



Persistent Systems Limited - Analyst Conference Call

Q4 FY17 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. Jitendra Gokhale

President – Alliance

Mr. Sunil Sapre

Chief Financial Officer

Mr. Mukesh Agarwal

Chief Planning Officer

Mr. Amit Atre

Company Secretary

Moderator:

Ladies and Gentlemen, good day and welcome to the Persistent Systems Earnings Conference Call for the fourth quarter and year ended March 31, 2017. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and 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 have with him Mr. Sudhir Kulkarni – President - Digital, Mr. Mritunjay Singh – Executive Director & President - Services; Mr. Jitendra Gokhale – President - Alliance; 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 am now glad to hand the conference over to Dr. Anand Deshpande. Thank you and over to you, Sir.

Anand Deshpande:

Thank you Ali and good evening to all of you attending this call from India. It is my pleasure to share with you the results from Q4 FY17 and Financial Year FY17.

In terms of the financial highlights:

The USD revenue for the quarter was 109.03 million which was a YOY growth of 8.6% and a quarter-on-quarter dip of 0.9%. For the quarter, the PAT was Rs. 727.95 million, which dipped 9.9% YoY and 11.1% QoQ. Now, if you look at it on an annual basis, the revenue was US USD429.01 million or Rs. 28,784.39 million. The US dollar revenue was at 22% year-on-year growth and the INR revenue was at 24.5% year-on-year growth. The PAT for the year was Rs. 3014.65 million which is a 1.4% year-on-year growth. I am also pleased to share that the Board of Directors had this meeting concluded today recommended that final dividend of INR 3 per share for FY 2016-17 be distributed. Earlier the company had paid an interim dividend of INR 6 per share. The dividend recommended by the board is subject to approval by the shareholders during the annual general meeting in July this year.

In terms of business highlights:

I will share with you very quickly some of the business highlights, so we have arrangements that we have done with the partnership with Partners HealthCare and Sudhir will share a little bit more about this arrangement that we have signed and the grant out development licenses and rights by USAA. Both of these, I will let Sudhir explain in more detail. We inaugurated a new development center in Riley, another in Guadalajara, Mexico, and the third one in Rehovot in Israel. These have been setup as a consequence of our IBM IoT partnership that we did last year. We had some of the people in these

locations who were working in IBM locations, now they are moved into our own locations, so that is really why these were set up. Then we had several other partnerships that we did.

I am also pleased to share that during this quarter more so on April 1st and 2nd, we organized Smart India Hackathon 2017 in conjunction with the All India Council of Technical Education under the aegis of the Ministry of Human Resource Development led by Honorable by Shri. Prakash Javadekar who is the minister for HRD. We had the pleasure of hosting honorable Prime Minister, Shri. Narendra Modi, who interacted with the participants at the hackathon, so this was one of the world's biggest hackathon. During the finale, we had in 26 locations all across the country, 1250 teams with about 10,000 students participating in a 36-hour hackathon. This was a grand success and we hope to repeat this into an even bigger event for next year.

Now, this quarter's results need some further explanation and while it is clear that the numbers quarter-on-quarter had dipped, I think it is important to look at the composition of the quarterly numbers and really look at why the changes happened and why we think that even despite the dip, there are lots of positives in this quarter's numbers. I am going to give you a quick distribution of the four business units and their numbers in terms of what they did this quarter as compared to the previous quarter to explain what I mean by the positive numbers that we see in this quarter. Lot of this data is visible in the factsheets, so let me refer to that, but the services revenue this quarter was US USD47.87 million, which was a 1% dip quarter-on-quarter. The digital business was 20.67 million which was 11.1% quarter-on-quarter growth. Over the year, we have done more than 50% growth on the digital business, which is really where we believe the growth is going to happen in the future. The IBM business was 30.14 million, which is a 10% dip over the previous quarter, but then this was an anticipated plan and this is as per plan, actually, it is ahead of plan because normally the Q4 business for IBM in their calendar Q4 is usually a very good quarter, so there is a 3 million dip quarter-on-quarter but that was sort of expected. The Accelerite business contributed to 10.35 million, which was a 7.7% quarter-on-quarter growth.

The IP revenues stayed at 28% roughly for the year and that bodes well for where we are going. We had some very good IP partnerships that we signed during this last quarter which will add to the revenues for IP going forward. The digital business, which is now fairly significant percentage of our business and growing rapidly is going to be an important part of our growth for next year. I am glad to note that through some of the partnerships that we will share with you in a minute, we have created a strategy to build leadership in Healthcare, in the digital segment and also in the financial services area and we are seeing extremely good traction there. I am also happy to note that on the IBM alliance part of the business, we see a very robust pipeline on the IoT business. We were at a few conferences during this quarter and all of those have resulted in a very positive outlook for the IBM IoT, Watson IoT business that we collaborated with last year and we expect that to generate positive growth and set us up for a very strong positioning in the IoT market for the year after that. We also expect that the profitability challenge that we have had in the IBM last year, which was known and had been announced, should be better managed this year. We have made adjustments in terms of growth that we see on other revenues and also reducing cost by redeploying resources from higher cost locations to some of the services opportunities that we are seeing.

