Expleo Solutions Limited
Q1 FY 2022 Earnings Conference Call

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MODERATOR: MS. ASHA GUPTA, CHRISTENSEN ADVISORY, INDIA

Moderator: Ladies and gentlemen, good day, and welcome to Expleo Solutions Q1 FY 2022 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 "*" 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.

Asha Gupta: Thank you, Stanford. Good afternoon to all participants in the call. Welcome to the Q1 FY 2022 Earnings Call of Expleo Solutions Limited. The results and investor presentation have been already mailed to you and they are also available on the company's website. In case anyone does not have a copy of press release or presentation, please do write to us and we will be happy to send you the same.

Representing the management today, we have Mr. Balaji Viswanathan – Managing Director & CEO, and Mr. Desikan Narayanan – Chief Financial Officer. Mr. Balaji will start the call with a brief overview of the quarter gone by, which would be followed by Mr. Desikan who will be getting into detailed financials. After that, we will open the floor for Q&A session.

As usual, I would like to remind you that anything that is mentioned 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 risk and uncertainties that we face. This risk and uncertainties are included but not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual reports, which you can find it on our website. Having said that, I now hand over the floor to Mr. Balaji. Over to you, Sir.

Balaji Viswanathan: Thank you, Asha. Thank you so much. Good afternoon, everybody. Thanks for joining our call. Just to give a quick overview about the quarter gone by, we have had a reasonably good quarter. And we continue to see positive trends, both in terms of pipeline and in terms of opportunities that actually presents to us. The entire ITeS industry in India, or rather across the globe, is actually seeing a good amount of traction, thanks to the acceleration of the digital transformation and acceleration of many projects that the clients are trying to do over the last couple of quarters. The initial challenges around COVID seems to have gone by and people are making sure that they are keeping abreast with the latest technologies more in terms of security and digital transformation as well. So that's actually giving us some opportunities, similar to how all our peers and the bigger IT companies in the Indian IT industry are also gaining as well. We continue to see good traction in the demand across all the regions, particularly in Asia. We have also seen demand picking up in Europe as well. The opportunity for automation, digital services, and specialized testing around testing, digital enablement, security and performance has been growing significantly and that's where we see massive amount of demand as well.

During the first half of this calendar year, we have added some key strategic clients. One client who is based out of Asia Pac and other client which is a large global company already operating out of India and further strengthening their offshore and India presence. Both of them are looking to contribute more than $1million during this particular calendar year.

Digital Services continues to grow from close to around 14% to 15% of our revenues in December 2020, currently it's doubled from there, and it's close to around 29% right now. And we expect it to be around 30 - 33% during the end of this calendar year.

Our offshore business contribution has once again significantly changed. And that continues to change over the last three quarters with more work coming offshore and some of the onsite presence reducing, which is actually good for us from a margin perspective, even though not so much from a top line. Currently around 60% of our business comes from the offshore headcount and around 40% comes from onsite, compared to 48% was the offshore contributions year-on-year, if I were to compare four quarters back. So, that's actually helping us in building a robust platform in India and also helping us in making sure that we are able to forecast and anticipate the kind of demand that we can expect; and based on that, we can up-skill and look at what kind of capability that we need to build as well. While the industry trends and the kind of heating up is also having a negative impact, primarily because the costs are increasing significantly, we are also seeing increased amount of attrition similar to all our other IT peers as well. While that may actually have a temporary impact on our costs, but we don't see that having the long term impact. We expect it to probably last for another couple of quarters at best.

The second wave of COVID also had some impact on us because the spread of COVID was quite significant and quite rapid. We also faced some covid impact at company's level for few infection cases within our teams and we had a few unfortunate casualties as well. We stepped up the vaccination and hypercare for our employees> We provided emotional health assistance to our employees through external specialists as well, trying to work through the current stressful situation across both the team members and their families. We conducted a few drives in Chennai where we had the scale, in other places we have been trying to partner to get our teams vaccinated properly> Currently approximately 55% to 60% of the teams getting vaccinated. We still have the remaining people who have to complete the vaccination doses on which we are constantly following that as well.

On the merger of the unlisted entities, which we announced three, four weeks back, the process has started, we have applied or we have submitted our documents to the regulatory authorities, we are going through the process. The process would take anywhere between two quarters to seven to eight months. We expect, in the best case scenario, to get this completed by the calendar year Q1 of 2022, that is March 31, 2022. But give or take the kind of timeframe that it takes nowadays due to the pandemic, it may probably happen either in March or late as by April. So, given that, we may probably not have all the information about the unlisted entities which we can present here, because they still follow the same private limited company norms and regulations, which is not the same as what we do in terms of quarterly results and publishing.

