clarification; so you said there could be an incremental impact of 150-200 basis points due to wage hikes. So this impact you highlighted especially for Q3 or this includes the entire wage cycle from January as well and this impact is for the full year?

Dr. Anand Deshpande: No-no, this is the increment that will happen in Q3 and of course once you increase salaries, that expense will continue in Q4 as well. But we do expect the revenues will be higher than that and we will be able to still improve profits despite the salary hikes that we are expecting in the next quarter.

Abhishek S: So there will be incremental impact in January cycle as well, right?

Dr. Anand Deshpande: Yes.

Moderator: Thank you. The next question is from the line of Bhavik Mehta from CLSA. Please go ahead.

Bhavik Mehta: A couple of questions; first is YoY Services appears to have remained slow due to ISV, this appears to be different from peers. Also over the last year while we have seen gross margin improve across like Digital alliance, however margins have fallen in the Services equally that has given back all the gains. So where does the profitability of the business stabilize if Service margin continue to fall?

Dr. Anand Deshpande: Services margin fallen, lot of that has to do with the fact that our Onsite numbers have gone up as compared to the previous year and the second thing is also the currency fluctuations have also contributed to that part. But by and large if you look QoQ the numbers on the Services side have improved. We think that while there will be some headwinds on certain projects, we are also winning new deals on the Services side. Even though we will not see very high growth rates on the Services side, we will continue to see some growth on Services and we have to push the overall growth rate higher because of higher numbers on the Digital business which has been the strategy that we have been articulating for a while. We also expect the IP revenue to overall grow despite seasonality on QoQ basis.

Bhavik Mehta: The second quarter is subcontracting costs are up around 400 basis points YoY both in first quarter and second quarter. So when can we expect that to come down?

Dr. Anand Deshpande: You have to look at it as part of managing the overall employee expenses, some of it will go to contractors, some of it will come directly. The benefit of having contractors in certain cases is that you can let them go if you do not need to and if you have short-term requirements you will need to do that. I am not trying to necessarily optimize contractors cost as such. We are definitely trying to optimize to make sure that the utilization on the contractors side is more than 95% rather than necessarily try to say okay, how do I reduce contractors expenses. They need to be profitable is clearly the goal and I think sometimes there is a benefit on using contractors as compared to using your own employees.

Moderator: Thank you. The next question is from the line of Anuj Jain from Value Quest Capital. Please go ahead.

Anuj Jain: My question is about the accounting policy for treatment of intangible assets. Up until FY'14 your annual report used to disclose the depreciation rates that you would charge for all assets including depreciation or amortization on intangible assets. Effective FY'15 there is no such disclosure. My first question is why is that? My second question is that in FY'17 you have capitalized Rs.217 crores in intangible assets mainly on account of certain contractual rights in respect of one of the products acquired, capitalization of internally developed intangible assets and acquisition of software platform and software licenses. Could you help us break out these numbers? You have also capitalized Rs80 crores additional in the six months ended September. So what is that capitalization for intangible assets and what does this mainly pertain to, could you help us understand that because the number is very significant, more than Rs.500 crores gross that you have capitalized over the years and the accounting policy for that is completely missing from the annual report because it gives you a lot of flexibility in managing earning?

Sunil Sapre: The recent addition is basically the PARX acquisition. You would have seen that the acquisition was of the order of CHF8.5 million and that is what is going into the intangible assets in form of customer contracts that get valued as intangibles. They basically get amortized as we move into the years over a period of time. So that is the recent big item. In the last year what you have observed is there are two items – one is the acquisition that we have made of the Master Data Management (MDM) product from IBM which was of the order of 17 million and the other was the Inflight product that we acquired as a part of CE/CLM what we call as the IBM IoT transaction where we continue to co-invest with IBM over a period of two years. So far as the question that you had on the accounting policy is concerned, the intangible assets get amortized over the period of their economic life. So it will not be possible for having one particular number like a number that we assign to tangible assets. In case of customer contracts based on the underlying visibility and the tenure of the contract did get amortized, in case of contract, say for example, in the nature of MDM or in the nature of the IBM IoT it gets amortized over the period of the contract. So that is the reason why there is no specific mention of number of years over this intangible assets. It is there as a separate note which you can refer, it is the Note-C which is part of the accounting policy disclosure.

Anuj Jain: Yes, we saw that. We just want to know what is the range of period over minimum to maximum which you are amortizing this significant recognition of assets from the balance sheet?

Sunil Sapre: It is three to six years.

Anuj Jain: On the IBM deal, are there any themes that you took over, what is the nature of that capitalization on the IBM deal, what is that cost – is that people cost or something else?

Sunil Sapre: In case of IBM, there are two items – one is the MDM which is the consideration that we paid to IBM which is 17 million and second item is the Inflight projects where we are co-developing IP with IBM. The nature of expenditure is basically in form of people and the cost of software that goes into this development of IP.

