"Datamatics Global Services Limited Q2 FY23 Earnings Conference Call"

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MODERATOR: **MS. ASHA GUPTA - EY LLP, INVESTOR RELATIONS PRACTICE**

Moderator: Ladies and gentlemen, good day and welcome to Datamatics Global Services Limited Q2 FY23 earnings conference call. As, a reminder, all the participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touch-tone telephone. Please note that this conference is being recorded. I now hand the conference over to Ms. Asha Gupta from investor relations, EY LLP. Thank you and over to you, Ms. Gupta.

Asha Gupta: Good afternoon to all participants in the call today. Welcome to the Q2 FY23 earnings call of Datamatics Global Services Limited. The results and investor presentation have been already mailed to you and it is also available on our website, www.datamatics.com. In case anyone has not received a copy of the press release and presentation, please do write to us and we will be happy to send it out to you all. To take us through the results today and to answer your questions, we have with us the top management of the company represented by Rahul Kanodia – Vice Chairman & CEO, Sandeep Mantri – EVP & Chief Financial Officer, and Mr. Mitul Mehta – EVP & Chief Marketing Officer. Rahul will start the call with a brief overview of the quarter on business, which will be then followed by financials which will be reviewed by Sandeep. We will then open the floor for Q&A session. As usual, I would like to remind you that anything that is said on this call which gives any outlook for the future or which can be construed as a forward-looking statement must be viewed in conjunction with the risks and uncertainties that we face. These risks and uncertainties are included but not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual report which you can find it on our website. With that said, I now hand over the call to Rahul. Over to you, sir.

Rahul Kanodia: Thanks Asha. Welcome and thank you everyone for joining our Q2 FY23 Earnings Call. We are glad to have you all with us on this call today. I hope each and everyone of you had a great Diwali and I wish you a very happy and prosperous new year. We announced our Q2 FY23 Results on October 28th detailing out our operational performance. I will touch upon some of the key business performance and Sandeep will update you on the financials, and post that, we will get into the Q&A.

On the business front, I am happy with the overall performance of the business. We have continued our revenue growth momentum from Q1 FY23 and saw a growth of 14.2% on a year-on-year basis. The year-on-year growth was broad based across all the 3 segments of Digital Operations, Digital Experiences, and Digital Technologies. Our EBIT margins on a year-on-year basis reduced marginally from 12.8% to 12.3%, primarily due to the increased cost of salaries and some cyclicality in our business. We are seeing a drop in margins across the industry this quarter; however, we are confident that our margins will be stable during the rest of the financial year. Our margins in the Digital Operations and Digital Experiences for this quarter remain healthy at 22.7% and 25.4% respectively. We expect these operations to continue giving healthy margins in the same range. Our margins in the Digital Technologies improved marginally from a negative 4.3% to a negative 2%. This improvement was driven by stabilization in a large shrinking account, growth in new customer acquisition, renegotiating prices, and de-weeding low-margin customers. In parallel, we continue to focus on the US and European markets. We are confident that we will further improve our margins in this financial year.

Our attrition stood at 20% which is in line with the industry. This is the result of efforts we have put in into retaining, training, and upscaling key talent, as well as the market environment is cooling off a bit. We expect this to further come down in the coming quarters.

While there are recessionary feelers on the horizon, we are not experiencing any shrinkage in demand. In Q2 FY23, we signed a new business worth $29 million which is about 50% more than Q1. In H1, we have signed a total contract value of $48.3 million and our deal pipeline remains healthy.

In conclusion, going forward, we are optimistic about our overall demand environment and are confident of maintaining a growth of 15% in the coming year.

With that, I will now hand over the call to our CFO, Mr. Sandeep Mantri. Sandeep over to you.

Sandeep Mantri: Thank you Rahul. Welcome everyone and thank you for joining us in the Q2 FY23 earnings call. I hope everyone had a wonderful time during the festive season.

Let me take you through the financial performance for the quarter ended September 30, 2022. Our Q2 FY23 revenue stood at Rs. 343.4 crores which is up by 5.1% on a sequential basis and 14.8% on a year-on-year basis. Our consolidated EBITDA for the quarter was Rs. 51.7 crores which is up 8% on a sequential basis and 3.6% on year-on-year basis. Our EBITDA margin for the quarter was 15% compared to 14.6% in Q1 which is a slight increase from the last quarter. Our consolidated EBIT for the quarter was Rs. 42.9 crores which is up 9.1% on a sequential basis and 2.4% on year-on-year basis. Our EBIT margin for the quarter was at 12.5% compared to 12.1% in Q1 and we aspire to maintain this double-digit healthy margin in the coming quarters as well.

Our Other Income on a consolidated basis stood at Rs. 9.6 crores compared to Rs. 13.2 crores in the last quarter. The primary reason for drop in Other Income was a one-time export incentive which was booked in the last quarter.