Apart from that, we have signed up for the facility in Coimbatore. We are doing significant amount of hiring and ramp up, both from campus and also in the early stages and investing in the upskilling for the teams across multiple locations, primarily between Coimbatore and Chennai and Bangalore and we expect that to continue those initiatives . We are also working on enhancing that to spread across Pune and the other locations as well, anticipating to be ready before the actual merger of the entity as well.

So, that's quickly about the past quarter and some latest updates. I will pass it on to Desikan to cover the specifics on financials.

Desikan Narayanan: Thanks Balaji. Good evening to all. We started the first quarter of FY 2021-2022 with revenue of Rs. 88 crores compared to Rs. 79 crores in the previous quarter, growth was around 11%. We have reached new benchmarks in the revenue numbers compared to any of the previous years. EBITDA ended at Rs. 14.6 crores against the previous quarter of Rs. 19.1 crores. We did see a drop in EBITDA percentage to 16.6% compared to 24.1% in the previous quarter. Earnings per share have grown by 16.6% from Rs. 10.72 to Rs. 12.50 due to PAT ending higher compared to the previous quarter. Major contributor to the increase in cost, as mentioned by Balaji was, salary cost and third-party consultant cost due to headcount increase. Our third-party consultant cost is grouped under other expenses, that's reason you see the increase in the other expenses starting previous quarter. We started doing this change from previous quarter. Our third-party headcount increased to 336 now from 263 last quarter. Other than third-party consultant, we also incurred cost of merger programs and some training costs during the quarter. And we also had some rates and taxes reversal in the previous quarter because previous quarter we had a true-up of certain capital this quarter it shows a little higher amount. That's about the reason for the change in the expenses. Under the other income, it also includes a forex gain of Rs 26 million. Last quarter, we had a loss of Rs. 26 million. That is on quarter-on-quarter comparison.

With respect to last year same quarter year-on-year comparison, we had a 16% growth year-on-year, with revenue ending at Rs. 88 crores compared to Rs. 76 crores during the previous year same quarter. Dip in EBITDA from 25.5% to 16.6% majorly contributed by the same set of reasons what I mentioned before. PAT is at 14.1% against 18.3% in the previous year same quarter.

So, this is the brief about the results. Now I will open it up for the Q&A session.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Mithun Aswath from Kivah Advisors. Please go ahead.

Mithun Aswath: Just wanted to understand this increase in cost. Is this more like a one-time increase? Because, obviously, our EBITDA margins have come much lower than what we had guided in the previous call, so just wanted an insight on that. And what has driven this appreciable growth in the top line this quarter, is that we won several new orders? Just wanted your take in terms of what is the hiring number that we are looking for in FY 2022?

And secondly, could you just give us a little bit of an update of the business which is getting merged, and at least in terms of trends, how they are shaping up, even if you can't talk about explicit numbers. Thanks.

Balaji Viswanathan: So, the reason for the cost increase, like what Desikan mentioned, are threefold. One is the increase in the third-party consultants, Third-party consultants actually it's the delivery team primarily. But instead of hiring them in our rolls, we are actually trying to source it through consultants, so that we can actually deploy them faster. Because if we were to hire laterals from the market, it takes anywhere between 30 to 60 to 90 days, depending upon what kind of notice period they go with. And that's the reason why we normally go through consultants for short term requirements or who we need to hire faster. And typically what happens is that, there is a time lag from the time you hire before you deploy them of anywhere between three weeks to four weeks, because it takes that kind of timeframe to do background verification and all those other elements because we service mostly financial services clients, and we can't just hire and deploy them straight away. So, that's the reason why you see that now, because if you were to look at the growth, most of it has a lag effect. So, you will see this over the next couple of quarters as well as we see the demand. But it's not something which is going to be a long-term impact per se. It will settle down as we start hiring more in the coming quarters.

And the second element of the cost increase is, like what Desikan mentioned earlier around the merger cost and some of the rates and taxes which we reverse in the last quarter, because of which we saw a higher EBITDA margin in the last quarter. So, now there are no reversals, most of the catch-up accruals and reversals happen only at the end of the financial year. So, that's the reason. So, there is no systemic challenge. And we still expect that we would be in anywhere between 18% to 19% EBITDA margins is what our expectation is. Even though it's not our guidance per se.

On your second question on what is driving the growth? it's similar to what you see across the Indian IT industry; there is a lot of pent-up demand which was held up in the first three quarters of COVID, which is now surfacing. And everybody wants to try and accelerate most of the digital transformation program because they want to reach to the customers faster as they see competition catching up as well. So, that is the primary reason. So, the demand is increasing, and primarily the demand is increasing in the newer technology spaces, and also the traditional testing spaces as well. And we are seeing demand across Asia, U.S. and the European markets as well. And we have seen the change, if you were to look at the earnings presentation as well the talks about the growth by region, you could see that the primary growth has been in the Asia Pac and the Europe region.

