Persistent Systems Limited

Analyst Conference Call

Q4 FY19 Results

Date: Apr 30, 2019

Time: 11:00AM IST – 12:00PM IST

MODERATORS

Dr. Anand Deshpande
Chairman & Managing Director

Mr. Christopher O'Connor
Executive Director & Chief Executive Officer

Mr. Jitendra Gokhale
President – Accelerite Unit

Mr. Atul Khadilkar
President Delivery Operations – Technology Services Unit

Mr. Sunil Sapre
Executive Director & Chief Financial Officer

Mr. Mukesh Agarwal
Chief Planning Officer

Mr. Amit Atre
Company Secretary

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Moderator: Good morning ladies and gentlemen, welcome to the Persistent Systems earnings conference call for the 4th quarter of FY19 ended March 31st 2019.

We have with us today on the call Dr. Anand Deshpande – Chairman & Managing Director. We also have with him Mr. Christopher O'Connor – Executive Director & Chief Executive Officer, Mr. Jitendra Gokhale – President (Accelerite Unit), Mr. Atul Khadilkar – President (Delivery Operations, Technology Services), Mr. Sunil Sapre – Executive Director & Chief Financial Officer, Mr. Mukesh Agarwal – 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.

Anand Deshpande: Good morning all of you and it is a pleasure to welcome you to Persistent Systems' annual conference call for the annual results and for Q4 results. I am going to start by giving you a short update in terms of the financial numbers. The revenue for the year was $480.97 million which is a 2.2% year-on-year growth. In rupee terms, we had 11% growth and the total revenue was Rs. 33,659 million. The EBITDA growth was 23.9% and overall PAT was Rs. 3,516.79 million. For the quarter as such, the revenue was $118.30 million which is a degrowth of 2.1% and the PAT was Rs. 844.73 million which is a QOQ degrowth of 7.9%.

Beyond these financial numbers, I would like to report that the board of directors at its meeting concluded on the April 27th recommended final dividend of Rs.3 per share on the face value of Rs. 10 each. This is in addition to the interim dividend of Rs. 8 per share that the board had declared in January 2019. So, total dividend for the year was Rs. 11 per share. Clearly, this dividend recommended by the board is subject to approval by the members during the annual general meeting. The board had approved a share buyback plan via the open market route for an amount of Rs. 2,250 million at a maximum buyback price of Rs. 750 per share. As of April 26, 2019, the company had purchased 2,230,113 shares for a total value of Rs. 1,421.71 million representing 63% of the total buyback size.

I would like to also report that we have Christopher O'Connor here who joined us on February 25th as the CEO. The board appointed him as an Executive Director in the board during this board meeting. I would like to also announce that Sandeep Kalra who used to be at HARMAN & Samsung will join as the President of the Technology Services Unit on May 1st, i.e., tomorrow in California.

With this, I am going to hand it to Sunil to give you a little bit of an overview on the financial numbers and I will take this back, make a few introductions, and then have Chris share his experience with the company for the last 2 months.

Sunil Sapre: Good morning to everyone. You have heard Anand on a few updates and some of the leadership changes that we have had in the organization. Let me explain the financial performance for the quarter and the year ended 31st March 2019. The revenue for the quarter at $118.3 million was lower by 2.1%

quarter on quarter. On YOY basis, it was higher by 1.2%. In INR terms, the revenue was Rs. 8,319 million which was lower by 3.7% on QOQ basis and on YOY basis, it was higher by 10.5%.

For this quarter, as you are aware, Q4 of the fiscal which is the first quarter of the calendar year is seasonally weak for the IP-led revenue as the customers are just starting their new fiscal in the US and budgets are getting allocated. This is the seasonality we have been seeing in our business that the Q1 and Q3 of our fiscal year are stronger and Q2 and Q4 are weaker.

The linear revenue grew by 2.3% QOQ while the IP-led revenue as anticipated was lower by 15.4%. On an overall basis if you see vis-a-vis the last quarter of the last financial year, our growth in the services revenues, i.e., the Technology Services revenue helped us to offset some of the IP revenue decline and hence the net revenue decline was not very high.

For the full year FY19, revenue came in at 480.97 million with a YOY growth of 2.2 % and in INR terms, the revenue was Rs. 33,659 million with YOY growth of 11%. Within this 2.2% growth, the growth in linear revenue was 3.2% while the IP revenue was lower by 0.5%. In respect of linear revenue QOQ, the increase in volume was 1.7 % and billing rate was up by 0.6%. The on-site linear revenue grew by 2.7% constituted by decline of 1.2% in volume and an increase in billing rate of 4%. Offshore linear revenue grew by 2% comprised of growth in volume by 2.2 % and billing rate decline by about 0.1%.

