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"Datamatics Global Services Limited Q3 FY22 Earnings Conference Call"

January 21, 2022

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MANAGEMENT: **MR. RAHUL KANODIA – VICE CHAIRMAN AND CEO, DATAMATICS GLOBAL SERVICES LIMITED**
MR. SANDEEP MANTRI – CHIEF FINANCIAL OFFICER, DATAMATICS GLOBAL SERVICES LIMITED

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

Moderator: Ladies and Gentlemen, Good day and welcome to Datamatics Global Services Limited Q3 FY22 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 call, please signal an operator by pressing '*' and then '0' on your touchtone phone. 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, Ma'am.

Asha Gupta: Thank you Lizann. Good afternoon to all participants in the call today. Welcome to the Q3 FY22 earnings call of Datamatics Global Services Limited. The results and investor presentation has been already mailed to you and it is also available on our website www.datamatics.com. In case anyone has not received the copy of press release and presentation, please do write to us and we will be happy to send it to you all.

To take us through the results and to answer your questions we have with us the top management of the company represented by Mr. Rahul Kanodia – Vice Chairman and CEO and Mr. Sandeep Mantri – Chief Financial Officer. Mr. Rahul will start the call with brief overview of the quarter on the business which will be then followed by the financials which will be given by Mr. Sandeep. We will then open the floor for Q&A session.

As usual I would like to remind you that anything that is said in this call which gives any outlook for the future, or which can be construed as forward-looking statement must be viewed in conjunction with risks 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 hand over the call to Mr. Rahul. Over to you, Sir.

Rahul Kanodia: Thank you Asha and good afternoon everyone. Welcome and thank you for joining us Q3 FY22 earnings call. Let me start by wishing you all a very Happy New Year and a safe 2022.

I am glad to share that we have reported another stable quarter and we have been able to sustain margin performance despite the sourcing and supply side issue that we are all facing across the IT industry. The prolonged strong demand environment especially in the newer digital technologies has forced large scale hiring of fresher. During the quarter we added 541 net additions taking a total headcount to 11,089. In Quarter-3 of FY22 our annualized attrition rates stood at 29% versus 27% in the previous quarter and should remain in the range of about 30% for this year. We have ramped up our hiring process and we continue to invest in hiring, training and upskilling all our employees.

Coming to the quarter performance, our revenue growth remained stable and excluding CIGNEX which was a subsidiary we divested in Q4 of FY2021, we have grown 14.8% on a year-on-year basis and have grown a 0.5% on a sequential quarter basis. Despite resourcing, supply side pressure, and increased salaries; we have sustained EBITDA margins of 16.8%, a growth of 460 basis points on a year-on-year basis excluding CIGNEX and 396 basis points including

CIGNEX. If you notice over the last two or three years we have moved from an EBITDA at a company level from 9.7% in 2017 steadily to 16% for the third quarter as of this financial year. So, we have steadily improved our margins quite a bit.

Traditionally, our Quarter-3 results have always been softer than Quarter-2 and we have seen the same this year. Although this year it was weaker than usual. Our expected growth for Quarter-4 on a sequential basis could be around 3%. We are seeing a significant traction in our BPM business which contributes 55% of our revenues and grew at 13.7% on a year-on-year basis. BPM EBITDA margins were at 23.1% and the growth of was aided by an expansion of business from existing customers and continuous effort on cost optimization. Our IT revenues which contributed 45% of our total revenue grew at 1.1% on a quarter-on-quarter basis. Our IT EBITDA margins were at 13.4% however after factoring in the investment in products our margins stood at 9.1% for the quarter.

Over the years IT margins have also moved up if you look at four quarters in particular we moved up from 4.7% to 9.1% and likewise the EBITDA margins on the BPM side in Q1 of FY21 stood at 10.1% which has steadily moved up to 23.1%. We presently have over 500 open billable positions in IT. The current environment of high attrition, high salary expectation and very high dropout ratio is hindering us from encashing these opportunities which is reflected in our growth. We saw several deal wins during the quarter across IT and BPM. We added 34 new clients this quarter. In Q3 we signed a total contract of about $85 million of which there were three large deals ranging between $15 million and $30 million spread over three to five years, plus several other deals totaling to about $15 million to be executed over the next one to two years.

I am glad to share that recently we were awarded automatic fare collection contract from Delhi-Meerut Corridor by NCRTC and the Kolkata metro by Rail Vikas Nigam Limited both of these are fare collection projects where we are doing the automation of ticketing systems and fare collection for the metros in India. Additionally, we also entered into a long-term strategic partnership with a global leader in workforce solution for providing digital customer management solutions. All these large deals which are worth about $70 million will kick off from the next financial year. So, we will see no impact in this financial year and these will all last for three to five years. We are witnessing a strong demand environment across sectors we operate in. To capture these opportunities we are ramping our marketing and pipeline generation activities and have realigned our sales team with a sharper focus dedicated to each of our business units.

