Datamatics Global Services Limited
Q3 FY21 Earnings Conference Call

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MODERATOR: **MS. ASHA GUPTA, CHRISTENSEN IR**

Moderator: Ladies and gentlemen good day and welcome to Datamatics Global Services Limited, Q3 FY21 Earnings Conference Call. As a reminder all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Ms. Asha Gupta from Christensen IR. Thank you and over to you Mam.

Asha Gupta: Thank you Inba. It gives me great pleasure to invite all of you for Q3 FY21 Earnings Call of Datamatics Global Services Limited. The results and investor presentation have been mailed to you and is also available on our website www.datamatics.com. In case anyone does not have copy press release and presentation, please do write to us and we will be happy to send the same to you.

To take us through the results today and to answer your questions, we have with us the top management of the company represented by Mr. Rahul Kanodia – Vice Chairman and CEO, Mr. Sandeep Mantri – CFO and Mr. Mitul Mehta – Senior VP & Head Marketing and Communications. We will be starting the call with a brief overview of the quarter given by Mr. Rahul Kanodia which will be then followed by financials given by Mr. Sandeep Mantri. We will then take the Q & A session.

As usual, I would like to remind you that anything that is said in this call which gives any outlook for future or which can be construed as forward-looking statement must be viewed in conjunction with risk and uncertainties that we face. These risk 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 handover the call to Mr. Rahul, over to you sir.

Rahul Kanodia: Thank you Asha and welcome and thank you everyone for joining our Quarter - 3 FY21 earnings call. We are glad to have you all on the call today and wish you and your families a safe and happy new year.

I will touch upon some key business performance and Sandeep will update you on the financials and post that we will get into Q & A.

I am glad to see that business is bouncing back across segments. We are seeing increase in demands in technology spending cycles, both from new and existing clients. This acceleration is expected to remain a key growth driver for the IT industry for the next few years as digital transformation plays out. It is an era of technology upgradation which is creating huge opportunities for the IT industry. We are seeing specific opportunities in the process automation and dynamic content management areas.

Despite a seasonally weak quarter and the challenging environment, our overall quarter performance has seen a decent improvement over the last 2 quarters. With a continuous focus on execution and long-term client's relationship, we are returning to our growth path. We reported a revenue growth of 6.1% on a quarter-on-quarter basis. We had a negative sequential quarter of 10.7% in quarter-1, followed by a positive growth of 3.1% in Quarter-2 over Quarter-1 and now it is 6.1% in Quarter-3 over Quarter-2, which brings us to an almost flat performance on a year-on-year basis. The key highlight for the quarter was the sustainability of a double-digit margin. Our EBITDA grew by 18.1% on a quarter-on-quarter basis and margin improved by about 130 basis points to 12.8%, which was mainly aided by cost optimization and savings due to COVID.

On the business front, our IT services which constitutes 54% of our revenues, witnessed a growth of 2.5% quarter-on-quarter and a degrowth of 12.9% on a year-on-year basis. The degrowth was mainly due to closure of some projects and loss of a key customer which we had focussed on the last earnings call. The loss has been partially recouped by new customers and other existing customers. Our BPM services which constitute 46% of our revenues, witnessed a growth of 10.3% on a quarter-on-quarter basis and 16.5% on a year-on-year basis. The growth was primarily driven by a rebound in banking and insurance back office processing and new projects in customer management and publishing businesses.

A major event was the divestment of 62.51% of our stake in Cignex at a valuation of USD 16.6 million effective 1st January 2021. Cignex on an average had a revenue of about Rs. 40-42 crores per quarter, which will move out of Datamatics Financials from the next quarter of this year.

Our pipeline continues to remain healthy and we are confident of sustaining the growth momentum in the coming quarters. We have recently launched a new version of TruCap+, which is an AI-enabled Intelligent Document Processing (IDP) product. It will allow enterprises to realise faster time-to-value and achieve greater Straight-Through Processing (STP) with accuracy. The product is closely integrated with our Robotics automation product called TruBot.

Our total cash balance was Rs. 254 crores with no debt and I am pleased to see Datamatician's response and commitment to work in this difficult situation, we are closely working together as a team and focussing on execution and addressing global business opportunities.