I am very optimistic about the top line in terms of what we have seen this quarter and how it fits as compared to the overall number and if you look at it from where we are headed, this is a fairly good quarter results that I am trying to project here. In terms of the bottom line, there are three items that have caused the overall numbers to look challenged. One is of course, the USD3 million dip that we had in the IBM business from roughly 33.48 million that we did in Q3, 30.14 million that we did this quarter. The second one is again the foreign exchange numbers and Sunil will explain this in further detail, but as you are all aware, the Rupee was stronger this quarter and that caused bunch of places where numbers had to be restated or readjusted because of the various accounting practices and also the money received was less than what we had as compared to the previous quarter. I would also like to point out that there is a one-time exceptional item for an IP settlement that I would like let Sunil explain a little bit, but that has about INR 114 million impact, which is a one-time exceptional item that you see in the P&L.

I am going to take a pause here and invite Sudhir Kulkarni to share a bit about what he sees on the digital side and explain some of the new partnerships that we have done with USAA and Partners HealthCare, and then I am going to invite Sunil Sapre to give you a little bit of an overview of the financial details and explain the FOREX movement and also the one time exceptional item, and at the end of this again I will anticipate certain questions and give you answers to some of the questions that I expect and then we should have more than 30 minutes for questions at the end. With this, let me hand it over to Sudhir Kulkarni for details on the digital business.

Sudhir Kulkarni:

Thanks a lot Anand. It has been a year since we began the digital business unit and over the year, our revenue has been consistently growing quarter-on-quarter with the last quarter having grown at about 11.1%, which I feel could have been better but for some last-minute deals that got pushed over into June quarter. In Q4, we signed some really large new fortune 500 companies as customers and are planning big digital programs with them. As I mentioned to all of you over the last couple of quarters, our program to help key enterprise customers become software-driven businesses by moving from a platform based project like Salesforce to digital programs, I am happy to announce that this program has started bearing some fruit and we have seen some impressive growth over the last fiscal year, but the two most exciting events of the last quarter for me were the relationships that we signed. First with Boston based Partners HealthCare which owns Mass General and Brigham and Women's Hospital and the other with USAA, the bank for 14 million US military and paramilitary personnel.

We have entered a strategic collaboration with Partners to develop a new industry wide open source platform with the goal of bringing digital transformation to clinical care and Persistent will help the digital transformation of clinical care at Partners and together with Partners, develop this open source platform to lower the barriers of knowledge exchange across healthcare providers which is the whole concept of open systems, and enable new generation of decision support applications in the clinical environment. That is the nature of the conversation that we have had with Partners and the agreement that we have signed with them. With USAA, Persistent has secured development and intellectual property rights to patented innovation that USAA themselves uses to identify, verify, and protect their members and their privacy. We will extend these technologies and address a growing market opportunity for digital security products and solutions in the financial services industry. Persistent will

focus on authentication and security solutions based on concepts such as micro trust, risk aware, contextual and personalization in conjunction with technologies related to biometrics, risk modelling, and dynamic proofing, etc.

This investments and others that we are making in building solutions in the digital space as well as some accelerators that we have been building with partner platforms like Salesforce, Appian, and Oracle, etc., will continue and I believe that will be precursor of how the growth in the persistent digital business will continue, so back to Anand.

Anand Deshpande:

Let me now invite Sunil to share his perspective on the financial numbers.

Sunil Sapre:

Thank you Anand and good evening to all of you. While Anand has apprised you on the business updates and market outlook, let me explain the margin movement and some other financial details for this year.

Revenue for the quarter being 109.03 million, the growth of 8.6% year-on-year and decrease of 0.9% QOQ, and mainly resulting from the drop-in IP-led revenue by 3.9%. The QOQ growth of linear revenue was marginal at 0.3% mainly due to increase in billing rate by 1.1% while the overall volume showed a marginal decline of 0.8%. The onsite linear revenue grew by 3.5% driven by volume growth of 2.1% and increase in billing rate by 1.4%. The offshore linear revenue dipped by 1.6% quarter-on-quarter due to decrease in volume by 1.3% and dip in billing rate by 0.3%. The digital unit as you heard had a very healthy growth of 11% quarter-on-quarter.

Coming to the margins:

The EBITDA margin was 16.3% as against 15.9% in the previous quarter and for the full year, EBITDA margin came at 15.8%. Few items which I would like to elaborate upon which impacted the margin for the quarter are, the appreciation in Rupee by 1.6% impacted EBITDA by 50 basis points. The second one was relating to the one-time expense which impacted margin by 160 basis points. This arose from an out-of-court settlement that was reached during the quarter in relation to a pending dispute. As Anand mentioned, this was one of the IP area under the Accelerite unit and relating to the rCloud product. Going into a long-drawn litigation carried certain risks in form of litigation risk, it would have caused distraction and bandwidth challenge for us, so it was in the interest of putting the matter behind us, the settlement was reached with the claimant without admission of any liability.