The lower IP-led revenue in this quarter coupled with INR appreciation has had an adverse impact on margins. So, you will find that gross margin level and at EBITDA margin level an impact of these two elements. However, this has been partially offset by cost optimization both on-site and better utilization of the delivery resources in the overall services portfolio. So, overall, the gross margin came in at 36.8% as against 38.2% in the previous quarter.

Moving on to SG&A expenses, the sales and marketing expense was in range. While we have had higher sales and business development headcount, there was reversal of sales incentive provision due to lower than target achievement for some of the sales people. G&A expense was higher as it includes the provision of Rs. 182.5 million towards the probable impairment of deposits with IL&FS.

So, currently the provision that we have made reflects the exposure that may arise given the uncertainty around IL&FS. The impact of this provision on EBITDA was 2.2% for the quarter and 0.5% for the full year. After this provision, the EBITDA for the quarter was Rs. 1,265 million at 15.2% of revenue as against 19.7% of the previous quarter. Excluding this provision, the EBITDA would have been 17.4%. For the full year, EBITDA was Rs. 5,805 million at 17.2% of revenue as against 15.5% in the previous year.

Depreciation and amortization was 4.5% of the revenue as against 4.6% in the previous quarter as couple of products have completed their amortization cycle. The EBIT was Rs. 889 million at 10.7% of revenue as against 15.1% in the preceding quarter. The EBIT for full year was 12.6% as against 10.2% in FY18.

The treasury income for Q4 was Rs. 283 million as against Rs. 229 million during the previous quarter. This is on account of M-to-M gain on long-term mutual funds and higher interest income. The foreign exchange loss was lower at Rs. 59 million as against Rs. 241 million in the previous quarter. With this, the PBT was Rs. 1,113 million at a margin of 13.4% as against 15% in the previous quarter, and for the full year, PBT was 14.4% versus 14.1% in the last year.

The effective tax rate for the quarter was at 24.1% as against 29.2% in the previous quarter, which is primarily due to R&D tax credit that we get on certain development expenses in overseas countries. On a going-forward basis, we expect the ETR to be in the range of 27% to 28%.

PAT for the quarter was Rs. 845 million at 10.2% as against 10.6% in the previous quarter. For the full year, PAT was Rs. 3,517 million, an increase of 8.8% over the previous year, and at a margin level, PAT margin was 10.4% as against 10.6% in the previous year.

On the operational CAPEX, we had a spend of Rs. 575 million and the cash on books amounts to Rs. 14,798 million as of 31st March 2019 as compared to Rs. 15,015 million as of 31st December 2018. The value of forward contracts we have on books as of 31st March 2019 is Rs. 112 million at an average rate of Rs. 73 per dollar.

With this, thanks everyone and I hand it back to Anand.

Anand Deshpande: Let me share with you some of the highlights or likely questions that you might have. First, I want to acknowledge the fact that we had a tough year this year and the growth rate was much lower than where we had anticipated. Some of the key reasons for this growth rate decline would be to do with the top-1 customer declining in terms of our revenue with them. This is for 2 reasons. One is some of the IP revenues were lower and their challenges also caused some of our numbers in that account to go lower. A positive that you might look at is that even though the top-1 customer declined, the overall alliance business grew by about 7% because of various other businesses that we are doing in the context of our top-1 customer and their ecosystem that has grown significantly during this year, some of it being the reseller business.

Some of the Accelerite IP also declined which caused the IP numbers to go down. We had at the beginning of the year a rather slow staffing ramp-up which contributed to the slowness in the Q1 and Q2 businesses and also the Q2 was a challenge where 2 customers of ours actually ended their projects with us which caused the Q2 numbers to go down.

Overall, many of these things I would say are attributed to internal challenges rather than really market which has been fairly upbeat and we do see a very good growth and activity in many of the key new areas that we are working on.

I just want to share with you a couple of next steps that we are doing which would be of interest to you. We have a sales kickoff for our sales team planned on the 29th, 30th, and 31st in Boston and we are proposing to do an investor day in Mumbai with Chris sharing his vision as to where we are going. He completes 100 days on June 5th and in the week of 10th June (tentatively the 13th), we are planning to do an investor meet in Mumbai where we will share with you what the financial year FY20 looks like.

I want to hand this off to Chris but I want to mention that Chris has been a Persistent customer for nearly 10 years. He has worked with us in various parts in his job at IBM and more recently, he was a part of the IBM's Watson IoT business where he was the general manager. I am really delighted to have Chris on board and he has been in the company for almost 2 months. I am going to hand it to Chris to share with us what he has seen so far and what his plan is. And after that, we will take questions.

Christopher O'Connor: To everybody here, good morning and thank you for having me on the call. I look forward to meeting many of you in the months to come. I have been in the company for 64 days now. I have spent about a month in the United States working in our primary market understanding the clients and the working structure that we have in place there. I spent the remaining time in India as well as a short brief trip to Europe to learn our businesses there at the same time. I have spent my time doing 3 fundamental activities. First, learning the people. Second, learning the business and refining its structures with actions already in place. And last, working with the clients and I am to the point right now where around key deals where I have background in subject matter contribution on helping progress the deals at this point in a go-forward manner.