With this I will now hand over the call to our CFO – Sandeep Mantri. Sandeep over to you.

Sandeep Mantri: Thank you Rahul. Good afternoon to everyone on the call today and thank you for joining us on our Quarter-3 FY21 earning call. Wish you all a very Happy New Year.

Let me start with the key financials for the Q3 ended on December 31, 2020:

Our net revenue in this quarter was Rs. 303.1 crores, a growth of 6.1% sequentially and a marginal drop on YoY basis. This growth was mainly driven by our BPM business. The ratio of IT and BPM remains at 54% - 46%, so BPM has improved from 45% in last half to 46% now. IT services revenue for the quarter were at Rs. 158.2 crores, a growth of 2.5% sequentially and a drop of 12.9% from last year same quarter. BPM revenue were at Rs. 145 crores, a growth of 10.3% sequentially and 16.5% over last year same quarter.

The key highlight for this quarter is our EBITDA margin. So, our EBITDA margin has improved substantially for the quarter, it was at 12.8% as compared to 8.6% in the last year same quarter and 11.5% in last quarter. So, compared to both the quarters, we have improved in terms of our EBITDA margins. Despite a seasonally weak quarter, when we have many holidays in month of December and November because of US Thanksgiving and US Christmas festival, we were able to maintain double digit EBITDA margin due to cost optimization and cost savings priority due to COVID.

Our Profit Before Tax for the quarter was Rs. 32.1 crores as compared to Rs. 21 crores in the same quarter of last year at Rs. 23.1 crores in the last quarter. So, our PBT also has improved significantly when we compare to last quarter and last year same quarter performance. Effective tax rate for the quarter was 24.4% which is similar to the same quarter of last year and it was 26.4% in the last quarter. So, we have improved on tax rate as well. As mentioned in earlier calls also, our estimated tax rate should be in the range of 25% to 26%. PAT after non-controlling interest for the quarter stood at Rs. 22.2 crores, a growth of 43.7% on quarter-on-quarter basis and almost 70% growth on YoY basis. Diluted EPS for the quarter was Rs 3.76 per share which is higher than Q2FY21 and Q3FY20, where Q2FY21 was Rs 2.62 and last year same quarter was at Rs 2.22 respectively.

Now coming to nine-month financials, our revenue was at Rs. 865.8 crores which is a drop of 3% on YoY basis, out of which 1.3% is due to Duo, a subsidiary we divested in March' 20, so the net drop is about 1.7%. So, we are almost flat in terms of YoY revenue. The growth was impacted mainly due to COVID-19 pandemic in the initial quarters of the current fiscal year. For 9MFY21, our BPM revenue were at Rs. 397 crores, a growth of 9.1% on YoY basis and our IT revenues were at Rs. 469 crores a drop of 11.4% on YoY basis. Consolidated EBITDA margin remains stable for 9 months at 11.6%, BPM EBITDA margin is now at 16.4% as compared to 9.7% in last year 9 months, so we have approximately 700 basis point increase which is driven primarily due to operational efficiencies and revenue growth. Our IT EBITDA margin remains under pressure at 7.5% as compared to 11.3% last year. The key reason for this drop is one-off as we explained in the last call also, is a loss of a key customer and closure of some of the projects and there are budget constraints also at few customers end, which has resulted into price pressure and ultimately lower margins. Our other Income for the 9 months was at Rs. 6.3 crores as compared to Rs. 13.1 crores last year, which is mainly due to exchange gains booked in last year, this year exchange gain is not there because hedged rate versus the current rates are more or less same. Our Profit Before Tax for the 9MFY21 is Rs. 74.8 crores as compared to Rs. 77.9 crores in the same period. Our EPS is Rs 8.67 per share as compared to Rs 8.85 per share in the last year same period. So, we have almost improved in every parameter for these 9 months and especially in this quarter.