The expense of INR 114 million on this account is shown as an exceptional item in the financials. Over the period of time, rCloud revenue contribution had reduced to an annual run rate of 2 million and given this marginal contribution, we have planned to move out of this product and focus on other products under the Accelerite portfolio, which have better growth potential. On the S&M and G&A expenses, you will see that they came in lower and we had a good quarter in terms of recovery from receivables which were provided for in the earlier quarters, so all these three items, S&M, G&A, and the recovery from customers helped the margins. Depreciation and amortization was at 5.4%, slightly higher as compared to 5.2% in the previous quarter and EBIT was 10.9% as against 10.7% in the preceding quarter.

Coming to the treasury income:

This came in at Rs. 171 million as against 143 million in the previous quarter. On the foreign exchange side, the appreciation as I mentioned resulted in a foreign exchange loss of Rs. 28 million as against a gain of Rs. 174 million in the previous quarter. As you know though we had a gain on MTM for the FOREX hedges that we hold, there was a considerable loss in restatement of receivables on March 31, 2017, when the Rupee significantly appreciated over the last three weeks of March. Due to the movement in foreign exchange, the PBT was Rs. 937 million at 12.9% of revenue as against 15% in the previous quarter.

Coming to the tax:

Effective tax rate for the quarter was lower at 22.3% due to lower tax in overseas subsidiary while for the year, the ETR was 24.8% which came in at the same level as the previous year. PAT for the quarter was Rs. 728 million at 10% as against 11% in the previous quarter, and for the full year, PAT was Rs. 3015 million at 10.5% with a growth of 1.4% on YOY basis. On the cash flow side, the operational CAPEX for the quarter was Rs. 187 million. We have cash and current investments on the books amounting to INR 9180 million as compared to INR 8820 million at the end of last quarter. The value of forward contracts outstanding at the quarter end was 90 million at an average forward rate of 70.67 per dollar. As Anand mentioned, the board has recommended a final dividend of Rs. 3 per share which along with the interim dividend of Rs. 6 per share adds to total dividend of Rs. 9 per share for the year as against Rs. 8 in the previous year, and with this the dividend pay-out ratio for the year is 28.7%. Thank you all and I hand it back to Anand.

Anand Deshpande:

Thanks Sunil and Sudhir for elaborating a bit on this and now before we go to the question, let me very quickly share with you our overview of what we are trying to do and how we see the year that has happened and what we see for the future as well. As we have said in the past, the software or the IT industry is in a phase of transition. We have known this for the last few years where we have seen that overall the effort required for the same work has been going down, and this is something that we had anticipated for a while and we have been trying our best to move our business from being completely effort driven to being billing on other aspects such as IP plus services and various other components. We have been on this journey for the last two years and I am really happy to say that this year and moving forward, our business that is based on non-effort based revenue is more than 45% of our revenues and this goes well with where we want to go in the future. Our IP business was almost 28% and we expect this to grow. We have in the last quarter released several new IPs in the system.

We signed up with IBM for a product called NPI, which is the Network Performance Indicator product that is going to be resold through IBM. We have added connectors, we have ShareInsights and some other IPs from Accelerite which were in the works for a while. Sentient and Concert have been released and we should start to see revenues on these new IPs and even from the ones that we already have with us for next year, so we are very optimistic about where that is going. As a company, we have decided to focus and again this is not very different from what we have been doing around data, digital, and IoT. On

the IoT side, we have made efforts to get the IBM IoT business and the Aepona Concert business aligned so that we can leverage the device partnerships, the monetization partnerships and solutions that we are building that can be sold across various platforms including the IBM platform. We have signed an IBM reseller agreement that allows us to sell directly in this market for IoT solution.

In terms of some of the partnerships that Sudhir mentioned, as you would notice we have been systematically trying to find market leaders to partner with for solutions that are relevant to the market. For example, we are very excited by the Partners HealthCare partnership that we are announcing today, for which a more detailed press release is coming out in the next hour or so, which will be distributed all across the world. I must point out that Partners Health is one of the most premier institutions in the US in the Healthcare area and our partnership with them sets us up very well for where we want to go. Overall, this year has been an year of rebuilding our next generation business. We have made extremely good progress on this during the last one year and all of this sets us up for a very systematic growth on these areas for next year as well. While you might look at this as quarter-on-quarter number as we have been telling you for a while, do not just go by the top line quarter-on-quarter numbers, look at the components that are causing it. The growth numbers on digital, the growth on IP are good factors and I think even on the profitability and operational efficiency side, you will see improvement quarter-on-quarter during this year, which sets us up very nicely for next year. I am going to take a pause here now and open it out for Q&A.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. We will take the first question from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: Anand could you elaborate on where we are on the IBM IoT contract and the MDM contract as well, when do we expect this to scale both on production services and also turn profitable?