So, it has been an exciting first 64 days and I am here in Pune right now and will be back in the market in another couple of hours and will be continued to be active there and I look forward to see you guys all in June.

I think the linear business that we have is fantastic. We have got great stories from our clients waiting to tell for the market and I think it is on us to tell the stories. By the data I see, I am optimistic that we are on top of our delivery staffing at this point in time as Anand indicated from last year to this year, and it's from the machine I see running that we will see a continued steeper, better, self-delivery-oriented top revenue on top of our business that is being on, and so, it has been a real thrill to learn that business as well as to see the mechanisms that are now in place.

On our IP-led revenue, we continue to enhance it which was exciting to see. I have a broad view of this business from my background as Anand indicated as well as I as a client. I have done nearly all of the IP-led models that are possible with Persistent as a company. So, I know this business very well. There are several steps we are taking to enhance that business beyond our primary first client or top client with additional partners as well as there are multiple models of revenue that we can add around the royalty, reselling, product services, and new Persistent-based IP that can be added into the next to give us multiple ways to stack revenue. So, it is exciting to be a part of taking that to the next year.

We have aggressive partnerships that we can use around our IP business and it gives us the opportunity to position ourselves as a category owner going forward in areas such as data, AI, machine learning, and industrial sector. So, I am excited to be here and I look forward to working with you in the future.

Moderator: Ladies and gentlemen, we will now begin the question & answer session. The first question is from the line of Gaurav Rateria from Morgan Stanley. Please go ahead.

Gaurav Rateria: A couple of questions. Firstly, based on the changes you have made at the organization, how have these changes been received by people? Have you seen any reflection of that in terms of higher attrition rate and what has been the client feedback?

Anand Deshpande: Actually, the reception has been pretty good. I think overall, we have been very transparent with the company in the context of how we were going through the CEO hiring. I think we had mentioned here as well that about 2 quarters back that this process was on, and there were several people who participated in that process. We have had actually no attrition because of new management team that has come in.

And the response from the customers has been also very positive, i.e., continuity in what we are doing right now. I am very much part and available to meet the customers and I hope to spend more time on it. Chris has met several customers on his own and we met several together, and overall, the feedback has been absolutely wonderful.

Sandeep joins tomorrow and he has not met customers yet, but I hope in the next 30 days, he will be quite up to speed and if we can get him here as well during the investor day, you would be able to meet him as well. But I think there has been no real concern in terms of the transition that we have announced.

Gaurav Rateria: Second question is for Chris. On the IP-led revenue, what do you think is the key driver going forward? Is it going to be a change in sales strategy or is it going to be a change in the way we are aligned to some of the products? Any first cut will be helpful.

Christopher O'Connor: I believe as I mentioned, we need to enhance the current business. Current business is very good. We have the opportunity to add other business models too, which give us greater selling power and category power around the places where we have IP business. So, opportunities such as reselling in our own IP as well as our own service structure around these areas let us fill out, I think, a richer part of the portfolio which lets us sell a little deeper and that's going to be an advantage.

Gaurav Rateria: Last question is for Sunil. The margin performance in fiscal 19 has been quite good despite muted revenue growth. How to think about margins going forward and any upfront investment you are thinking as far as fiscal 20 is concerned?

Sunil Sapre: In terms of FY20, at the constant currency level, we will use the lever starting with revenue the optimization and monetization of assets that we have built over the last couple of years and the on-site utilization which has some headroom for growth. Despite all the challenges that we have in terms of cost management in the current context of talent crunch, I think we are in a position to hold on margins and if we build on further momentum and enhance IP revenues as Chris mentioned, that will add kicker to the margin. So, we do expect margins to be steady and we will invest in growth but not let the margins get impacted.

Moderator: We will move on to the next question that is from the line of Madhu Babu from Centrum Broking. Please go ahead.

Madhu Babu: Sir, congrats on a good free cash flow generation. Sir, how should we see the capital allocation? (because almost we have 1,450 crore of cash on balance sheet and we are generating 400 crore kind of free cash flow per year including the interest income). Should we expect the buybacks to be an annual phenomenon from here on?

Anand Deshpande: I think it's a good question but I hope that's not the phenomenon. We want to use the cash that we have right now at least for a couple of quick acquisitions. We have a new team in place and the team is looking at what may be the best set of gaps that we need to fill. So, how do we look at maybe 2 or 3 different acquisitions that will fill the gaps that we have? I think it's a much better point that we should answer this question after 12 months, but right now, we have some ideas on what we are looking for and hopefully that's what the new management is going to guide us on.