Datamatics has a healthy pipeline of over $100 million this includes a product pipeline of about $12 million where we will be closing a few good deals this quarter. With this pipeline and large deals signed last quarter, we expect to have a growth of about 15% in the next financial year. The silver lining for us is that the overall industry continues to go through a large-scale digital transformation and at Datamatics we are very well positioned to capture these opportunities. To conclude going ahead we are very positive about our overall demand environment and are confident of a growth in the next quarter at around 3% and next year at around 15%.

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

Sandeep Mantri: Thank you Rahul. Welcome everyone and thank you for joining us in our Q3 FY22 Earning Call. I hope that all of you are safe and healthy wish you all a very Happy New Year.

Let me start with the key financial for Quarter-3 ended on December 31, 2021, and then I will take you through the 9 months results. So, our net revenue for this quarter was at Rs 300.8 crore marginally up by 0.5% on a sequential basis and flat on YoY basis. However, if we remove CIGNEX from our last year number which we divested, then we have grown at 14.8% on YoY basis and a ratio of IT and BPM was at 45:55 during the quarter.

Our BPM revenue for the quarter remained stable at Rs 164.7 crore on QoQ basis and grew by 13.7% over last year same quarter. Our BPM EBITDA margin was 23.1% for the quarter which is 237 basis point up on a YoY basis.

Our IT services revenue for the quarter was at Rs 136 crore which is a growth of 1.1% on a sequential basis and decline of 14% on year-on-year basis, but the decline was primarily due to CIGNEX divestment which we did in Quarter 4 of FY21. If we remove CIGNEX divestment then actually we have grown at 16.2% on a YoY basis. Our IT EBITDA margin was at 9.1%, but without products it remains at 13.4% for the quarter.

Our consolidated EBITDA grew by 30% on a year-on-year basis while without CIGNEX it was up by 58.1% on a year-on-year basis. Our consolidated margin for the quarter was 16.8% as compared to 12.2% in Quarter-3 of last year and 16.7% in last quarter. So, we were able to maintain a double-digit EBITDA margin mainly due to our constant effort on cost optimization and automation along with price increase for some of our customers. This was despite headwind due to increased salary and supply side pressure in our IT business side and as mentioned by Rahul we have taken several measures to get future ready and avoid any business losses due to the supply side challenges.

Overall industry is also facing this issue and we are not different from the situation. However we are confident of maintaining a double digit EBITDA margin for the rest of the financial year. When we talk about PAT which is often non-controlling interest PAT is at Rs 36.9 crore which is a growth of 4.7% on a quarterly basis and the growth of 66.9% on a year-on-year basis. In fact without CIGNEX our PAT has grown by 93.4% on a YoY basis.

Our EPS for the quarter was at Rs 6.27 per share which is higher than last year same period which was at Rs 3.76 per share. Our tax rate for the quarter remains at 24.2% which is same like last quarter and also last year quarter. These were the quarterly numbers.

Now coming to 9 months FY22 numbers, our revenue was at Rs 87.7 crore. Including CIGNEX we reported a growth of 2.5% on a YoY basis, without CIGNEX we reported a growth of 20% on YoY basis.

Our EBITDA stood at Rs 141.8 crore which is a growth of 41.2% on a YoY basis if we exclude CIGNEX then this growth is 75.5%. Our EBITDA margin for 9 months FY22 was 16% as compared to 11.6% in last year which is 438 basis point increase from the previous year margin. The growth is primary driven by our disciplined execution and cost optimization measure, our PBT (profit before tax and before exceptional item) stood at Rs 130.4 crore which is a growth of 133.9% on a YoY basis without CIGNEX. However, PBT after including exceptional item on account of one-time exchange at Rs 10.2 crore was at Rs 140.6 crore, this is a growth of about 152.1% excluding CIGNEX. Our EPS stood at Rs 18.98 per share as compared to Rs 8.67 per share in the same last year same period. Our YTD adjusted tax rate for 9 months remains at 23.1% as compared to 26% in previous year period. So, there is a slightly lower tax rate in these 9 months.

We continue to have healthy balance sheet. As on December 31, 2021, our total cash equivalent plus liquid investment stood at Rs 372 crores. Our free cash flow to PAT was at 113.8%, our DSO was at 64 days as of December 31, 2021, and we continue to remain cautious on the new variant of pandemic and are confident of competing challenges in maintaining growth momentum.