Anand Deshpande: Yes, absolutely, I will give you more details and I must say that both of those we should start to see good numbers this year and I will explain why and what we have changed in the last couple of months this quarter. Let me give you a little bit of context of where it is. When we started out, the agreement that we had with IBM was that we are going to take over a certain set of people and take a percentage of revenue from IBM on the IoT continuous engineering product portfolio, and we had committed to a certain commitment that we will have a certain team size for the first year and hence we knew that we were getting on a shortfall of about USD8-10 million for the first year, this is what we had mentioned last year around this time when we actually signed the deal. That was only for the first year. Of course, for the second year onwards, we have the charter to readjust costs to make sure that they are aligned with the costs or the earnings that we are expected to get, so some of that has already happened and we are doing some more cost readjustments.

Now, when you are doing these cost readjustments what we are able to do is to get some of the people who are in potentially high cost geographies to move from being on product development roadmap to being on the services side and also on the IoT side, so we are able to make these cost adjustments without necessarily reducing people on our teams who have the experience around these products, so

some of that has already happened and we are seeing good traction. Now, as I had said in the past, the IoT business that we have from Watson IoT from IBM has three components. The first component is the component that is related to percentage revenue that we get from the product that IBM sells. I am very happy to say that last year, this product had double digit growth as compared to the previous year and they expect a similar growth this year on that particular product, so it is low double digit and leave it at that point.

It is pretty good numbers from that point of view, and overall, that will result in a similar corresponding growth for us on the top line and with reduced costs that we have put in because of readjustment of high cost resources and moving them to other projects, we should see a more evenly balanced portfolio just on the IoT revenue side. Now, there were two other revenues streams that we had. One of them was a lab services revenue stream which did not deliver as much last year. We are seeing a much better pipeline on that, but again that is not going to be the big game changer for us. The game changer that we expect where we are starting to see some very good traction is in the overall IoT business as such, and we have in the last three months actually signed several entry-level deals with some of these companies where it is going to take a while for them to really mature. These IoT arrangements are going to take some time before real large amounts of revenue happens, but right now, it is a land grab business and we are very happy to see the number of customers that we have signed up which are all tier-I. There are some auto industry customers where we are directly working on implementing IoT solutions for these companies.

To further bolster our presence there, we are doing two other things that are worth pointing out. IBM has set up and I would highly encourage you to take a look at some of the work that they are doing, but they have set up a very impressive facility in Munich which is the world headquarters for the Watson IoT business. We are putting some of our key senior developers at that centre in Munich and we are going to work very closely with IBM in trying to implement solutions in the IoT space out of the Munich centre as an anchor for getting new customers. The other big thing that we did during this calendar year was sign up as an IBM reseller. This gives us clear charter to go sell on our own and sell directly to all these customers who are customers that we now have access to through IBM, so both of those things shall give us much better access to the customer portfolio that we are looking at and I am extremely upbeat about what we see from the IBM ecosystem.

In addition to that, one big change that we have made this year is that if you are aware that the Aepona business that we had taken from Intel had two components, the telecom component and IoT component, so the IoT component out there was called Concert and it is an independent orchestration and monetization platform for the IoT ecosystem. When we started out, we were working very closely with Amazon and to some extent Azure, but now we have been able to take that platform, retarget it into the IBM ecosystem as well, so now we have this working in IBM ecosystem, the Google ecosystem, the Amazon and the Azure ecosystem and we have got all the partnerships that we have across Aepona also to bear on the IoT business at IBM and we have brought everything together, so we have a much, much stronger presence in the IoT setup now and with the presence in Munich also readjustment of some of the stuff, reseller relationship with many of the key customers, we are looking quite optimistic

about where the numbers should be for next year on both the profitability and top line revenue on the IBM IoT space. That is that, I just want to put one cautionary note here is in the IoT space.

The IoT space, problem with the IoT space is that, lot of these large companies are going to need devices with IoT capability and until a large number of such devices become available in the market, the monetization potential for these devices is limited, so the real revenue opportunities that you will see from the customer where they say okay, we have made USD20 billion, USD30 billion saving because of IoT, that is going to take two to three years, but we are very much part of that ecosystem and we want to be early in that game and I think we are well set to be part of that ecosystem and the investments have to be made now rather than later to be part of this thing, so little bit long winded answer, Ankur, but since you are the first one I thought many other people will have a similar question.

Ankur Rudra: Just one follow up if I can, for the overall margins, the last two or three years, you have had several hits to margins, most recently was IBM investments where you had articulated in investments of around 200 basis points last year. Secondly, there were investment as we saw an onsite shift with the investments into digital and lastly in the sales and marketing over the last two or three years, on an overall basis, not limited only to IoT, when do we see scale, when do we see margins begin to recover on a scale fashion?