Madhu Babu: Another thing on the IBM ecosystem. I think we have seen HCL Tech doing multiple deals and trying to take over some of the products, and obviously because they have become so close to IBM, would we see any risk of vendor consolidation and we losing out our portion of business from the IBM channel?

Anand Deshpande: I am not so concerned about it. We have met all the executives at IBM and we don't see that as a huge risk at the moment actually. We actually see a different set of opportunities with our large customer predominantly because of the acquisition that they have made of Red Hat. This is a fairly large number that they are spending and they have defined a next generation strategy around cloud and various other things. So, we feel fairly comfortable about the IP businesses that we currently have. We also are comfortable with the services business that we have, though we do expect challenges in terms of growth rates in that business for a different reason, and we do think that there are new opportunities in terms of new business opportunities for us, especially considering the road map that we expect from IBM after their acquisition is completed.

Moderator: We will move on to the next question that is from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Anand, you mentioned the weak growth that we had this year was largely because of internal challenges. If I step back, I think last year around 1st or 2nd quarter, we had effected some changes in our sales programs and the account management structure. That does not seem to have so far led to any kind of an impact. Obviously, we have now gone for some leadership changes as well. I am just trying to understand that what is basically your assessment of the challenges really when you are talking about the internal challenges and what are you planning to do further on these areas and when do you think that we can look for growth coming back because of these changes in the leadership that you have spoken about?

Anand Deshpande: I think if you look at the basic performance of the company in the last 2 quarters, that has been better than the first 2 quarters and part of the reason for that has been the fact that we have made the changes that we had mentioned. So, our first half was really the biggest challenge that we had, but if you look at the numbers in terms of non-IP business, it's a fact that services and digital have grown at a certain rate during the last 2 quarters. Lot of that has to do with the fact that we have been able to staff people faster. The other challenge if you look at it or I wouldn't say it is really a challenge but what we have seen in the last 2 quarters is that the percentage of offshore business has actually gone up as compared to the on-site business which makes it harder to see per person revenue going down but overall profit margin on an offshore business is lot better than it is on-site. So, it is a balancing act every time you move more and more work to offshore.

I expect that offshore trend to increase next year as well considering the fact that visas and other challenges that are happening in the US make it very difficult to hire local people. We also expect rates to go up because of that. Overall, I think next year should be quite okay for us in terms of the structural changes that we have made. I think Chris has been already on board for nearly 60 days and he is quite familiar with the business, and I think Q1 will be his quarter and I feel pretty good about what I am handing off to him.

Pankaj Kapoor: If I look at last couple of quarters also, the YOY growth is still in a low single digit kind of a state. I am just trying to figure out that next year should it still be a build out year in which we may still be doing better than FY19 but we may still not catch up with the industry growth and maybe FY21-22 is when we can see a stronger growth coming back. Is that a fair assessment?

Anand Deshpande: I think it is not exactly a fair assessment but I don't want to really comment on it. I think we have to demonstrate this through real performance. I think if Q1 is a key number, Q2 would be a build on that, and Q3 and Q4 will follow. So, let me not say a whole lot at this moment, but I am quite confident about what the customers are telling us. I am very confident about the delivery capabilities that we have built out, we have hired new sales people who are already on board. This is an ongoing transition, this is not an abrupt change here, and I feel very comfortable about what I am handing off to Chris for Q1.

Pankaj Kapoor: Lastly, you mentioned pricing is improving and as well as we are going to do probably more offshoring and these obviously both of them are going to give us a significant margin lever whereas Sunil's commentary earlier was more around a stable kind of a margin outlook. I am just wondering where these gains are likely to get deployed in?

Anand Deshpande: As I said or rather Chris mentioned this already, I do expect increased sales and marketing expense a bit. We do expect further growth in our marketing budgets. I think this is what Chris would point out and what we have observed is that we are not representing much as well as we could. We need to tell better stories for the work we have done and I will let Chris comment a bit on this, but overall, I do see the margins being maintained but we will spend more on sales and marketing.

Christopher O'Connor: If I can add on to that great question, I think that we see an ability to drive some pent-up demand with the focus on telling our stories. I wouldn't yet call that a dramatic increase in spending but I do think there will be a focus on telling the story through some of the excellent clients we have. The second part of this is that we do see a relationship between the feet on the street and our ability to drive more clients and return revenue as well and so we are rising to meet that. Nothing outrageous but I think it is important that we rise to meet where we can drive greater flow in top-line revenue.

The last point I would go through is we have the opportunity to play with different mix of products and capabilities for different types of margin and we see that to our advantage to do so as well particularly on the IP-led businesses. It lets us play different, so to speak, around those strong partnerships with different offerings we can put around it that the team had already started before I got here, and we will continue to do that, that will allow us to change the components of our business that will come in at different margins.