Our tax rate for this quarter was at 23.8% compared to 17.3% in the last quarter. The primary reason for the increase in tax rate during this quarter is the change in profit mix of various legal entities. However, we expect our tax rate to be in the 20% to 22% range on a yearly basis.

Our quarterly PAT after NCI was at Rs. 40 crores which is a growth of 13.2% on a year-on-year basis, however, there is a decrease by 7.9% on a sequential basis.

When we come to our segment-wise performance, we have 3 segments which are Digital Operations, Digital Experiences, and Digital Technologies. Our Digital Operations revenue was at Rs. 143.2 crores which is down 2.9% on a sequential basis but has grown 12.6% on a year-on-year basis. Digital Operations EBIT margin remains very healthy at 22.7%.

Coming to our Digital Experiences, the revenue was at Rs. 52.4 crores which is up 13.4% on sequential basis and 39.9% on a year-on-year basis. Digital Experiences EBIT margin remains very healthy at 25.4%.

Our Digital Technologies revenue was at Rs. 147.8 crores which is up 11% sequential basis and 9.8% on a year-on-year basis. Digital Technologies EBIT margin for the quarter remains negative at 2% compared to 4.3% negative in Q1. Hence there is a recovery in profitability. As explained by Rahul, we are confident that we will further improve the margins for the Digital Technologies segment in this financial year.

Coming to the half yearly financials, our revenue was at Rs. 670.3 crores for this half, which is a growth of 14.2%. Our EBITDA was at Rs. 99.5 crores which is up by 9% compared to H1 previous year. Our EBITDA margin for H1 was at 14.8% compared to 15.6% in H1 of previous year. Our EBIT was at Rs. 82.1 crores, up by 9.2%. Our EBIT margin for H1 was at 12.3% compared to 12.8% in H1 of previous year.

Our Other Income was at Rs. 22.8 crores as compared to Rs. 8.5 crores last year, which is a significant growth of 168%. This is primarily due to increase in investment income, exchange gain, and export incentive. Tax rate for H1 was at 20.6% compared to 20% in H1 of previous year. So, our tax rate is stable at 20% to 22%. Our PBT before exceptional item was at Rs. 103.1 crores compared to Rs. 82.8 crores which is up by 24.5%. Our H1 PAT after NCI was at Rs. 83.4 crores compared to Rs. 74.9 crores which is a growth of 11.3% over the previous year.

If we see segment-wise results for the first half of FY23, our Digital Operations revenue was at Rs. 290.6 crores, up 15.3%. Digital Operations EBIT margin remains healthy at 23%. Our Digital Experiences revenue was at Rs. 98.7 crores which is 29.2% growth over the half of previous year. Digital Experiences EBIT margin remains healthy 24.4%. On Digital Technologies revenue, we were at Rs. 281 crores which is up 8.7% on YoY basis. EBIT margin for the H1 remains at minus 3.1%.

Coming to the balance sheet, our balance sheet continues to remain at a very healthy position. As on September 30, 2022, our total cash & cash equivalents plus current investment (net of debt) stood at Rs. 375.9 crores. Talking about DSO, as of 30th September, we were at 62 days compared to 74 days as on 31st of March in the previous year.

In terms of geographical perspective, US is the largest geography with 54% of our business coming from the US; India is 28%; rest of the world including the UK and Europe is 18%. In terms of industries, BFSI continues to remain the largest segment for us which is 24% of our revenue followed by Education & Publishing which is 23%, then Technology & Consulting which is 18%. Manufacturing, Infra, & Logistics is at 13%; non-profit or non-government organization at 11%; Retail at 7% of our business; rest all are 4% of our total revenue. Our client concentration remains very healthy with the top 5, 10, and 20 clients contributing to 26%, 35%, and 50% respectively. We added 26 new clients in this quarter.

With this, I will now pass on the call to the operator to open the floor for questions. Thank you for your patience and continued interest in Datamatics.

Moderator: Ladies and gentlemen, we will now begin the question & answer session. We will wait for a moment while the question queue assembles. Our first question is from the line of Yash Patel from Choice International. Please go ahead.

Yash Patel: May I know the total headcount for this quarter or any net addition for this quarter?

Rahul Kanodia: Total headcount for this quarter – we are running at about 11,300. Last quarter we were at 10,900. So, we have had a net increase of about 400.

Moderator: Our next question is from the line of Pavan Kumar from RatnaTraya Capital. Please go ahead.

Pavan Kumar: Sir, how is the progress on our ticketing project revenues from Indian Metro? And what is the kind of scale-up we can expect in terms of domestic revenues going forward?

Rahul Kanodia: I had mentioned in our earlier call that we have recently been awarded 2 contracts; one is Kolkata Metro which has been kicked off, the other one is NCRTC which is the Delhi-Meerut segment. Both these contracts have been awarded to us. We have started work on it. However, we have not accrued any revenues because it is still in the initial phase. But certainly within this financial year, we will see an uptick in the revenues from the AFC business. We have got a healthy pipeline. We have bid for several projects. But obviously, we cannot talk about them until we don't win them or lose them or until there is a clear decision. As those contracts materialize, we will certainly bring it to the notice of all the investors and analysts. Right now, the pipeline is looking healthy and we have got 2 large contracts recently, which have just about started.