Anand Deshpande: Clearly, how long can we keep saying, oh, we are going to keep investing, so we are going to invest for sure but that does not mean our margins should dip anymore. We have a charter this year to not let the margins dip, so we want to turn the margins around this financial year overall where our margins next year have to be better than the ones we have this year and this will be a trend that we are trying to focus on. Why is this possible? The reason is it is going to be possible is because of IP revenues and revenues that come out of non-linearity that we have built into the system and that is really the focus of this thing. We are going to make investments, investments are something like you have to eat well, exercise that kind of stuff, you have to do this on an ongoing basis, so that is not going to stop but I do not think it is going to cause a margin dilution this year.

Ankur Rudra: What about margin improvement, do you think it is more like maintaining margins as opposed to seeing margins?

Anand Deshpande: Improvement of margins and it will start to improve. This year our focus is to make sure that the margins in FY18 are better than FY17. I do not want to put numbers here, but you will see a quarter-on-quarter improvement and the way to track our numbers is to look at growth in IP, look at growth in digital and each of these are better margin businesses than the traditional business that we have and you will see an improvement on a quarter-on-quarter basis on this number. Do not go by my saying this right now, just watch it as it comes along.

Ankur Rudra: Any investments or people asset takeover for the USAA or Partners HealthCare deals, thanks?

Anand Deshpande: There are no asset takeover, none of those kind of things in those deals. The USAA is a clean license agreement and we are investing to make sure that that licensed products can be sold as Persistent

products, so there are a bunch of things that we have to do, but these are all taken in the stride in terms of what we are doing, it is not a very large number. Even on Partners HealthCare, the amount that we are doing on digital is very small percentage of the total team that we have on digital, so it is not going to hit the numbers at the level that we are reporting.

Moderator: Thank you. We will take the next question from the line of Ankit Pande from Elara Capital. Please go ahead.

Ankit Pande: My question is on spending of FY18, so do you have any observation from your initial conversation with the customers which you are having in US, UK and Europe like what are the spending patterns for FY18 and also for FY19 and are there any instances you know like your projects got delayed because of the regulation concerns?

Anand Deshpande: Let me say the following. The volatility in the market continues. There will be some ups, there will be some downs, but overall every company is starting to invest in technology, they are trying to become software-driven businesses, they are investing in digital, they are investing in thinking about IoT if that is of relevance to them, everyone is looking at data integration so some of these areas people are spending, no doubt about it, some of the partners that we have signed up whether it is Salesforce, Google cloud, Amazon, Azure, all of them are talking about significant growth opportunities for them and other partners in the ecosystem, so we will see this sort of volatility in the market on an ongoing basis where some projects will end, some projects will get delayed, this is going to be far off course, but overall, I am very optimistic about what the buying situation is across the world right now.

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

Mohit Jain: First is on the services side, so on the offshore side this weakness and also on the services segment we are seeing like third consecutive quarter of revenue decline, so what is happening there and what should we expect for next year?

Anand Deshpande: I will let Mritunjay give you more details on specific things, but that is a hard business that we are in right now, so it is going to see certain challenges and again where we are right now, we are investing a lot more on digital at the moment, so there is a little bit of that challenge that is there, but we think that our services customers also will buy digital from us as we look forward, so we are quite optimistic about getting growth in those numbers but it is going to be a fight. Let Mritunjay comment update on that. We had some movements as well, so hopefully next quarter should be better.

Mritunjay Singh: Thanks Anand. If you have seen the numbers it has been 1% down on a quarter-to-quarter basis. Like Anand said, we are able to marginally cross sell some of the other services that we have and we think that we should be able to do a lot more of other services like digital and our product sales into the existing business. There has been a little bit of like we have been saying volatility is high in the market, so we will see sudden shift in buying patterns or buying decisions which is going to continue and we have had a little bit of some of the things got delayed because of certain things, combined with all of this I

think we have a little bit of revenue slide from a quarter-to-quarter perspective. This is a business which is a traditional business, I call it a Red Ocean business and everybody is selling into this particular segment and trying to do like multiple things. We have been focusing on a few customers like we have talked about, we are trying to make sure that our 80% of the revenue comes from selected customer and we are trying to make sure that we are strategic to them and how our wallet share can increase, so that has been the focus and we are fairly successful in shifting the type of revenue we are getting and that is reflecting in some of these. I would not paint anything more than that, but I think it is a business which is little different and we will continue to focus and make sure that we leverage the broader suite of persistent offering for selling into this ecosystem.

Mohit Jain: Second was on your IBM IoT offering, what was the revenue contribution for this particular quarter?

Anand Deshpande: Sunil will send you that number.

Mohit Jain: Last thing was if you could repeat your FOREX hedges which you mentioned in the beginning?