And on the last question on the merger, and the to-be merged entities, the unlisted entities as a group. Since they are private limited companies, there isn't really any quarterly financials or audits that gets done. But if we were to look at the current trend, they are in line with what we were expecting as part of the merger as well. And they are also growing in similar places because the industry as a whole is growing, and we are just trying to keep our growth pace as faster than the industry. And they are in line with whatever expectations that we have in terms of the merged entities numbers as well. Desikan, you want to add anything more?

Desikan Narayanan: No, I think you have summed it up very well.

Moderator: Thank you. The next question is from the line of Ashish Das from Sharekhan. Please go ahead.

Ashish Das: Sir, you mentioned that EBITDA margin would be 18% to 19%. And this quarter, it is around 16.6%. So, do you mean that on sequential basis there would be improvement for the remaining quarters? And when would you take the wage hikes?

Balaji Viswanathan: Yes, so like what I mentioned, the primary reason for the costs increase or the EBITDA margin to go down is around the third-party costs, third-party consultants who we are hiring to deliver. And depending upon when they get hired and when they are able to build is where the lag is. So, some of the growth which happened in the month of the last part of May and June, we have to hire and keep them for three weeks or so and their verification and all those kinds of stuff happens. So, that is the reason why there is a lag. Over a period of the next two to three quarters it will all settle down because the pipeline will be streamlined. So, we expect that for the financial year we will still be in the range of around 18%. Sorry, I missed your second part of the question.

Ashish Das: Salary hike.

Balaji Viswanathan: The salary hike is calendar years. So, our salary hikes actually happen in January. But the kind of pressure that we are seeing on costs, particularly on compensation from the industry, the kind of salary increases that we are seeing in the market, we may probably have some impact when we do the salary hikes in January. But we are still confident that we should be able to manage some of the other levers if we are able to increase the offshoring percentages and those things.

Ashish Das: Okay. So, when you mentioned that January is the cycle for your salary hikes, so you would take salary hike in Q4 FY 2022, correct?

Balaji Viswanathan: That's right.

Ashish Das: And sir, on the revenue side, last concall you mentioned that the growth would be between 15% to 20% in FY 2022. And with the Q1 sequential growth has been very strong, 11%, so you are saying that demand is strong, you are hiring third-party consultant and all these things happening. So, the growth momentum on sequential basis, can we expect to continue for the remaining quarter?

Balaji Viswanathan: Yes, we expect that it will continue for the remaining quarters as well. Q4, that is the quarter of October, November, December normally gets a little slowed down because of number of holidays. But overall, I think for the financial year we should still see the 15% plus growth that we talked about.

Ashish Das: On a sequential basis I am asking, and this quarter you have reported 11% Q-on-Q. If this happens, this run rate goes on, so the growth would be around 25% to 30% year-on-year in FY 2022?

Balaji Viswanathan: That's what I am saying. So, your Q4 or Q3 of the financial year, considering that the number of working days will be much lesser compared to the other quarters. And most of the countries go on holidays and other stuff, we may have a small plateau there. But other than that, the rest of the quarters should still see one which you are talking about sequentially at 10% to 15% growth. And that could end up anywhere between 15% to 20%.

Ashish Das: Sir, last question. Your top five client growth has been remaining strong for last two quarters, so could you please highlight or give some color why or how the growth has been so strong for top five clients? What has happened here, and these top five clients would continue to report strong growth?

Balaji Viswanathan: Yes. So, it's not the same top five, so that is what I had mentioned in the initial comments as well. We signed two new customers between Q4 the calendar year that is October, November, December 2020 and the January, February, March 2021, we signed two new clients who have actually now moved into our top five as well. Primarily, these two clients are actually contributing to accelerated growth. And our existing customers, like I had mentioned earlier as well saying that we have done investment in sales and client engagement teams in Spain and in Belgium that we have some of our strategic customers, and that's showing some results as well.

Ashish Das: My last question, if I can. On last concall, you mentioned that combining entity cash position was Rs. 277 crores, so any number around that as of June 30, 2021? And as we mentioned that there are supply side issues and we saw margin impacted for our entity Expleo Solutions, so can you give some qualitative commentary, is there any impact on unlisted companies margin?

Desikan Narayanan: On the cash side, currently what we have is Rs. 137 crores is our cash balance, the numbers of the unlisted companies are not Audited. So, I can tell that only for our listed company. And I am sorry, I missed the second question, can you repeat it again, please?

Ashish Das: There are supply side issues in the industry, so any qualitative commentary from your side, so our margin for the unlisted state entity was 19%, so is there any impact also for the unlisted companies on margin front due to these supply side issues?