Pavan Kumar: How would the accounting be? In the sense, I am assuming the expenses part until now for that work on project would already have been done through P&L, right?

Sandeep Mantri: Yes.

Pavan Kumar: But the revenues not recorded?

Sandeep Mantri: We account for the revenue based on percentage completion method, which is basically mark up over cost. So, estimated cost and estimated revenue and whatever is the markup, basis that, we recognize revenues. There is a very insignificant recognition as of this quarter, but from, I think, this current quarter, we will start accruing revenue for NCRTC as well as Kolkata Metro, both the projects.

Pavan Kumar: From which quarter you said, sir?

Sandeep Mantri: From this October quarter – Q3.

Pavan Kumar: And once these particular revenues start kicking in, is there a chance if the global revenue growth also remains constant that we might overshoot our growth projection?

Sandeep Mantri: As explained in the last call also, we are maintaining our guidance for revenue growth at about 15% as of the moment because of many uncertain factors which are playing in the market. But having said that, it may grow beyond that as well. But as of now, we are mostly maintaining a guidance of 15% revenue growth.

Rahul Kanodia: But our confidence remains high.

Pavan Kumar: What can be the incremental expenses that should come on the cost structures going forward, especially on the employee front from the next quarter?

Rahul Kanodia: On the employee front, the cost structure One is that we do see the market cooling off a little bit. So, we do see a reduced attrition, I mentioned in my address that it is running at 20% which is very much in line with the industry. Having said that, the attrition factor is still there. We have been able to renegotiate prices with several customers anywhere between 5% to 20% hike and that has offset some of the hike in salaries that we have had to give. So, I don't think the hike in salaries or the cost associated with that will be very high because we see the market cooling off a little bit and we have been able to adjust it with the price hikes that we have got from the customers.

Pavan Kumar: What would be our outlook in terms of margins going forward?

Sandeep Mantri: As we explained in the last call as well, our margins are likely to remain in the same range which is if we talk about EBITDA which is 15% to 16%; if we talk about EBIT, it is between 12% to 13%. That's what we are maintaining. And if you see the last 2 quarters, we are in the expected range.

Pavan Kumar: But we are not seeing any kind of deceleration there?

Sandeep Mantri: No, not really.

Moderator: Our next question is from the line of Shreya Bhivalkar, an individual investor. Please go ahead.

Shreya Bhivalkar: My question is about moonlighting. I just wanted to know what are your views on moonlighting. As I see, industry views are kind of divided. So, just wanted to know will you allow it at Datamatics or how it is.

Rahul Kanodia: We do not encourage moonlighting. As it is, there is a shortage of staff and the attritions being high, people are working extra hours anyway. A few cases that have come to our attention, we have parted with those employees. We have had an honest conversation with them and then when it was established that they were two-timing or three-timing, we did separate from them. As a company, our policy does not encourage moonlighting.

Moderator: Our next question is from the line of Asha Gupta. Please go ahead.

Asha Gupta: I would like to ask that given the macro concerns are going on like in the US there is a fear of recession and Europe also is struggling on the macro levels like energy and gas things, do we see any pressure coming on our business due to these macro issues in the US as well as in the UK or Europe?

Rahul Kanodia: No, we don't see any major impacof the uncertain environment in the world, but as I mentioned in my address that our pipeline is very strong – the number of deals we have signed – we have signed $29 million in Q2 which is almost 50% higher than Q1. So, we are not seeing any slowdown in our business. Having said that, there is this uncertainty that remains with the war with Ukraine and the China economic war that you see, oil prices, fear of Europe going into a recession. America fortunately seems to have bounced back. This quarter, they are showing a positive GDP growth, so that's looking positive. So, they seem to have turned the corner hopefully. Europe still is very uncertain and on a tightrope. But as far as our business is concerned, we don't see any major impact.

Asha Gupta: In terms of industry-wise, do you see any pressure on any of the industries like BFSI or Education & Publishing or Technology?

Rahul Kanodia: No, we see an even growth across the industries and no, we don't see anything. We have not been very heavy in the hospitality and transport segments and those were the ones that were hit quite badly by Covid. They seem to have bounced back but it is not impacting our numbers because those are not very large segments for us.

Moderator: As there are no further questions, I now hand the conference over to the management for closing comments.

Rahul Kanodia: Thank you everyone for being on the call with us. I once again wish you a very happy new year and hopefully we will meet next quarter and share some good stories about our performance. I look forward to engaging with you again in the next quarter.

Moderator: Ladies and gentlemen, on behalf of Datamatics Global Services Limited, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.