Coming to balance sheet number, as mentioned in last earnings call, we are now a debt free company and as of December 31, 2020 our net cash and liquid investments stood at Rs. 254.3 crores as compared to Rs. 181.5 crores at the end of Q2 FY 2021. Our DSO stood at 68 days for the 9 months as compared to 83 days in last year. So, our current ratio is also healthy at 3.59x compared to 3.38x in last quarter. So, almost in all balance sheet parameters we have marked significant improvement. We have generated operation cash of about Rs. 145 crores during the period. So, free cash flow also grew significantly in 9 months, mostly led by consistent focus on liquidity and collections and cash management at our end. We continue to remain focussed, cautious on uncertain situations and we are confident of combating challenges and maintaining growth momentum.

In terms of our geographical footprints, US is 59% now, India is 21%, UK and Europe are 15% and rest of the world is about 5%.

In terms of industry, our largest segment is BSFI which is 23%, Tech & Consulting is 19%, Education & publishing is 26%, Manufacturing is 5%, Retail/e-retail is 6% and rest of segments are 21%.

Our client concentration also remains healthy with top 5 client contributing about 27%, top 10 at 38% and top 20 contributing 51%. So, these are the financial updates for the quarter and for the 9 months, with this I will now pass on the call to operator to open the floor for questions.

Thank you very much for your patience and I appreciate your continued interest in Datamatics, with this I pass on the call to Operator.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Vikas Parikh an Individual Investor. Please go ahead.

Vikas Parikh: Thank you very much for taking my question and congratulations for good set of numbers. So, you have announced about divestment of stake in Cignex, so can you elaborate on this what was the thought process behind this decision?

Rahul Kanodia: We touched upon it last time as well, as Cignex did not fall into the core focus of Datamatics, we are focusing more on Hyper automation, robotics, Intelligent Document Processing, those kinds of areas, Cignex was more on the area of open source and things like that and because we wanted to sharpen the focus of Datamatics so we decided to divest non-core areas of our operations, so that is really the thought process behind divestment of Cignex. In any case, Cignex was a 62% subsidiary of Datamatics, with the divestment of Cignex we pretty much have now a 100% control on all our operations.

Vikas Parikh: Okay thank you sir and what is the status now about this deal, have we got approved from all the stake holders and authorities and other?

Sandeep Mantri: So, we have got all the approvals and in fact first transaction is already completed, we have transferred the share and they have paid as per the agreement, so effective 1st of January Cignex is not in the fold of Datamatics.

Moderator: Thank you. Our next question is from the line of Darshil Jhaveri and Individual Investor. Please go ahead.

Darshil Jhaveri: Good afternoon and congratulations on the good growth. I just wanted to ask could you just share any outlook for revenue and EBITDA margin for FY 2022?

Sandeep Mantri: We are in the midst of business planning for FY2021/22, so right now it will not be appropriate for me to share the guidance but when we meet next time after March call, we will share more concrete number on FY2021/22. I can say that we are on a growth path now.

Darshil Jhaveri: So, the margins will be stable only, if you could just clarify that?

Sandeep Mantri: Margins will remain stable; it may marginally increase next year as well.

Rahul Kanodia: So, once we do the financial planning, I think we will be in a position to comeback with more concrete numbers.

Moderator: Thank you, our next question is from the line of Amit Dudhani an Individual Investor. Please go ahead.

Amit Dudhani: Congratulations for the good numbers, just a quick understanding we have these Rs 200+ crore cash and liquid assets in our balance sheet, are we planning any acquisition or any other kind of investment with this cash reserve?

Rahul Kanodia: Yes, so we are planning to invest into our robotics and intelligent automation area of service, we have built some products in that space and they will call for some significant investment. So, yes lot of this cash will be consumed in that area of business, what the exact numbers are as we said we are going through our planning process, so we do not have the numbers but we will certainly have these numbers by the end of this quarter.

Amit Dudhani: Okay and sir this cash will also include the divestment investment, the recovery for this Cignex?

Sandeep Mantri: Yes, partially this is included. So out total USD 16 million, about USD 8 million is included in this Rs. 254 crores and another USD 8 million will come over a period.

Amit Dudhani: Okay and sir how do we plan to add up this growth like we have diversified this Cignex, so do we have any plan for match the revenue in subsequent financial year?

Sandeep Mantri: So, we are more on profitability right now, our goal is to be more profitable in terms of margins and obviously we will have decent growth in our businesses which we are currently in, so that is the thought process.