Anand Deshpande: FOREX hedges are 90 million at an average rate of 70.67.

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

Madhu Babu: Which are the verticals which you will be targeting with the IoT solutions, is it the traditional BFS and Healthcare?

Anand Deshpande: We are trying three of them. We are trying Healthcare partly because of the partnership we have with Salesforce and also the partnership push we have been getting through many hospitals that we are working on for the provider side, we are really focusing on Healthcare. The Banking and Financial Institutions again are one of the fastest moving guys in terms of moving to the digital platform and that is the second one, and the third is all the industrial stuff around the business that we are working with IBM, so those are three verticals that we are focusing.

Madhu Babu: Industrial would be a new vertical again, that will require domain capabilities again?

Anand Deshpande: We are already there, so we have picked the whole team from IBM that did all of that stuff.

Madhu Babu: Considering the tie up with IBM, can we work on either IoT platforms like GE's Predix?

Anand Deshpande: There is nothing that stops us from working with them, but there is a limit to how many different things you can do at the same time, so currently we are not working on GE Predix.

Madhu Babu: Next year, earlier we said 20% growth in the IBM IoT, so would we stick to that or can we see further acceleration?

Anand Deshpande: Actually, we have not said any number like 20% growth. We are saying that we are seeing good growth and it could be whatever, I do not want to put a number there right now.

Moderator: Thank you. We will take the next question from the line of Mayank Babla from KR Choksey Shares & Securities. Please go ahead.

Mayank Babla: Just had a couple of questions, first was the two new products that were launched last quarter, have you booked any revenues for the same in the last quarter?

Anand Deshpande: Yes, so we have booked, of course small numbers of revenues from both ShareInsights during the quarter and also we have booked some revenue on the NPI products that we launched with IBM for those and again ShareInsights is a very cool product. I think we will see lot more revenue on it this year. We have a very good pipeline on that, but this quarter, yes, we had a sale on that product and we have revenue that we have booked.

Mayank Babla: Sir, any new launches coming up in the next financial year?

Anand Deshpande: As I said, we have several IP solutions that we are launching. We are going to see lot more of the add-ons in the Salesforce ecosystem and various other places, so it is going to be incremental right now, again if it is something big bang, I am not going to announce it today, I will do it separate call for that, so I am going to leave it as saying, yes, there will be lots of things going on and I do not want to lose that for this one.

Mayank Babla: Sir, at the beginning of the call, there was a comment that digital there was good growth in this quarter, however, there were two deals which spilled over in the next quarter, so could you just throw some light on that?

Sudhir Kulkarni: We were hoping to close a couple more deals at the end of the last quarter, but they spilled into April, so you will see those happening in April. I cannot spell out which deals they were obviously, but we are excited to see some of these IP type of deals falling through towards the end of the month of March, and hopefully, we will see some more of those happening in this quarter.

Anand Deshpande: Let me say that we have actually this IP that we have from USAA, it is being branded and sold as a risk-based product that we are selling and one of the benefits that we have now with the way we are selling all these things is that we have substantial number of units of IP that we can sell and they are quite attractive in the market, so it is just a question of cranking the sales teams to make sure we hit as many customers as we can.

Moderator: Thank you. The next question is from the line of Ganesh Shetty, Individual Investor. Please go ahead.

Ganesh Shetty: Sir, just wanted to ask regarding the deal of USAA which we have got during the last quarter, do you think that this will open up a large market for cyber security type of business, can you please comment on that?

- Sudhir Kulkarni:** Yes, absolutely, I think you kind of hit the nail on the head. We are looking at the security market for not just banking, but also ecommerce and even Healthcare transactions, so all kind of transactions. This is basically what, the area is called risk-based authentication. For example, if I usually withdraw USD300 every week from an ATM close to my house and suddenly you start seeing withdrawals of USD30,000 from a remote location using my Username and Password, that clearly is a problematic transaction. No authentication system that just uses Passwords can prevent this kind of a fraud from happening, but if there is an risk-based solution which is this technology that we are building solutions on, then you can actually risk stratify the transactions and when you risk stratify the transactions, you decide what kind of authentication you want, you want a different kind of a biometric authentication, you want a call back to the customer, you want to do something like that, so there are some steps being taken with OTP etc., one time passwords, but I think these are also falling very short, so the market is really looking at Password-less authentication where the transaction is sensed and there is a lot of data level work that is required, there is a lot of machine learning that is required from the point of view, the kind of transaction that people are used to regularly doing etc., so we see this as opening a very big sort of area in the space of transaction security and we believe that there will be a pretty big market for this, so we are starting out with banking because that is where USAA started out with, but we will be expanding into ecommerce and other areas as well.
- Ganesh Shetty:** Thank you very much Sir for that detailed information. As far as digital business is concerned, we are active in the areas of Banking and Financial Services, whereas the insurance space is not where we have been very active in, so Sir, can we try to go for an inorganic acquisition for any insurance based digital platform company so that we can have a good presence in that insurance business also?
- Anand Deshpande:** I think it is a good idea, I would not say yes or no at this time, but I think it is a great idea, we will keep that in mind.
- Ganesh Shetty:** The third thing in the last conference call, I had just queried regarding our cash balance which is now around INR 914 crores and do you want it to be used for acquisition or buyback or increase in dividend payout, that will be helpful for us?
- Anand Deshpande:** This is an item that we are monitoring and I think the current call that we had during the board meeting was that we should hold some of this at this moment in the context of some of the acquisitions and other things that we might be looking at. We think the digital IoT and some of the areas that we are working on are hot areas and we should use the money to acquire things that may be helping us fill gaps that we are looking at. That is the current plan and as soon as we have something, we will definitely announce that, but that is where it is at the moment.
- Moderator:** Thank you. We will take the next question from the line of Nilesh Shah from Envision Capital. Please go ahead.
- Nilesh Shah:** My question has been answered, thank you and all the best.