Desikan Narayanan: I think Balaji was mentioning about both the unlisted companies. On an overall trend, it seems to be in the same trend of what we saw in the month of March, that continues. On the margin side, generally the quarterly things have ups and downs on this, so we don't see any much change in that. But once a quarter moves to the second or third quarter, there we will have more known numbers which will come out rather than the first quarter if you look at it.

Balaji Viswanathan: I don’t think there were supply side issues, Mr. Das. The supply side issues are not impacting what we are delivering to our customers right now.

Moderator: Thank you. The next question is from the line of VP Rajesh from Banyan Capital. Please go ahead.

VP Rajesh: Congratulations Mr. Balaji and Desikan on very strong traction on the customer side. So, Balaji, if you can just give a little more color on these two large customers, in terms of what segment they are in, and who were the competitors for this piece of business? That will be helpful to start with.

Balaji Viswanathan: Sure. So**,** one customer is actually a large payment technology company, who have customers and their own services across the globe, and we are actually servicing them through their own center in India, and we are doing it through their own center in India for multiple geographies, including their U.S. operations and their European operations, and also the Middle East operations as well. So, that's one customer where we have been growing quarter-on-quarter sequentially for the last three quarters, that was signed sometime in November, the first week of December of 2020. And the second customer is actually another multinational insurance carrier, but this is signed in the Southeast Asian market, covering across Singapore, Malaysia and Indonesia. And this is also for their digital transformation program and how we are helping them, both in the quality assurance services and also in security and performance engineering services as well.

VP Rajesh: Great. And any update on the U.S. side, I think we hired some people last quarter, if I remember correctly, so how's that coming along, if you can just comment on that?

Balaji Viswanathan: We hired a person last quarter and he started the traction and his pipeline is something which is coming up at this particular point of time. We are also organizing a couple of events and road shows in the U.S. by end of September and early October as well, just to try and create some brand visibility for ourselves. And others are inside sales teams which we have dedicated for the U.S. market as well to try and build some of the leads and opportunities through him. And we expect that we should start showing some results starting from the next quarter onwards.

VP Rajesh: Got it. And just on the numbers, if I look at your other expenses year-over-year, they have gone from Rs. 16 crores to over Rs. 30 crores this quarter, right, year-over-year basis. So, whereas the revenue year-over-year has gone up by Rs. 12.2 crores so obviously you won't be hiring these consultants at a negative margin. So, I am assuming the merger cost must be also a big chunk in that Rs. 30 crores number, so any color on that?

Desikan Narayanan: Predominantly it is only the third-party consultant increase. I have mentioned you about the number of people, almost 100 people increased. Compared to last year, it is much more, last year same quarter we had around 120 to 130 third-party consultants, now it has grown up to around 300 third-party consultants. So, that's the reason you see the big increase in the third-party consultant cost. As far as the merger, it's in the range of around Rs 20 million is the range what we have spent on the merger related expenses.

VP Rajesh: And you will see that you are going through in the next few quarters also basically?

Desikan Narayanan: You are talking about the merger thing?

VP Rajesh: Merger cost.

Desikan Narayanan: Merger cost will reduce because major part of the things has been done, now only it is milestone which is pending with SEBI. And there are only two things that are available, one, we need to get the stock exchange and SEBI and NCLT. There it's only a part of the cost will be coming in, not major cost will come in, most of the cost is got done for all the DDs and other related items.

Balaji Viswanathan: But one thing, just to add, one big element of stamp duties that's a huge element. This will happen when we get the final NCLT approval, which is expected either in March or April of next year.

VP Rajesh: Okay. And any idea of what that cost would be like?

Desikan Narayanan: I can check and get back to you, because it depends upon the number of shares we issue. I will get back to you on that.

VP Rajesh: Okay. And lastly, what was the contribution from the group in this quarter? And did it increase compared to the last quarter?

Desikan Narayanan: It was almost flat, it was around 21% of our revenue was from the group.

VP Rajesh: Okay. So, it seems that then the growth in the quarter was predominantly from the initiatives that we have taken, right, that seems to be growing at a much higher pace then?

Desikan Narayanan: Correct.

Balaji Viswanathan: I just wanted to, clarify one point there, Rajesh. While we said the group revenue is still 21%, the engagement in countries like Spain and Belgium, even though it is actually a direct client of ours, the selling and client engagement is through the group. Because while we are reimbursing or we are having a salesperson for us dedicatedly, but it's actually managed through the group. So, that also has a significant contribution. So, if you include that, I had mentioned this some three, four quarters back as well, so if we include that the group contribution is almost 45%.

VP Rajesh: Right. But what I am saying is, compared to the last quarter, if you include that in the last quarter also.