Rahul Kanodia: So, when we will be able to fully cover the hole created by divestment of Cignex? I do not know right now, we are in the planning process but as Sandeep said our focus is more on profitability, but yes, we will put in a lot of effort on sales with the agenda of selling the products businesses that Datamatics has, so we will claw back a good component of it but exactly how much we will call back? I cannot say right now because we are going through the planning process.

Sandeep Mantri: When we meet next time, we will have more concrete numbers on FY21/22.

Amit Dudhani: Okay thank you sir, last question of the EBITDA margin, like due to COVID you were able to save a lot of cost but when the company again begins to be fully operational, so whether this EBITDA margin will be sustainable, going further because of the COVID we are saving a lot of cost but once we are fully operational, we have to incur the similar cost again?

Sandeep Mantri: So, it will be a partial, because there will be some saving because of COVID, like travel and hospitality cost which will not be there in last 9 months but once business resumes operations, those costs will again start picking in the next quarters or next to next quarters but partially we have saved a lot of cost due to cost optimization we have let go almost 5 facilities across the globe in last 9 months, which has resulted into a significant saving and then we have tried offshore many of our projects from onsite location, which is also giving us good saving and you can see the results, results are coming because of those initiatives and we continue to do so, we continue to do more and more automations in the operations which will result in higher margins.

Rahul Kanodia: So, to answer your question some of the cost reductions are permanent, we will not get all the offices back, some of the cost reductions will bounce back, like travel there will be an increased travel but it will not go back to same levels where it was last year.

Moderator: Thank you our next question is from the line of Vikas Parikh an Individual Investor. Please go ahead.

Vikas Parikh: Thank you very much sir for the opportunity, my question is related to the question just before me so this work from home model, as per my understanding commentary from other companies, the offshore has increased their share in business, so how is this happening with our company and how is this demand environment because the view about the offshoring and the BPM business has improved or not, so what is the case with our client?

Rahul Kanodia: So, we had a mixed bag in Q1, we took a significant debt and our quarter revenues de-grew by about 10.7% but then Q2 we had a little bit of a bounce back and we grew at 3.1% and then Q3 again we had a better growth and we grew at 6.1%, so we see it bouncing back, the hit was largely taken by the BFSI segment because a lot of the banking work that we do, they do not allow you to work from home because of data security reasons, so that piece of business was hit hard, now that is bouncing back because we have resumed some partial work from office, so those people working in those banking projects have started working from the office once again, so that piece is bouncing back, however the travel and hospitality business is still kind of struggling. So, we have had a mixed reaction, so business is growing, we see it growing again but initially we did take a hit.

Vikas Parikh: Thank you sir, so in this work from home model where we are able to save cost and there is a cost saving which is rebel to others as well, so is there any pricing pressure from client side, do they want to take some share of this cost saving also?

Rahul Kanodia: There was pricing pressure earlier during the year, I think that pressure has partially eased now, the clients are not looking at taking advantage of the cost saving we are doing because they themselves are in the same mode and they themselves are also reeling under the COVID impact. So no, they are not asking to reduce cost because of your cost cutting, some of them want a reduced price because they are under pressure themselves because of COVID, but now I see the pressure easing off as the world economy is opening up.

Vikas Parikh: Just last question sir, if I may squeeze in. So, we have recently launched new version of this True Cap, so can you throw some light on that as well?

Rahul Kanodia: So, True Cap is an Artificial Intelligence based data capture solution which is able to ingest data from multiple different sources and it is a very critical component of the robotics practice, so it will plug into our robotics practice, it also very well fits into the intelligent document processing area that we are targeting very actively. So it is a very key component of our go-to-market for the intelligent document processing practice as well as it augments the robotics practice that we have. We are very bullish about it and we see good traction coming from the market on this product.

Vikas Parikh: So, there was some UTI Mutual Fund deal that also happened, so can you say something about that as well?

Rahul Kanodia: UTI Mutual fund, this is more around their digital transformation process, that creates specific project, I do not have specific details on that project right now, but I know it was around digital transformation. So, we have got a solution around the e-office and we call it the digital workplace and many companies are increasingly going with digital workplace because of all this lockdown more. So, we successfully delivered to some of our marquee clients and this one was for the UTI Mutual Funds for the same solution. So, it is all around a digital working environment for all these companies, we have done some very marquee projects in this space. So, this is just another customer in the same space.

