January 05, 2023

Datamatics Global Services Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/ Short-term – Fund-based/ Non-fund Based	170.00	180.00	[ICRA]A+ (Stable)/[ICRA]A1+ reaffirmed/assigned
Total	**170.00**	**180.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation favourably factors in Datamatics Global Services Limited's (DGSL, or the company) steady financial performance, as demonstrated by its steady revenue growth, healthy cash accruals and strong liquidity profile (unencumbered cash and liquid investments of ~Rs. 416 crore as on September 30, 2022). Moreover, healthy internal accrual generation has continued to result in minimal reliance on debt, translating into a comfortable capital structure and robust debt protection metrics. DGSL posted ~17.4% YoY[1] growth in revenues in FY2022 and 14.2% YoY in H1 FY2023, supported by healthy growth across segment and geographies. The company's order pipeline remains strong with TCV[2] of deal wins worth $126 million in FY2022 and $48.3 million in H1 FY2023, which provides revenue visibility over the medium term. Additionally, the ratings continue to factor in the extensive experience of promoters in the IT and business process management (BPM) industries.

However, the ratings are constrained by DGSL's moderate scale of operations and profitability compared to other major IT services players and its exposure to intense competition from other established industry participants in India and other low-cost locations. Additionally, the industry participants, including DGSL, continue to face challenges in the form of wage inflation, foreign currency fluctuations, talent acquisition and retention. The company's operating margin (OPM)[3] moderated to 14.9% in H1 FY2023 versus 16.2% in FY2022 owing to wage cost inflation amid high attrition across the IT industry, high production and development costs and lower revenue from one key customer due to its adoption of a multi-vendor strategy. However, attrition levels are likely to start tapering from the end of the current fiscal, which coupled with better realisations and operational efficiencies is likely to support DGSL's profit margins over the medium term.

ICRA also notes the company's plans to grow inorganically through acquisitions in the short to medium term, funded by its sizeable cash and liquid investments. Any sizeable debt-funded acquisition can materially impact the company's financial risk profile and will be evaluated on a case to-case basis. Further, with significant presence in the US and Europe, the company's business remains vulnerable to any regulation restricting outsourcing and evolving macroeconomic headwinds in these key markets.

The Stable outlook on the rating reflects ICRA's opinion that DGSL will continue to benefit from its established business profile, order book position and diverse customer base.

[1] *FY2022 YoY growth is adjusted for divestment of cignex in January 2021*

[2] *TCV: Total contract value*

[3] *Operating profit refers to profit before interest, tax, depreciation, and amortisation*

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in IT services & solution and BPM industry – The promoters, along with the company's other senior management, have extensive experience in the IT and BPM space, which has helped drive the company's growth over the years. The Founder and Chairman of DGSL, Mr. Lalit Kanodia has been associated with the IT service industry for last five decades.

Diversified customer profile – DGSL's customer profile remains diversified across sectors, such as BFSI, manufacturing, publishing, hospitality, and international organisations, among others. The BFSI sector contributed 29% to DGSL's total revenues in FY2022, while the publishing business generated 23%, followed by other verticals (48%) during the same period. The company's top five customers drove ~24% of its revenue in FY2022 and ~25% in H1 FY2023.

Healthy financial profile characterised by strong earnings and net debt free status – The company's financial profile remains healthy, aided by steady revenue growth, healthy internal accrual generation, comfortable capital structure and robust debt protection metrics. In FY2022, DGSL recorded revenue growth of 4.5% YoY (17.4% YoY adjusted for cignex divestment) to reach Rs. 1,201 crore. Further, in H1 FY2023, DGSL's revenue grew by 14.2% YoY supported by growth across geographies and segments. Coupled with healthy internal accrual generation, this has continued to result in minimal reliance on debt and a comfortable capital structure with gearing of 0.1x as on September 30, 2022, and robust debt protection metrics. Moreover, in the absence of any material capex or investments towards inorganic growth, the cash and liquid investment levels have continued to build up, translating into strong liquidity position for the company. ICRA expects DGSL's financial profile to remain healthy over the near to medium term, given its strong balance sheet, order book in hand and steady earnings outlook.