In terms of geographical footprint, the US is 54% of our business while India is 25%, UK and Europe is 16% and rest of the world is 5%. In terms of industry footprint, BFSI continues to remain largest segment for us which is 32% of revenue followed by Education and Publishing which is 23% then Technology and Consulting at 17%, Manufacturing, Infra and Logistics at 9%, then Retail at 7% and non-profit or government organization at 7% of our business, rest all other are 5% of our total revenue.

Our client concentration remains healthy with top 5, 10, 20 clients contributing to 27%, 41% and 53% rspectively. We added 34 new clients in the quarter. Our total head count for the quarter was 11,089.

With this I will now pass on the call to operator to open the floor for Q&A and thank you very much for your patience and I appreciate your continued interest in Datamatics. Thank you.

Moderator: Thank you. Ladies and gentlemen we will now begin with the question-and-answer session. The first question is from the line of Faisal Hawa from H. G. Hawa and Co. Please go ahead.

Faisal Hawa: So, can you give me some steps that we have taken to tackle rising attrition? Definitely it is an industry wide problem, but how we can retain the employees because for larger organization the opportunity for growth and learning and relearning are much better, so how we retain our employees in this kind of a scenario and are we taking any steps to increase our business in USA and Europe?

Rahul Kanodia: So, I will answer the second one first. So we have increased our sales team both in USA and Europe. We have also augmented the marketing team as well as lead generation team substantially for these geographies. So, yes to your point we have augmented that and we should see a stronger growth in Europe and US for next year. Coming to your first question in terms of employees typically what we do is that in smaller organization you give employees a higher level of responsibility that empowers them. In larger organization they kind of get lost in the hundreds or thousands of people that are there. So, employees do enjoy the liberty the flexibility to take responsibility and deliver on their own. So, of course apart from that occasion you do have to factor in the salary increases that we have to give to maintain a certain level of parity. If you see our attrition at 30% is high, but it is not so high. I believe Infosys is also someway in the range of 25%. So, we are not so way-out vis-a-vis the industry outreach to some of the larger competitor. However, the dropout ratio is right now extremely high.

Faisal Hawa: Ok. If you were to name just three verticals that you feel has tremendous growth within the IT services which would be these and any steps we have taken to really augment our growth in these verticals?

Rahul Kanodia: So, BFSI and manufacturing would be the dominant verticals and as I said we have increased our sales activities in those segments and we should see results because both of these run themselves very well to automation and robotics and things like that. So, and they are large tenders on technology and today technology is driving all businesses so these were the large ones we focus on and we are seeing good traction there.

Moderator: Thank you. We will move on to the next question that is from the line of B Chetan a Private Investor. Please go ahead.

B Chetan: I have a question for Rahul. So Rahul you talked about 3% growth for the next quarter, so just wanted to ask how confident are you about achieving given the current state of the economy?

Rahul Kanodia: Given the pipeline and given the deals that we have signed I am confident that we will hit that number for Q4.

B Chetan: About the pipeline you mentioned that you have a $100 million pipeline so how much out of you think you would be able to close?

Rahul Kanodia: Statistically speaking we would close between $25 to $30 million as per our past track record and performance in conversion ratio are concerned. The conversion ratios are much higher for existing customers and lower for new logos. Existing customers tend to range between 60% to 80% new logos tend to be about 20% to 40%. So, statistically speaking we should close around $30 million out of a $100 million.

Moderator: Thank you. The next question is from the line of Gopal Agarwal an Investor. Please go ahead.

Gopal Agarwal: Sir I was wanting to know regarding this contract Delhi-Meerut Corridor that you were explaining so I was curious to know when we expect revenues to start flowing from this particular thing and also are we eying more contracts similar kind under this AFC so that was my first question?

Sandeep Mantri: The Delhi-Meerut Corridor will start from beginning of next year and this is a primarily five-year contract with another five to six years of maintenance post implementation. So, most of the revenue Delhi-Metro contract will get accrued in next three to four years. So, from April onwards next year and this contract is a large size for us so this should give us upside and margin as well**.**

Gopal Agarwal: Also, if you see even you have decent cash in hand so are we planning for any M&A, etc., and also I would like you to provide some guidance on dividend payout policy and if you are planning to pay any dividend for this particular fiscal year?

Rahul Kanodia: So, overall we have dialogue with about 7 to 8 companies, but these are all initial stages. So, as they mature we will certainly reveal to the appropriate authority. As far as dividend policy is concerned, this year as you know we have declared an interim dividend. I think it depends on the board, once we close the year the board will sort of review and take correct decision and make a recommendation.