Moderator: Thank you, our next question is from the line of Keshav Garg from PCIPL. Please go ahead.

Keshav Garg: Sir, very good morning to you and many congratulations for a good set of numbers. And I hope that the growth that we showed this quarter will carry on in future and I wanted to first of all understand that after the sale of Cignex, our subsidiary as per announcement that we have made, as on 31st March, 2021 what will be the net cash balance with the company?

Rahul Kanodia: So, this quarter if you see, we added about Rs. 70 crores during this year.

Sandeep Mantri: I think the cash balance will remain more or less same because Cignex will go out of fold effective 1st of January. So, the Cignex balance will not be there in the next quarter. I cannot estimate right now but if the collections are good and if everything is normal, then we will have about between Rs. 220 crores and Rs. 230 crores.

Keshav Garg: If I can, as of September only we had around Rs. 200 crores cash and investment combined, so after the sale of subsidiary and internal accruals of the second half of this present financial year. So, the cash balance should, I mean I thought it will exceed some Rs. 300 crores, Rs. 400 crores

Sandeep Mantri: So cash balance included Cignex balance also till 31st December, so Cignex we have 62% stakes, so though the cash balance will show at 100% but we claim only 62% in the total. That is why the cash balance will go from Cignex and will move into Datamatics where Datamatics can use the cash balance now.

Keshav Garg: Okay but you are saying it would be approximately Rs. 200 crores or thereabouts.

Sandeep Mantri: More than Rs. 200 crores, Rs. 220 crores approximately, I would say.

Keshav Garg: And Sir, also this quarter our IT division somehow, the profit swell and our BPM division profit short up, so I mean is it product mix change or what exactly is the reason behind this?

Rahul Kanodia: So, we spoke about in the last Earnings Call as well, it was basically due to a loss of some highly profitable customers and a few projects; in the IT space and just laid back of that, essentially.

Keshav Garg: Okay Sir, and wanted to understand that on the working capital side, are you seeing some pressure on receivables ease?

Rahul Kanodia: Pressure on receivables in the sense that we are putting a lot of pressure on collections, however, we have a lumpy business when we come to the AFC business, which is focused on the Metro work which is, working with government bodies, so they tend to be lumpy and that gets a little eradicable. When we do the invoicing on that, we could have an increased DSO, however outside of that, the rest of the DSO is well under control and we keep the pressure on a consistent basis.

Sandeep Mantri: And there is no pressure on the working capital as far as this MMRDA, only I think 60 to 90 days is the time when we get the invoice collected. So, during that period, our DSO goes high, when we collect the billing it again brings down to normal level. And even if you see, our December is 68 days compared to 83 days in last year March 2020. If we do the billing in let us say, February or March for these Metro projects, then obviously we are not going to collect immediately. So, to that extent, our DSO will again bounce up to some extent.

Keshav Garg: Okay Sir, and after the fourth quarter results, please consider a share buyback or a liberal dividend.

Sandeep Mantri: See we said last time also that we will discuss in the next board meeting about dividend and about what you said, I think last time also.

Keshav Garg: And, just a general question. Like you must be aware, since COVID-19, the expenses of IT companies have dropped drastically on travelling, visa expenses, etc. So, the margins have expanded to all time a multi-year high for the sector in general. And so, if we see other sectors, the industry on a whole says the debtor outstanding days are approximately 45 to 60 days. So, but in our case, our debtors are around 80 to 90 days and our margin is on the lower side, it is barely 10%.

Sandeep Mantri: It is not 10%, if you see our last quarter, it is 13%.

Keshav Garg: Sir that is very encouraging but still I am saying that why our expenses did not reduce as others, like for others in industry, why our expenses did not fall?

Sandeep Mantri: No if you see our other expenses, they fall substantially, I think Rs. 130 crores to Rs. 100 crores; about Rs. 30 crores decrease in nine months, which is a significant decrease. If you see our published results, you will see those numbers and second, on the margin front, we are stable.