Moderator: Thank you. The next question is from the line of Ashish Chopra from Motilal Oswal Securities. Please go ahead.

Ashish Chopra: Just a couple of quick ones from my end, firstly on the two partnerships, could you share any details or visibility on the scale in terms of business, would there be meaningful needle movers if we put in a reference as the IBM IoT deal, and secondly, was on the gross margins this quarter, while they came in flattish, while overall EBITDA was managed with SG&A, but even the gross margin was flattish despite a 3 million decline in IBM which was seasonal, so would those cost savings that you mentioned have already impacted and this margin is explained entirely by that or was there anything else over and above the cost savings on the IBM front as well?

Anand Deshpande: Regarding the first question, will there be needle moving, the answer is absolutely yes, that said, the IBM arrangement that we did was a little different in the sense that we took in a large amount of cost, we had a USD 50 million impact on the top line, bottom line, everywhere else, so these deals are not of that order of magnitude on day 1. They will eventually grow to be very large businesses and I think depending on how much interest you have, we would be happy to showcase some of the partner agreement that we have and tell you the extent to which some of this work is going on and we think that this is a very large market and we have with Partners HealthCare is one of the best possible partner that we could get for doing this kind of work, so extremely bullish on the revenue potential, but again just want to caution that these things do not happen in one quarter, two quarter, these are like six-quarter plans and once they start to hit the market, these are all IP-led and you will see an opportunity to grow significantly once things start to roll in, but they take certain amount of time. Let me now request Naina to share the answer to the second question that you asked about the margin.

Nayana Bhandari: The gross margin showed flattish, yes, you are right on the IBM part, partially we could achieve some cost reduction and there were other some operational efficiencies that played out.

Moderator: Thank you. The next question is from the line of Sandeep Agarwal from Edelweiss. Please go ahead.

Sandeep Agarwal: Just one question, the way you made the comment it is very optimistic particularly the effortless portion which is now 50%, so my quick question was that if you see the digital and the Accelerite, which is around 28-30% of the business, if it grows the way we are structuring everything and we have been investing I think much ahead of anyone else probably, so if these two engines also fire the way they have fired in last year and if I may add that things have improved significantly because of the pipeline because of signings and because of the partnership we are doing, so will it be fair to say that this 30-35% business alone could drive a double digit growth for the company and whatever comes from the other part would be a bonus, will it be fair to say that?

Anand Deshpande: The answer is yes.

Sandeep Agarwal: You do not foresee the other parts to decline at least?

- Anand Deshpande:** Let me not say anything because it is a volatile market, we are sitting as Mritunjay said, in a Red Ocean market there. What we do believe though is that even if the current business, as we do with them, may decline a bit here and there, these companies that we are working with are all market leaders in their own space and we have a good partnership with them, so the strategy is to focus on them, hug them, build good relationships with them and work with them through their transition to digital and their next generation IoT solutions, next generation data solutions and everything else and not be restricted to just a traditional business that we had done in the past. I will leave it at that, of course we think that everything will grow tomorrow, sometimes it just takes time.
- Moderator:** Thank you. The next question is from the line of Abhishek S from Equirus Capital. Please go ahead.
- Abhishek S:** Sir, you mentioned about the margin trajectory for FY18, just wanted clarification, so is this a constant currency margin that we are discussing or it is assuming the current exchange rates?
- Anand Deshpande:** It is at constant currency, meaning, of course if the Rupee becomes like very strong, then of course lot of that stuff becomes much harder to demonstrate. It is at constant currency, it does not factor exchange rate in it.
- Abhishek S:** Secondly, the enterprise business momentum seems very strong, any colour you want to add as what is happening especially in that business?
- Anand Deshpande:** No, lot of the enterprise business is also about doing digital work for them or doing next generation work for them, and it is not just traditional IT services business, so I think it is all good quality business that we are trying to chase.
- Moderator:** Thank you. We have the next question from the line of Vimal Gohil from Union Mutual Fund. Please go ahead.
- Vimal Gohil:** Anand Sir, while you have given some colour on the margins for FY18, could you just elaborate on the roadmap as to how the margin improvement will come, is it going to be through higher IP revenues, rationalizing employee cost and other operational efficiencies from other SG&A may be, so if you could just take me through the roadmap of margin improvement in FY18?
- Anand Deshpande:** Main reason why we are optimistic about margin improvement is to do with growth of revenues and the second part of it is that if the revenue growth happens from more profitable businesses such as IP and digital and other things that we are doing which is a new stuff, then that is going to give you improvement in margins. We are not trying to do margin improvement by reduction in workforce or any of those kinds of things. I think margins will play out if the revenues grow as we plan them to grow.
- Vimal Gohil:** Sir, while the investments have, would you say that obviously normal investments will go on, but the bulk of investments that were necessary for growth for the next at least four to five years have that already happened, would you say that is the correct statement to make?