Moderator: We will move on to the next question that is from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: Anand, I just want to build up a bit on the previous question. You said there were several challenges but we seem to be having almost maybe 10 quarters of missing peer group average on growth. If we just step back and think on a very broad level, what are the learnings on what did not work out in the last 2 or so years? Where do you see changes on either in the business in terms of focus or strategic areas between what you and Chris have decided so far? And as part of that, what will your continuing role in the business be?

Anand Deshpande: I am not so sure in the 10 quarter peer numbers; we are that far off. But overall, if you look at what we could be doing, yes, we have missed numbers and we could have been doing lot better. And many of those challenges have been to do with the fact that we have been transitioning our business from traditional outsourced product development business to a combination of IP-led business along with a lot of digital and working with enterprises. And some of those have been a bumpy ride in certain cases.

But I think, as we look at the next set of people that we have gotten in, in this team, they have better experience on both IP, and if you combine that with what Sandeep brings in, I am pretty optimistic of what can happen. Now, clearly, the numbers have to be demonstrated by showing quarter-on-quarter results and that is what I would say in terms of what might be the next few quarters as such. But there is enough opportunity in the market, so I do believe that there is enough for us to do and we are in a fairly good spot in that context.

In terms of what I plan to do in the future, my current plan is to sort of look at some of the technical areas that we work with and sort of focus a lot more on what are the strategic imperatives in the market, what are the changes and the shifts that are happening in the market, and I am looking at talking to several customers who are our leading customers where technology shifts happen and that's sort of my plan for the next few months at least. And then, we will see how it goes.

Christopher O'Connor: I would like to add on just in terms of what Anand is going to do next, I don't think he will be far from me, and in fact, I think we would be talking and working together in a daily mode. One of the things I just had pointed out which Anand mentioned at the very beginning is I am a 10-year client of Anand, and to be here is a privilege, and he and I will continue to maintain the strong relationship we had prior through this entire work that we are doing now, and his set of work that he has done is invaluable and I intend to keep it close and him closer in the work that we will do in the coming year through this transition.

Ankur Rudra: It may be a bit early to ask this question but do you perceive any changes in focus or strategic bets going forward?

Christopher O'Connor: I think, as we articulated, we have a multi-pronged business. We have several different areas to explore. The linear business we continue to refine and the ability to expand that business and to cross-sell up-sell on that becomes something that I think we can perfect another level.

In terms of the IP business, we have the opportunity to be a category owner inside of that business and some of the places where we participate in. A category owner then can ingratiate us not only to our major large client but also to other people that are in the same ecosystem. And we intend to thoroughly explore that. We appear to have permission by the wins that we have already to be this person in the marketplace and play with multiple platforms that led us position ourselves as the expert in the category or the domain which puts us in a great position, and we will explore that. It's a build on top of what we are already doing, I would not call it a radical change.

Moderator: We will move on to the next question that is from the line of Rahul Jain from Emkay Global. Please go ahead.

Rahul Jain: Two questions, firstly for Anand. If you could give the drivers for growth in digital business. This year was weak on start but picked up gradually. So, can we say that we should aspire for similar to market rate, growth rate in the range of 20% to 30% or we are away from that right now?

Anand Deshpande: No, I think we are in good shape for looking at those kinds of numbers. Again, I don't want to put out a big number at this moment and not make it. So, let us go Q-on-Q but I think the big drivers that we have are from other partners that we have. We have very good partnership with Salesforce and we see that partnership strengthening. We have made some very good deliveries and products that we have built on the ecosystem. For example, one of the loan origination systems that we have built out has started to deliver good results for us. We have several such successes from the healthcare area as well with Salesforce. We are today nearly their top 20 sales partners as well worldwide and I think that will bring us much better opportunity there.

We also have very good partnerships now with some of the next layer of players such as Appian and OutSystems and others and also the RPA side. So, there are a set of partnerships that we are looking at in terms of the digital activities. Also, our Amazon status on the partnership has gone up quite significantly. We are now an advanced partner in 3 or 4 areas and that is helping us see some leads. So, there is a bunch of investments that we did in the last year which were not entirely visible during the year. We hope that during the next quarter, you will see some of these.

Rahul Jain: Secondly, for Chris, welcome sir and congratulation for your new assignment but if you could share your top reason that inclined you to take up this responsibility and what are your specific comments on the Persistent as a vendor and what were the strengths of the company and what are the areas that you would like them to contribute and give a boost up so that we mine the IBM world far deeper and wider?