Rahul Kanodia: I think the bigger issue is that in Q1, we had a de-growth of almost 11%, 10.11% to be more precise. When the cost did moved up but the revenues were dropped and that is a huge impact and is really that I think many of the other companies probably did not had that drop and unfortunately the times were not very good for us where we lost that customer and I think that is really the issue.

Keshav Garg: Sir basically, your other expenses have dropped, so but employee expenses have gone up, so the basically there is no margin expansion as has been seen with the other players. So now with our revenues finally stabilizing, so Sir you think that our margins will go up now?

Rahul Kanodia: Yes, in this quarter, certainly. In the first quarter this year, our margins will go up.

Sandeep Mantri: Will go up and right now our margins are at about 13%, this is I think from last year's levels if you see, last year same period, it was 9% or 8%, something like that.

Keshav Garg: Okay, Sir so going forward, the margins should stabilize at like, this 13% level only or it can still go higher to mid-teens?

Rahul Kanodia: Depending on our investment plans that we have, which we will be planning in this quarter for the year and as far as investments are concerned, we are writing-off, we are expensing the investments, we are not capitalizing them. So, depending on the investment plans, we will see the impact on the margins. So that is the decision we will take as we go through the planning process.

Moderator: Thank you. We will take our next question from the line of Amit Dudhani an Individual Investor. Please go ahead.

Amit Dudhani: Thank you Sir for giving again opportunity. Sir quickly, question on the IT Solutions, as you mentioned like as I run through your presentation, 95% of our business are retention business and you mentioned that you have lost a big client which pressurizes our IT Solutions businesses. So what was the contribution of this big customers, if you are saying 95% are retention business, then is it more than 5% or how and what is the margin contribution from these customers?

Sandeep Mantri: So about this customer wise, last time also we said, these customers were about Rs. 5 million to Rs. 6 million, between Rs. 5 million to Rs. 6 million revenue range and it was a high margin. We do not disclose margins for the customers, it was a high margin customer.

Amit Dudhani: Okay but what will be the constitution like, suppose right now whether it was contributing to say, 20% into overall margin or how, if you can just give us some highlight?

Sandeep Mantri: We do not get into the individual customer wise margin and we are out of this right now, we are not disclosing each project and every customer. So, but having said that, you can see our margin profile this quarter, which is very healthy despite having lost this customer.

Amit Dudhani: Okay, Sir do we have any business in the mortgage industry and mortgage back office processing because it is another industry where the automation is happening for the processing or management of the entire mortgage process, do we have any plans in this industry?

Rahul Kanodia: So that would fall into the BFSI industry and we do have a good footprint in BFSI, specifically around mortgages I would not be able to say whether we do work or not but I do think we have some ….

Sandeep Mantri: We did some good projects in last-to-last year, last year also we did some good project on mortgage.

Amit Dudhani: Understood, because we saw like we did some research because it is a kind of recurring business for the mortgage industry for the maintaining the property as per the US laws and regulations. So just wanted to understand, are we planning into this industry because kind of recurring revenue and some much easier work for the automation process.

Sandeep Mantri: Yes.

Rahul Kanodia: Yes.

Amit Dudhani: And Sir on the UTI business, it is kind of one-off business or do we get any recurring business from this project?

Rahul Kanodia: So, this is a semi, it is a platform sale, so there is a onetime constant, that does not have recurring licences. So, there is some degree of recurring because of annuity license.

Amit Dudhani: 80-20 ratio as standard, 20% will be AMC and recurring.

Sandeep Mantri: 10-15% approximately.

Moderator: Thank you. As there are no further questions from the participants, I now hand the floor back to the management for closing comments. Over to you sir.

Rahul Kanodia: Thank you everyone for being on this call, we really appreciate the time you spent with us and the interest that you give us. We would like to once again wish you a very Happy New Year for 2021, hopefully COVID will be behind us very soon, now that the vaccine is out, and we look forward to vibrant industry and environment and hopefully a good growth. So, thank you all for being with us again.

Moderator: Thank you members of the management. Ladies and gentlemen on behalf of Datamatics Global Services Ltd., that concludes this conference. Thank you for joining us and you may now disconnect your lines.