Credit challenges

Relatively moderate scale of operations and geographical concentration risk compared to large IT companies – With revenues of Rs. 1,201.1 crore in FY2022, DGSL's scale of operations remains moderate than some large/mid-sized domestic IT players, thereby restricting its pricing flexibility and margins. The company's margins are less than other major IT layers owing to its moderate scale of operations and high exposure the India and West Asian geographies, which have thin margins compared to the US and Europe. ICRA expects the company to generate steady revenue growth and maintain its current margin levels in the short to medium term.

Margins vulnerable to competitive pressures, wage inflation and forex fluctuations – Given the intense competition in the industry, DGSL's profit margins are susceptible to pricing pressures and wage inflation. Further, much of the revenues and margins are exposed to forex risks, although the company's hedging mechanisms mitigate the same to an extent. Being in a highly labour-intensive business, the availability and retention of a skilled workforce are the key challenges. In line with the trend witnessed across the industry, DGSL's OPM also moderated in H1 FY2023 partially due to continued wage cost inflation. Attrition levels are likely to start tapering from the end of the current fiscal, as record net employee addition at the industry level in FY2022 is likely to address the demand–supply gap to a large extent.

Exposure to policies and macroeconomic environment in key operating markets – DGSL is exposed to macroeconomic uncertainties and any adverse regulatory/ legislative changes in its key operating markets of the US and Europe, which drove ~70% of its revenue in FY2022. ICRA has noted the evolving macroeconomic headwinds in the US and Europe in recent times. Despite the healthy order book position, the industry is cautious of the same as it could moderate the industry's (including DGSL's) growth over the medium term, if it intensifies.

Liquidity position: Adequate

DGSL's liquidity is strong with healthy estimated fund flow from operations (FFO) of Rs. 150–170 crore in FY2023, aided by steady revenue growth and operating profitability. The liquidity is also strengthened by sizeable, unencumbered cash and liquid investments of ~Rs. 416 crore as on September 30,2022, considerable cushion in the form of unutilised working capital limits and no debt repayment liability. ICRA expects the company to continue to scout for investment/ acquisition opportunities to support its inorganic growth initiatives. The impact, if any, of the same on DGSL's credit and liquidity profile will depend on the ticket size of these investments/ acquisitions and their operational and financial synergies.

Environment and Social Risk

Environmental concern: Given the service-oriented business, DGSL's direct exposure to environmental risks as well as those emanating from regulations or policy changes is not material.

Social concern: Like other Indian IT service companies, DGSL faces the risk of data breaches and cyber-attacks that could affect the large volumes of customer data that it manages. Any material lapses on this front could result in substantive liabilities, fines, or penalties and reputational impact. Also, DGSL remains exposed to the risk of changes in immigration laws in the key developed markets where it provides its services. While such changes would be motivated by those economies' own social and political considerations, they could have the effect of heightening the competition among IT players for skilled workforce leading to higher attrition rates and may have an adverse impact on profitability. Managing various facets of human capital, including skills, compensation, and training, is in any case a key differentiating factor among IT companies.

Rating sensitivities

Positive factors – ICRA could upgrade DGSL's ratings if the company exhibits a sustained improvement in its business profile, supported by increase in scale of operations, while generating adequate returns and maintaining strong credit metrics and liquidity.

Negative factors – Negative pressure on DGSL's ratings may arise in case of any significant reduction in the company's revenues and profitability weakening the credit profile. The ratings may be downgraded if any increase in working capital intensity, or any significant debt-funded acquisition(s) weaken(s) the debt coverage indicators or liquidity position. Specific credit metrics that could lead to a rating downgrade include gross Total Debt/OPBDITA above 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology (IT) Services Industry
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of DGSL. The details of the entities consolidated are shared in Annexure 2.