Moderator: Thank you. The next question is from the line of Danesh Mistry from Investor First Advisor. Please go ahead.

Danesh Mistry: Sir I basically have two questions one was this time your Q-on-Q growth was about flat 0.5% QoQ anything to read into that, is it just some projects rolling off or like last time are we seeing some customer attrition that is number one and number two is you have answered it in a way what the previous caller asked on employee attrition, but if you have to see our employee cost is about Rs 20 crores today and we have also spoken about expanding in different geographies, obviously that would require increase in sales headcount as well as we could be obviously facing some wage pressure here, so how do you see that panning out and are we in a position to pass on those cost to our customers?

Rahul Kanodia:: In terms of passing on the cost we cannot pass on sales cost, but we have been able to reprice our services though some of our customers are facing the same situation of high attrition and the tech staff and resource crunch and since they are all facing the same issues they are more open to the idea of giving you a higher price. So, we have been able to go back and renegotiate with several customers and increase our prices in several contracts that we have.

Danesh Mistry: Are we able to pass on the entire cost to them or is it a staggered thing?

Rahul Kanodia:: So, there is no perfect answer because the renegotiations have ranged anywhere from as low as 3%, 4%, 5% to as high as 30% as well. So, depending on each contract somewhere you are making more money, somewhere you are pretty much recovering the cost and then there are some contracts we have not been able to renegotiate at all so it is a mixed bag.

Danesh Mistry: And on the revenue side sir the flattish growth you are seeing this quarter 0.5% QoQ?

Sandeep Mantri: As Rahul earlier said that we are ramping up our sales team, pre sales team, marketing team, we are putting lot of effort in marketing and sales and pre sales. So, those will actually start giving result probably from next year and we are quite sure as we said that we will at least manage 14% to 15% growth in next year.

Danesh Mistry: And currently what is our current order books on hand in terms of contracts yet to be delivered?

Sandeep Mantri: We do not track order book that way. In BPM we have mostly volume driven businesses. So, we really do not have an order book as such, but this quarter we had about $85 million worth of new order which gives you definitely a significant growth in next year.

Danesh Mistry: And last question from me what will be our utilization today?

Rahul Kanodia: Manpower utilization is extremely high, as I mentioned that we are facing shortage of about 500 billable people. So, our bench is very low, typically though we have technically a bench because of the tax season we have a spike in Q4 every year because we do tax processing and for that what we end up recruiting people who have to get trained so that shows up on the bench in Q3 and in Q4 they get deployed. So, that is the annual cycle that we have, but as such our bench would be in the range of about 4%, 5% at best, some of it we have to maintain because of attrition.

Danesh Mistry: And what is our total employee count today?

Sandeep Mantri: 11,000. One of the reason for revenue growth in past 12 months we have let go many of the low margin customers. So, that also has resulted in some kind of revenue cut during the period that has another impact on improving margins you can see that.

Danesh Mistry: And what would be a top 10 concentration has that increased then because we have let go of the low margin customers?

Sandeep Mantri: Top 10 contribution remains more or less same with 1% or 2% here or there so how much in top 5, top 20 is more or less I am saying top 5 is 27% and top 20 will be about 50 odd percentage.

Moderator: Thank you. The next question is from the line of Mihir Manohar from Carnelian Asset Management. Please go ahead.

Mihir Manohar: Sir you mentioned about the 15% growth for the next financial year should you throw some more light on a qualitative aspect as to which segments and what kind of deals do you see flowing into the revenue for next year. I mean what gives you that confidence of that 15% for the next year?

Rahul Kanodia: As we mentioned we have signed three large deals in Q3 of this year they will all start delivering from next year. So, two of those deals are in the transport segment which is doing fare collection. One of them is in the customer service management area and then we have a strong pipeline of about $100 million and the bulk of it is in the BFSI segment. So, the BFSI segment is the other promising segment for us. So, transport, customer management and BFSI.

Mihir Manohar: I mean on the margins any color on the margins for the next year?

Sandeep Mantri: We are still in a planning stage. On margin we will comeback maybe in the next board meeting.

Rahul Kanodia: I think the question is how do we improve margins further and our focus is on how much we will be able to improve it? So sustaining margin should not be a problem, but improvement is something that we are going through a detail planning.

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

Rahul Kanodia: Thank you Asha and thank you everyone for being on this call. It is a pleasure talking to you and I look forward to talking to you once again when we have the year ending numbers in Q4. I wish you all the very best and a good New Year.

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