Anuj Jain: There are no revenues from this IP which are recognized on the P&L?

Sunil Sapre: No, the revenue is happening in form of revenue share from IBM as you know. While these inflight projects as like Anand mentioned, there are periodic releases and we expect the major co-development work to get concluded by the end of this year.

Anuj Jain: I guess what you are saying is that you are recognizing the revenues but the matching expenses pertaining to people cost are being capitalized, is that right?

Sunil Sapre: No, the matching expenses are getting capitalized in form of the IP capitalization which is getting amortized, the amortization has already started from last year, so there is matching cost as well as matching revenue.

Moderator: Thank you. The next question is from the line of Ruchi Burde from Emkay Global. Please go ahead.

Ruchi Burde: I have a related question to previous question regarding depreciation and amortization. This quarter we saw especially sharp decline in the amortization line. Would it be correct understanding that in absence of any further capitalization on new IP products this line can trend down here onwards?

Sunil Sapre: What has happened in this quarter is one of the Accelerite products completed its tenure of amortization and that is why the amount of amortization has come down. But as you know we have acquired PARX for which the amortization has come for two months in this quarter and next quarter it will be for full quarter. So I do not think that is a consistent downward trend or something for some time. You should expect depreciation and amortization as a combined item to be in the range of 5% to 5.2% of revenue.

Moderator: Thank you. The next question is from the line of Girish Pai from Nirmal Bang. Please go ahead.

Girish Pai: Sunil, you mentioned that the amortization for the CE/CLM is going to be in the range of three to six years. Does it mean that the contract with IBM will be for a maximum of six years and from then on what is the revenue share like does the product go back to IBM, how does that work?

Sunil Sapre: The earlier question was to know the broad range over which the intangibles get amortized which is three to six years. With respect to specific IBM case, the contract period with IBM is actually much longer of 10-years. But we have planned on conservative basis that we will be amortizing this over a period of five years with respect to the IBM capitalization.

Girish Pai: Anand, you had mentioned that you would be growing the CE/CLM business in double-digits this year FY18. If you look at the calendar year you have finished nine months. Is the growth tracking the double-digit number that you mentioned?

Dr. Anand Deshpande: How much is it tracking, I am not sure. The last year whatever we did in CE/CLM, what we will do this year, we do expect low double digit say 10% growth YoY on that product and it is tracking at that and we will know the exact number when we see the Q4 number, but that is clearly the plan and that is what we are working on.

Girish Pai: There is a difference between the alliance number and the top client number, it is a few hundred basis points. Does it mean that you have alliance is besides the one with IBM?

Dr. Anand Deshpande: No, actually there are some other customers for where we are billing directly. For example, if we do a project which we bill directly to the customer, right, still part of that business where it is not top 1%. So say for example if we did a services project as part of the CE/CLM team, and it got executed for a particular customer, then it would not be counted as IBM as top 1% but it will show up in the alliance part. So the alliance piece should be by and large greater than the total number that you see on the top 1%. That said, there is some cross-selling and other things that is happening as well. It is not a huge significant number. So I do not think it is something… I can explain to you later offline but it is 6:59 pm so I am going to ignore this one right now.

Girish Pai: Sunil mentioned something about Inflight projects. I did not catch that. This is not discussed before. Is this something new that we need to know?

Dr. Anand Deshpande: No, actually those are all the projects work which is going on with the CE/CLM. Everything else got an Inflight. It is a product development team, so there is ongoing work, that is going on, that is all we can say.

Moderator: Thank you. The next question is from the line of Ritesh Rathod from UTI Mutual Fund. Please go ahead.

Ritesh Rathod: This MDM deal, when this was announced?

Dr. Anand Deshpande: About five, six quarters back.

Ritesh Rathore: Have you discussed this thing in past transcript or concall just so I can go back and refer?

Dr. Anand Deshpande: It should be there, I think it was disclosed.

Moderator: Thank you. We have a follow up question from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: Quickly on the Digital part, Sunil did talk about push out of some deal. It will be helpful if you could quantify how big those numbers were and what could have been the impact had those not been pushed out and do you expect the growth rate in Digital to continue to remain strong in the range of 50% for the full year?

Dr. Anand Deshpande: The answer to the first question is about half a million dollar. The second part is 'yes', we think we can retain a very healthy growth rate on the Digital piece. I am sort of being brief on this one because we are really close to 7 p.m. But if you have more questions, we can answer them offline.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Dr. Anand Deshpande for the closing comments. Thank you and over to you sir.

Dr. Anand Deshpande: I would like to thank all of you for being on this call and I would like to wish all of you and your family all the best of health and happiness as we enter the Diwali season may you have a great year ahead as well. Thank you very much and we will close this call.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Persistent Systems Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.