About the company

Incorporated in November 1987, DGSL provides solutions for data driven businesses to enhance their productivity and customer experience. The company's services can be bifurcated into three segments—digital operations, digital experience and digital technology. The company has also developed products in robotics process automation, advanced analytics, business intelligence, and automated fare collection. DGSL is headquartered in Mumbai, with offices across North America, Europe, Australia and Asia, through its subsidiaries. DGSL's customer base is diversified across various sectors, such as BFSI, manufacturing, hospitality, publishing, and international organisation, among others. The company is headed by Dr. Lalit S. Kanodia, the Chairman, and Mr. Rahul L. Kanodia, the Vice Chairman and CEO.

Key financial indicators (audited)

DGSL - Consolidated	FY2021	FY2022	H1 FY2023*
Operating income	1,149.1	1,201.0	670.3
PAT	83.6	155.4	81.9
OPBDITA/OI	12.5%	16.2%	14.9%
PAT/OI	7.3%	12.9%	12.2%
Total outside liabilities/Tangible net worth (times)	0.2	0.3	0.2
Total debt/OPBDITA (times)	0.1	0.3	0.3
Interest coverage (times)	30.6	47.1	38.2

Source: Company, ICRA Research, All ratios as per ICRA calculations

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest and taxes and amortisation; amount in Rs crore, unaudited*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years				
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sept 30,2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021	Date & rating in FY2020	
					Jan 5, 2023	Dec 20,2021	Nov 16,2021	Sept 4,2020	Dec 31,2019	June 07, 2019
1	**Fund-based/Non-fund Based Limits**	Long term/ Short term	180.0	-	**[ICRA]A+ (Stable)/ [ICRA]A1+**	**[ICRA]A+ (Stable)/ [ICRA]A1+**	**[ICRA]A+ (Stable)/ [ICRA]A1+**	**[ICRA]A (Stable)/ [ICRA]A1**		
2	**Fund based/Non-fund Based Limits**	Short term	-	--	-				**[ICRA]A1**	**[ICRA]A1**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/ Short -term – Fund-based/Non-Fund Based	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based/Non-Fund Based	NA	NA	NA	180.0	[ICRA]A+ (Stable)/[ICRA]A1+

Source: Company

[*Please click here to view details of lender-wise facilities rated by ICRA*]

Annexure II: List of entities considered for consolidated analysis

Company Name	DGSL Ownership	Consolidation Approach
Datamatics Information Solutions Limited	98.81%	Full Consolidation
Datamatics Global Services BV	100%	Full Consolidation
Datamatics Global Services Corp	100%	Full Consolidation
Datamatics Global Services FZ LLC	100%	Full Consolidation
Datamatics Global Services Inc	100%	Full Consolidation
Datamatics Global Services Pty Limited	100%	Full Consolidation
Datamatics Global Technologies AG	100%	Full Consolidation
Datamatics Global Technologies Limited	100%	Full Consolidation
Datamatics Infotech Limited	100%	Full Consolidation
Datamatics Robotics Software Inc	90%	Full Consolidation
Datamatics Robotics Software Limited	90%	Full Consolidation
Datamatics Staffing Services Limited	100%	Full Consolidation
Datamatics Foundation	100%	Full Consolidation
Datamatics Cloud Solutions Private Limited	775	Full Consolidation
LDR eRetail Limited	100%	Full Consolidation
Lumina Datamatics GmbH	100%	Full Consolidation
Lumina Datamatics Inc	100%	Full Consolidation
Lumina Datamatics Limited	100%	Full Consolidation
Lumina Datamatics UK Limited	100%	Full Consolidation
Sunrise Setting Limited	70%	Ful Consolidation
RJ Globus Inc	100%	Full Consolidation

Source: Company
Note: ICRA has taken a consolidated view of the parent (DGSL), its subsidiaries and associates while assigning the ratings.

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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