Christopher O'Connor: I am happy to help you with the first question. I might need some more definition on the second one what you asked. On the first question, I think as mentioned, Anand and I have been working together for 10 years and I have worked in a variety of roles in that relationship. Great opportunity to partner not only with Anand but also with other people across the industry. And as you develop inside of a large company, you decide whether you want to be entirely clippered or whether you start to fall in love with a certain area of the industry and technology. And as a person, this is a great shift for my desire to help an area of technology and the industry grow. And IBM has a long policy of executives that have gone to their key partners and played significant roles and so this is a very friendly thing to move from IBM into one of the key partners and work with some of them on the future of growth and enablement. And so, it's a natural thing and we can point back to multiple places in IBM's history where they have welcomed them and there has been a strong part of working with key executives who will lead key partners. Persistent has built a key relationship there as well as I had a key relationship, so it plays very well. So, it's just a great fit all around with all of the needs of everybody.

If you can help me some more with the second question.

Rahul Jain: Just to rearticulate that. Basically, in the simple words, we have multiple ways we do business with IBM under the alliance; be it engineering side, be it on the IoT or CECLM, reselling. What are the areas where you could contribute where you think somewhere Persistent could have strengthened that aspect of it and could have taken it to the next level and what is that you would be working on? (because if we look at the size of the revenue that we are doing here versus the total opportunity, that's a huge number). So, what we would do here to change some of the things to a different level altogether?

Christopher O'Connor: My thought process is at 2 ways. My first thought process is on our Number-1 client and continuing to enhance and encourage that revenue model. And if you look at from where it started to where we are today, in the simplest form when it started, we added people to help their teams. In its complicated form today, we are product owners, we are producers of capability, we receive revenue in a variety of ways, we aren't just simple people tied to materials that includes other mechanisms for payment. And that model can continue with that large client to flourish and grow even deeper.

As we write Persistent-based IP that we can sell for our own margin rate, it's not just entering into the opportunity to become a value-added reseller which is more than just a provider of services. We provide domain expertise, we provide software, we build software for that client, and we work with them as a category owner to help advance the total marketplace around the acceptability of the need for that capability, which is beyond software. So, it's a very unique possibility for us that we see in current deals to what I call revenue stacking which is multiple different methods for Persistent to deliver value with the partner and bring in different marginalization rates at the same time all the way up to the marginalization rate of standard software which really changes our stance in the business.

That's the pattern. And so, to do it with that large client is certainly an action we want to take place and I will be directly involved with. To do it again with other partners is something that we have been approached about doing and in noncompetitive ways with our large client, but there are other people that have platforms that have worked with this and would like to explore the same types of possibilities. So, in a go-forward manner, I will be working on that as well and it really gives us a different dynamic to the company to build that revenue model in addition to our linear model which we talked about at length. So, I will be focused on both of those aspects heavily in terms of driving our growth.

Rahul Jain: Basically, on the utilization front, are we good equipped for this year's growth to be captured on the current base or there would be a commitment on further addition during the year that we have already worked on?

Sunil Sapre: We have added people on the offshore side. You would have seen significant headcount growth over the last 2 quarters. So, we are getting that internal rescaling along with the lateral hires that we need in certain specific areas. So far, as on-site is concerned, the talent crunch has certain issues that the ability of people to be available at the right time and the right place is at times a challenge. So, we are working on that to fix that particular piece, as from the last couple of quarters, we have intensified that effort, but I think overall, the staffing situation has its own challenges to continuously be on the guard to staff requirements and build it into the model based on the forecast that we get on the exact skill requirement.

Rahul Jain: So, addition would continue to address this?

Sunil Sapre: We will continue to hire this year as well and this is a continuous process. Let's move on, Rahul. We can take your questions offline.

Moderator: The next question is from the line of Shekhar Singh from Excelsior Capital. Please go ahead.

Shekhar Singh: Just want to know like, is there any specific reason why you are not giving a revenue guidance? And second thing is, can you give a guidance on the margins and on the CAPEX?

Anand Deshpande: We have not been giving guidance for quite some time, partly because one is the volatility of the market, it makes it very hard to give guidance, and we find that providing guidance has no real upside in some sense because at the end of it what matters is what you deliver. So, that's sort of where it is. I think we will be able to give you a trend of where we are heading in the investor conference that we are hosting in June because by then, Chris would have had his 3 months (100 days) in the business. He would have gotten the strategy or at least the execution plans on place and we would have a much better view of where we are headed. So, I think we will do that, maybe if we need to do an additional call at that time, but that sort of when it will be the best time to talk about it.

In terms of your other question regarding guidance on margins, all we are saying is that we can maintain the current margins, and while we do see expenses going up on various accounts, we think the growth rate that we will have and the fact that we are looking at all of the numbers going on, we will be able to maintain margins because offshoring is going to increase as a percentage of all and that will help in improving the margins.

Regarding CAPEX, I don't really have a specific number to share at the moment, but we can take that offline.

Shekhar Singh: Sir, offshore going up while on-site actually not doing that well, that is sort of a negative signal, right?

Anand Deshpande: Why do you say that?

Shekhar Singh: Because if your new project starts, then that is an indication of new business coming in and that will be more or less on-site, and having more of offshore without equivalent increase in on-site is actually not a very positive signal.