Balaji Viswanathan: Yes, apple-to-apple comparison is still flat.

VP Rajesh: So, that means your other business is growing much faster than the group?

Balaji Viswanathan: Yes.

Moderator: Thank you. The next question is from the line of Rahul Picha from Multi-Act. Please go ahead.

Rahul Picha: Sir, firstly wanted to understand the growth outlook better. So, you are saying that this year we could end up achieving 15% to 16% growth, but when I look at our Q1 numbers, and if I were to analyze the current Rs. 88 crores run rate and compare it with what we did in the last full year, we did around Rs. 301 crores, so that itself works out to about 15%, 16% growth for the year. So, are we not expecting sequential ramp up from here on? Or we expect to grow much more than 15%, 16%?

Balaji Viswanathan: See, once again, I don't want to make it look like we are doing a forecast of what our numbers are. The expectation is that we will continue to grow at more than what we are at right now. Because even in this particular quarter, that is the next quarter, Q2 of the financial year, we will actually see an even larger growth as well. So, the expectation is that we will certainly cross the 15%, 16%, but that's the modest target that we want to go with at this particular point of time. So, we expect that we will probably be in that Rs. 90 crores plus what our expectation is.

Rahul Picha: Got it. And sir, could you also please give us what is the constant currency growth for the quarter?

Desikan Narayanan: Quarter-on-quarter constant currency growth was 10.3%, year-on-year it is 12.8%.

Rahul Picha: Okay. And sir, on the headcount, could you please share what is the employee count including subcontracting end of June, 2021 compared to what it was a quarter back?

Desikan Narayanan: The subcontractor is around 330 and including the employee it is 1,470.

Rahul Picha: Okay. And sir, what would be our utilization in the first quarter?

Balaji Viswanathan: Around 83% to 84%.

Rahul Picha: Okay. And what would be the optimal utilization for us?

Balaji Viswanathan: 85% to 86% is what we normally target.

Rahul Picha: All right. Sir, last question from my end, sir on capacity office space that we have at a group level, what is the kind of headcount that it can accommodate? And after this new Coimbatore thing that you have done, what would that capacity increase to?

Balaji Viswanathan: The Pune entity has a lot of capacity, because it's an SEZ location, it's a 2 acre campus. And the current constructed capacity, it's around 1,150 to 1,200, out of which only around 800 is being used. And then there is another bar shell, which also can accommodate another 700 to 800. So, the merged entity, that is including the Coimbatore one and all the other centers put together, our current capacity itself will actually take us to close to 4,000, 4,300. And we expect that as part of this new normal of work from home, at least 20% of our population will continue to operate from home, even post pandemic, so that should actually give us a capacity of at least 5,500 to 6,000 people with whatever facilities that we have got right now in the merged entity or going to be merged entity.

Moderator: Thank you. The next question is from the line of Rajesh from Zenith. Please go ahead.

Rajesh: My question is, what are the challenges that we foresee with the merger? And what kind of opportunities that you foresee with the merged entity?

Balaji Viswanathan: Challenges with the merger, its two different entities and obviously the challenges is basically to make sure that we are able to integrate both people and processes effectively. And that's the challenge with any merger, particularly in a service industry. The importance of people is very, very important, that's the most critical element. And so that is what will probably be our endeavor to make sure that we do that right. And in terms of opportunities, there are plenty of the opportunities, the first thing being the entire engineering capability that we can take to our direct customers. And the opportunity of trying and leveraging more work from the group now that we have an end-to-end capability in one entity rather than going between multiple entities, which was the case earlier. So, both of those put together, we are quite confident that the kind of opportunity that at present is quite strong and will continue to drive our growth over the next at least two to three years.

Rajesh: So, can we see more traction from the U.S. business in that case?

Balaji Viswanathan: Not from the U.S. business, I am saying from the group, because the U.S. business, if you were there in the last call where Rajesh Krishnamurthy was also there post the merger, the U.S. business, well, we have close to around $70 million, $80 million worth of business from the U.S., that's not our biggest forte. Our strong geography is still Europe and we still have a lot of opportunities which we haven’t tapped there in Europe itself.

Moderator: Thank you. Next question is from the line of Vikesh from ONGC. Please go ahead.

Vikesh: Just one question. Can you give some idea of what is the order book position of the Expleo and what would be the order book position for the merged entity at this moment?