Anand Deshpande: That is not a very fair way to look at it. You should look at it like a flywheel effect, so you keep investing at a certain pace, returns are not in direct relationship with a particular point, you get an effect after a point, you start to get disproportionate improvement in revenue as the engine sort of cranks in. So, investments are not going to go down necessarily, but because revenues start to grow up because of the investments that are being made, you will see an effect of better margins coming out of that, so that is really what is happening. I do not want to say that we are going to stop doing investments. It is not like you build the house once and then you live in it for the next 100 years, it is sort of something like this you keep doing all the time.

Moderator: Thank you. The next question is from the line of Rohan Advant from Multi Act. Please go ahead.

Rohan Advant: Just a quick one from my end, employee costs have gone down this quarter around 300 basis points in spite of a jump in number of employees, so A, is this sustainable, and B, is there any one off in the employee cost?

Anand Deshpande: There is nothing one off there. It is probably lot of that has to do with the yearend numbers being adjusted to total of bonuses and various other things, and the variables being adjusted to reality of what needs to be at the end of the year, so some of it is because of that and sort of some FOREX numbers changes especially with people onsite and all that could create some other effect like that, so there is nothing unusual in it. I would not read too much into it.

Rohan Advant: Okay, but this number you think is sustainable going forward because it is almost at a pre IBM employee cost as a percentage of the revenue, pre-IBM IoT?

Anand Deshpande: You should look at margins from a full year perspective and not quarter by quarter.

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

Madhu Babu: Just one more question on the digital side, can you give a breakup of how much is from Salesforce, Appian ecosystem and how much is from our own IP solutions?

Anand Deshpande: No, that is confidential.

Moderator: Thank you. The next question is from the line of Avinash Sharma from Dalal & Broacha. Please go ahead.

Avinash Sharma: Just one bookkeeping question related to the EBITDA margin, you have mentioned about the 160 BPS one off exceptional item, so was there some other one off benefit as well ex- of which the margins would have been a bit lower because otherwise I am seeing around 17.9% margin it would have been, just some clarity on that?

Sunil Sapre: Yes, you would have seen this recoveries from customers that have happened this quarter, like last quarter you would have seen 1.1% of revenue being provided as doubtful debts whereas this quarter you are seeing minus 0.2%. So, 1.3% delta has been created out of this, so at times what happens is that

because we have a conservative policy of provisioning for doubtful debts like invoices which cross 180 days, that we make a provision in that quarter and it might take one or two more quarters before the recoveries happen, so this is that kind of an unusual item which may not necessarily repeat every quarter, but other than that there is no one off kind of items.

Moderator: Thank you. The next question is from the line of Sangam Iyer from Subhkam Ventures. Please go ahead.

Sangam Iyer: Sir, just a couple of clarifications, while mentioning on IoT you mentioned that you are looking at a double digit growth for IBM-led business or the IP led business?

Anand Deshpande: We are looking at overall double digit growth for the IBM part of the business.

Sangam Iyer: Okay, on the IP-led business since there are few deals etc., being signed, how should one be looking at overall IP-led business as a whole?

Anand Deshpande: It will also grow, but I do not know what to tell you.

Sangam Iyer: Sir, given that now we are slowly getting back to the growth trajectory, how should that the margin profile of around 18 odd percent that we had in FY16, by when do you expect to cross that and move towards the 20% level? What would be the new steady state norm for the business going forward that one should be factoring in over next two to three years?

Anand Deshpande: You are putting me in a spot, I do not really want to answer this question right now, but let me say this, this is going to happen step by step. We really need to make sure that our IP and other businesses are going to get better margins. It is too early to say what percentage we should stabilize at, at this moment, I do not want to answer that question.

I would like to thank all of you for being here on this call and appreciate your conversation and questions, and thank you all.

Moderator: Thank you. Ladies and Gentlemen, on behalf of Persistent Systems, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.