Anand Deshpande: No, actually that is not true. But what is happening is that there is lack of availability on-site and people are fairly familiar with how to get work done offshore. We have done it with many customers. So, I am not at all worried about the fact that we can do more offshore. It is per revenue count goes down but profitability increases.

Shekhar Singh: That is fine, but like when a project start happens when you get a new project, isn't it true that significant portion has to be done on-site?

Anand Deshpande: Not really. It all depends on what the project is.

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

Apurva Prasad: While you touched upon this earlier, if you can maybe give a more medium-term outlook. I understand that you are going to be doing the meet next month but anything in terms of how to make the business model more predictable in terms of whether derisking from top account is one thing that you are looking at more from a medium-term perspective.

Anand Deshpande: I think in the medium-term perspective, we are trying to move more and more business on the enterprise side of the market as compared to the ISV market which is really what the medium-term strategy at the moment is. And to do that, we are looking at partnerships such as Salesforce and others that I talked about. We are looking at cloud data security as the key sort of technology assets. And we are looking at 3 industry segments; mainly financial services, healthcare, and the industrial markets. That's really where our focus is, and I am quite optimistic that if we execute well, some of the challenges that we have had will be addressed and we should see significant growth in all these areas. I think the market is pretty good, there is no real problem there.

Apurva Prasad: Yes, but anything in terms of improving our predictability because that's obviously something which has not been the case relative to peers or anything in terms of maybe focusing more on the existing accounts or could be cross-sell a lot more. Your assessment of changes, particularly to drive growth in the services and digital piece?

Anand Deshpande: We are focusing on the driving growth in the digital and services piece for sure. That is the plan, and as I mentioned, some of these enterprise digital projects that we are talking about are all in that area. That said, the overall objective is to focus on growth and not necessarily just on the quarter-on-quarter growth. I understand your concern and the predictability of it, but let me not say too much at this moment and we will cross fingers.

Apurva Prasad: You mentioned about acquisitions. Anything that you can talk about in terms of size or the white spaces that we need to fill currently?

Anand Deshpande: As I said, we have 215 million USD in our balance sheet at the moment in cash and reserves. So, essentially if you look at what we are looking at or where the gaps are, we are looking for more domain-related capabilities. We are also looking at our diversification in the European markets. So, those would be the 2 vectors that we would look at, and of course, some of this activity is ongoing at the moment as to identifying where the gaps are and also more importantly where the growth is. So, you will look at acquisitions that are growth oriented rather than additive. At this moment, I am going to not say too much more at this time. I think we will be able to answer this in greater detail in June because there are so many things happening at the moment with Sandeep joining tomorrow, Chris just here for 60 days. So, there is a lot of internal activity going on at the moment and we will have better results and better commentary in the next quarter, and we will show some of it in the June meeting that we have.

Moderator: The next question is from the line of Ankit Gupta from SAM India. Please go ahead.

Ankit Gupta: My first question is regarding the IP-led revenue. I just wanted to understand the trend here in terms of pricing and volume specifically. If you could help out on that, that would be great.

Anand Deshpande: Let me give you a little of what's happening in the IP revenue and then I will share with you what the trend is. If you look at our IP revenue right now, there are I would say 4 buckets of revenue that you would see in the IP part of what we do. One set is around Accelerite. The second set is with our largest customer where we have revenue share agreements with customers. Third case, we have some of our own new IP that we have built out. And in the fourth case, we have reseller and other things, that's also being shown as IP-related revenue because we are selling IP as part of the whole equation that we have there.

If you look at all these four, they have very different characteristics. The revenue that we have from Accelerite has traditionally been on end-of-life products and products that we have acquired from some of our ISV partners. We haven't done a whole lot of acquisitions in the last 2 years, so that has contributed to the decline in that market, but I expect more of those coming in this year.

The IBM ones that we talked about we have already discussed that and you know much about it. So, I am not going to comment a whole lot. Some of the new IPs we are starting to see some traction. Let us see how those perform. And the business that Chris talked about is the next version of what we are trying to do with the reseller version, is again likely to be the real focus for us in the next year, and you will see improved revenues on that for sure.

Moderator: We will move on to the next question that is from the line of Sudheer Guntupalli from Ambit Capital. Please go ahead.

Sudheer Guntupalli: Coming to the leadership attrition, I am sure we must have done an exercise to understand what is driving this attrition. Any qualitative color on this will be helpful if it is purely coincidental or there is some factor which is driving this. If so, what are the measures we have taken to arrest this and how confident are we that it will not continue going forward?

Anand Deshpande: You are referring to employee attrition, right?

Sudheer Guntupalli: In general, at the leadership level as well.