Desikan Narayanan: For the merged entity, it will be difficult to tell, only we can say about us compared to what we have. Because we only follow ours, we don't get into that as of now. For us, if we look at the order book facility, this quarter will be a major quarter for us where we will have Middle East going in, APAC also we are seeing more traction coming in out of the existing client which will grow in the APAC. And we see some traction from Europe as well as some of the client also is coming out in the U.S. So, that way, we see that we will be achieving little more than what we thought in the quarter two of the financial year. Quarter three will be a little bit slump, as Balaji was mentioning that we have holidays and leave coming in, there we see a little bit slump, not to a great extent but we will have a slump, that is traditionally our little weak quarter what generally we have. And quarter four, we see that it will be a little bit higher, around 10% to 15% higher than what the quarter three will be. That's the way it is, and we see that more traction it is more from an angle of how we are going to serve them is the thing which is going to come in this. The demand is there in the market, we need to time the demand and get the people and supply it, that's more challenge currently we are facing into.

Vikesh: But can you give some idea about quantified numbers, like you said 15% or 18%, no idea on quantified number? In other companies I get to hear quantified that our order book position is like Rs. 400 crores, something like that.

Desikan Narayanan: Generally, we don't give a forecast because that becomes a guidance statement from us, which is not something which we do. We can generally give an overall kind of how the trend will be in each quarter, what we are coming out until the end of the financial year. We generally don't do that, that's the reason I am not giving it. But overall, as Balaji mentioned, year-on-year we are looking at something around 15% to 16% growth. But quarter-on-quarter basis, it will be too detailed for us to even give it a thought.

Moderator: Thank you. The next question is from the line of Rohit Balakrishnan from iThought PMS. Please go ahead.

Rohit Balakrishnan: Balaji, just two, three questions. One is, I mean, we are at almost Rs. 88 crores, Rs. 89 crores in this quarter, so I mean the industry and other companies who are slightly bigger than us, but not as big as some of the major ones are growing at 4%, 5% on a constant currency basis sequentially. So, is it something that we can do? Or you think that given we are not in the largest market could be a challenge for us? I mean, just wanted to get your perspective on that.

Balaji Viswanathan: You are saying 4% to 5% CAGR on a constant currency?

Rohit Balakrishnan: Yes, sequentially, right.

Balaji Viswanathan: Yes, this quarter we have done around 10.3% and we are confident that we should be able to continue at least for the next three quarters in that either a high single digit or in double digits in constant currency.

Rohit Balakrishnan: Sequentially you are saying?

Balaji Viswanathan: Sequentially, yes.

Rohit Balakrishnan: Okay, got it. So, just as a side note to this question, I mean, we have not grown like that, I mean, in a very long time. So, just from an organization perspective, are we geared up in terms of bandwidth of maybe middle management? I mean, is there something that…

Balaji Viswanathan: I get the gist of it. You are saying that whether we are geared up for that kind of growth? Yes, Rohit, we are building that capability and we are leveraging the full benefit of what the group offers as well, because if you recollect two, three quarters back, as soon as Rajesh joined, we made that announcement around what the group is doing in terms of consolidating all the capabilities and competencies under digital capability and also on automation and quality capability as well across the globe. And that capability is something which we are leveraging to the maximum extent to make sure that that particular team guides the middle management team here and also helps us in recruiting the right kind of talent as well.

Rohit Balakrishnan: Sure. The other question was, I think in the concall that happened sometime back after the merger, I think Mr. Krishnamurthy said that at a global level there is a target to sort of increase the overall offshoring from single digit to 20% or so, or 25%. I mean, has that process started? I mean, I think you mentioned that this quarter also the group business was sort of flat. So, I mean, is it that once the merger has happened, only then the process will start or just wanted to get some sense.

Balaji Viswanathan: Yes, the process has started, there is a specific governance around what is being offshored and how it is being offshored. But most of it is around the engineering business where the offshoring percentage has been traditionally very low. So, once we do the merger, we will probably start seeing a lot more traction there, because that's where the focus to increase offshoring is, because that's the low hanging fruit and that's where the maximum number of opportunities are.

Rohit Balakrishnan: Right. And typically, engineering services is a higher margin business? I mean, I am not taking what numbers you have given, because I think there was some one-off there in terms of COVID, etc. But in general, is that business a higher margin business? And going forward also, would that be margin accretive for the listed entity?

Balaji Viswanathan: The margins are not very different, it's slightly lower than the typical IT services margin, but it's not very different. Particularly when we do offshore and particularly when we do the transfer pricing through the group, the margins don't differ much, because it's end of the day a cost plus when the group business comes in.

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

Rohan Advant: Thanks for the opportunity. Most of my questions have been answered, just on the financials of the unlisted company, you said they are privately audited, and they don't do the quarterly thing. So, when will we get to know these financials, will it be half-yearly or will it only be after the merger that these Financials will be disclosed to their shareholders?

Desikan Narayanan: See, generally the way it happens is, it will be around the end of the year, they have their own audit cycle, where it starts around the January, February timeframe for them to close it for the 31st of March. So, that's the time we expect that we can get audited numbers from them. And also, the date of sales, our merger date is also 1st April 2022. So, maybe at that time we will have the full-fledged financials of all these three. Once their audit is over, then we will have some numbers in place so that we can provide it to everyone.

Rohan Advant: Got it. Sir, when you talked about our current capacity, and you adjusted it for work from home and you said its 5,500, this is including the recent announcement that you gave of Coimbatore increase of capacity and recalibration in Chennai? Or that will be over and above that?

Balaji Viswanathan: Yes, this includes the Coimbatore capacity as well. We have rationalized some of our premises in Chennai and we are looking at primarily utilizing Coimbatore and the spare capacity that we have in Pune.

Rohan Advant: Okay. And this capacity you expect to utilize at the group by FY 2023 end, is that the plan?

Balaji Viswanathan: Yes. So, like what I mentioned, the Pune capacity, there is only one part of it which is ready and which we can use right now. The other one is a bar shell at this particular point of time which we will develop or which we will fit it out once we have the right level of demand. And including the promises, yes, by 2023 is when we expect that demand to be fulfilled.

Rohan Advant: Okay. And sir lastly on the engineering R&D piece, if I look at the Expleo group, I think about more than 60% of its revenues are in ER&D, could you give us some color on the kind of services that they do? Is it software, mechanical, electronic, and is there any peer set that are our they like entity address of India, because over time, this would become a larger piece of the merged entity, so something on that front? Thank you.

Rohan Advant: Yes. So, the engineering services, the key elements which are done from India is primarily around, what we call it as emerging engineering services, which is around embedded systems and software design and software testing and software validation for the automotive and avionics industry. Another one is the mechanical industry, which is around the plants and setting up of plant and setting up of assembly lines and the assurance around those particular services. These two are the major ones. The third, which is fastest growing even in that segment is the digital services within the emerging engineering services as well, around embedded systems and the automated car and the electronic vehicles and all those kinds of elements as well. So, these are the segments which are growing faster. And on your question on when the entity gets merged, the entity that is getting merged is only around 78% or 80% for the listed entity at this particular point of time, they are not larger than the current listed entity. But the expectation is that it will grow faster because as they start doing more offshoring.

Moderator: Thank you. Next question is from the line of Subhash Naik from Tridap Capital. Please go ahead.

Subhash Naik: If I am correct, you said you will have utilized the capacity of 5,000 plus people by FY 2023 end or calendar 2023 end?

Balaji Viswanathan: The expectation is by calendar year by December 2023, give or take two, three months here and there, which will basically complete the financial year as well.

Subhash Naik: So, typically what we are assuming is more than doubling the capacity, we are at 2,200, 2,300 today, both combined between Pune and…

Balaji Viswanathan: No, we are at 3,400 today.

Subhash Naik: Okay. So, 3,400 will go to about 5,500 in the matter of two and a half years?

Balaji Viswanathan: Yes.

Subhash Naik: And you said your optimum utilization is about 86%, we are at 83% already. So, what kind of manpower addition plans are there for the next three quarters, if you can share that?

Balaji Viswanathan: We are currently hiring at the rate of around 110, 120 people per quarter, net addition, because we also have an attrition challenge as well. So, the net addition is around 120, 125 in terms of employees; and another close to around 75 to 80 in terms of contractors. So, that's what we expect for this quarter, that is the Q2 of this financial year. It will slow down a little bit for October, November, December, but once again we expect that the first two quarters of the next calendar year also should see similar kind of a demand. We can't foresee beyond that at this particular point of time.

Subhash Naik: Second question is about the margin profile, once you combine both entities, can you just probably just give us some guidance about what kind of margin profile we are looking at? Are the margins similar between Pune and our entity or are the margins different?

Balaji Viswanathan: Desikan give you more details. But at this particular point of time, that is as of the March 2021 EBITDA numbers, the Pune entity is slightly more than what the listed entity is, but the Bangalore entity is lesser than what the listed entity is. Combined between the two, it's almost the same. Desikan, you want to add something there?

Desikan Narayanan: Correct. The Pune entity as of 2021 was slightly higher on the EBITDA side, so around 26% for that, and ours was around 23.1%. That's the way we ended last year. Technology was around 15.6%, and the combined was around 22.2% as of 31st March 2021.

Subhash Naik: With the 10% kind of Q-on-Q growth, which is very strong growth we are talking about, would it also impact our margins, it would give some leverage there?

Balaji Viswanathan: In the shorter term, yes, it will have some impact on the margins because we need to invest in building that capability and competency. But in the longer run, that is over a three to four quarter timeframe it should ease as we build the pipeline and streamline it.