Anand Deshpande: The leadership attrition partly has to do with the fact that we are making a change in the strategy. So, some of this leadership attrition was also forced in some sense, but if you look at the rest of the attrition numbers that they have gone up to about 16.5% at the moment and while that is a cause for concern, it is not a cause for alarm at the moment. We have put in several conditions and activities that we have planned and also some salary raises have already happened in terms of key specific things. Some of the promotions have taken place. And I think as growth starts to happen, more and more people feel like there is alignment in terms of what they are doing and what the company is doing, and I think some of that will help in reducing the attrition. The reason why this is happening is partly because overall the market is growing and a lot of the attrition is partly because of not so much people leaving us but because people are being hired by someone else.

Moderator: We will move on to the next question that is from the line of Ashish Chopra from Motilal Oswal Securities. Please go ahead.

Ashish Chopra: Anand, I just had a question on the CE/CLM business and if we perhaps look at the run rate within that outside of the reselling, it would have come down, I am assuming from the rates maybe a couple of years back. So, obviously, that is one segment that has not gone according to plan and part of it is the visibility. Obviously, there is not a lot of control that you have on how much IBM sells, but what is the view that you are taking on that particular segment from here on going forward since it is still a substantial chunk of the revenue?

Christopher O'Connor: You are right. There is some component of this that is not in our control and while we see revenue as a royalty, we cannot always drive all the sales. So, that has a degree of some variability. If you look at the market space that this capability is in, that market space is completely alive, it's viable, it is growing. It is a major part of the Internet of Things in terms of large industrial companies needing to associate and understanding of how software is managed on industrial equipment, everything from machines to cars to robots to the airplanes, etc. So, this is a healthy market space and we have, as a part of working with the large client, key experts on our team. We have built over the past year a sales capacity that goes along with it to start to drive our own destiny, so to speak, with our own sales using our own royalty. And we have built IT around this which has given us the opportunity to partner with others around this space who play at the same time. And so, if we do this step correctly, we will continue to partner well with our large client. We continue to build around the category with other spaces in the market and we will establish the Persistent brand as a category expert with multiple different vendors' platforms being our market space to play in, which is a unique place compared to everybody else in the industry.

So, on that, I am extremely bullish and I have seen the elements in some of our first deals of this actually taking place now that Anand has made the investment and brought the execution capabilities to bear around our own sales team and our own abilities to build IP. So, it is a careful sidestep and continued partnership moves that we do.

Anand Deshpande: One last thing I would like to add to this, Ashish. We have looked at the numbers that we get in terms of the royalty that we get on this particular product for the last several years, and while it has been low this year, we find that this was an aberration rather than a reality in terms of where this would be. We think that in next year, this number looks already lot better because there is no real customer attrition. We sort of know why this number was lower last year and there are some structural issues on that in terms of why it was lower on a 3-year target, and while I don't want to go into the details of it, we do believe that next year, this number should look a lot better just structurally looking at how our partners sell these products.

Moderator: The last question will be from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: You said that this is a healthy market for the continuous engineering product. What do you think about the Microsoft's GitHub acquisition? They have got a strong IoT product lines, so does that impact us in any way?

Anand Deshpande: GitHub actually plays in a very different market space. When you look at regulated industries where you are looking at products where the regulations or just the nature of the products that you are building requires the kind of tracking that you need to have, GitHub doesn't meet those standard requirements. There are certain standards in the automobile engineering space, which our product is completely compliant with which no other product is able to meet these requirements actually. So, it is a hard market to be in and GitHub doesn't solve this problem.

Ravi Menon: Should we read Sandeep's hiring as an attempt to kind of drive some synergy between your services business and the continuous engineering product?

Anand Deshpande: I think we should look at Sandeep and Chris sort of as a team here rather than look at them just as individuals. Chris comes in with extensive experience of working in large companies looking at billions of dollars of businesses. He also brings in a global face to the company, which is something that is very important in the directional change that we want to make. He is the person who is going to sit in the US market and in addition to that, having worked with IT products, he brings that kind of an experience.

With Sandeep in the picture now, we have someone who is also fresh in the company, works with Chris. He brings in experience of running our Services business. So, he will drive and ensure that the traditional services business keeps moving at a greater growth rate than can be done so that then Chris has time to focus on marketing, how do we tell our stories, what should be our offerings, and also working with some of our large customers. So, I think the two of them will work in tandem.

I help on the technology and the road map. I am also looking at sort of the future trends, and I think we are all looking at the company as one team trying to focus on the next generation growth of the business.

Clearly, we have made some mistakes in the past in terms of where our numbers have been, but the only way to deal with mistakes is to correct them. So, we have made some changes and with this, this is where we are.

I would like to stop here and we are at the top of the hour. I would like to thank all of you for being part of this call. We will do a next meet-up in the week of 10th of June and we will work with you on what is the most suitable date. I know that some of you have conferences at that time, so we will work around that. But we will find a date in that week to have this next meeting. Thank you very much and thank you for all your support.

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