Moderator: Thank you. Next question is from the line of Faisal Hawa from HG Hawa & Co. Please go ahead.

Faisal Hawa: Sir, within engineering and R&D, what would be the pecking order of our parent in the world listings? Or who are the top 10 engineering R&D firms of the world? This is one question. And second is, for the hiring part, will we be comfortable with hiring much more and having some kind of a bench strength rather than be short of talent in some quarters to come? And how will you strategize that? And third, do we see any kind of cultural or any kind of issues in integrating both the firms, as far as management structure or the leadership because we have had two different leaders for both the companies and we propose to continue with that arrangement as a separate business unit, so do we see any kind of cultural issues in integrating both firms which are actually in very, very different verticals?

Balaji Viswanathan: Okay, I will probably go from the last one. We don't see any cultural issues, because we have always been part of the same group. So, that has never been a concern. And it's not too different businesses, because the Pune entity, 90% of the business has always been on the quality side, it's been on quality assurance, which is similar to what Expleo Solutions have been doing, so it's not very different. It's only the engineering side of the business which is different than what Expleo Solutions was doing. So, we don't see any cultural challenges there, because it's under one group and under one management and most of the cultural elements and the policies and procedures are all defined at the group level, with some amount of flexibility of what we are able to do in India.

On your second question on bench and what we are trying to do in strategizing for building the supply side or building the capabilities, or rather capacity. We have always had a small bench to cater to our future demand, but the demand nowadays is higher than that. And the challenge always is that you can’t keep people idle, and with the kind of demand that others are seeing, the guys whom we keep idle are the ones who will get targeted first as well. So, at this particular point of time, the objective is to try and keep it as optimum as possible. And that's where we are using some of these third-party consultants and some of them who are able to actually supply us resources on a shorter timeframe, even though we have to spend a little more. But our objective is to try and make sure that we tap into the demand, get into the customer, which will help us grow in the future as well.

The first question was around R&D and where we are in the pecking order as a global engineering company. We are certainly there in the top 10, but we are something which I also need to figure out through any of the Gartner reports and others, because we have also figured in some of them, but I don't have the exact pecking order. We are certainly there in top 10 for sure, whether we are in top 5 or whether we are between the 5 and 10 is something which I need to come back to you.

Faisal Hawa: So, would India be the first option for any kind of outsourcing that they would like to do?

Balaji Viswanathan: No, there is already another engineering offshoring center in Romania, which the group has. So, depending upon what the languages are and what kind of capability we are able to build here, it will be between Romania and India.

Faisal Hawa: So, Romania would be for which language?

Balaji Viswanathan: All the Eastern European languages and also considering that it's part of Europe, you have German capability and others as well. So, in the engineering business the language capability is only that much, it's more the technical capability which we have to build, which is what we are trying to do as well. And there is really no preference between where the work will have to go. It's the question of where we are able to build the capacity in the fastest possible time frame.

Faisal Hawa: Scaling up could happen much better in India, because of the sheer engineering population that we have here.

Balaji Viswanathan: Yes and no, it's the question of whether we are able to tap into that as well, because the kind of demand that we are seeing in the market right now, we need to make sure that we stay competitive.

Moderator: Thank you. Ladies and gentlemen, we take the last question from the line of Zohair Nasser, an individual investor. Please go ahead.

Zohair Nasser: My question was mainly around the date of the consolidation, when is it expected to take place? And when is it expected to show on the books? I think the last question you answered, you mentioned that you are expecting it to close by 1 April, 2022, if I am not wrong!

Balaji Viswanathan: Yes, that's right.

Zohair Nasser: And we can expect on the books by Q1 2023?

Desikan Narayanan: Yes, that is the current thing after getting the approval we will be doing it around the first quarter of next year.

Zohair Nasser: Just another question that I have is, as of the moment, what is the cash balance on the books? And is there any plan on dividends front of it?

Desikan Narayanan: We have around Rs. 137 crores in books, that is the current balance of cash what we have as of quarter ending. And if we look at it, the current focus is more from a successful merger of the entity, once subject to the approval of the authority and shareholders. Having said that, we are formulating the dividend distribution policy, so the plan is to get it done before the end of the calendar year 2021. And we will be bringing it up to the board for the decision for dividend by maybe early CY 2022, it will be the Board's decision again.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now have the conference over to the management for closing comments.

Balaji Viswanathan: Thanks, Stanford. Thank you so much for the active participation in the questions and the interest shown in us. We are looking forward to an even better quarter coming up. And stay safe, take care all of you. Thank you so much.

Desikan Narayanan: Thank you.

Moderator: Thank you. Ladies and gentlemen, on behalf of Expleo Solutions Limited, that concludes this conference. We thank you all for joining us. And you may now disconnect your lines.