Fractal Q1 FY2027 Earnings Conference Call

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Moderator: Ladies and gentlemen, a very good morning. My name is Inba, and I will be moderating today's session. Welcome to Fractal's Q1 FY2027 earnings conference call. All participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after management's remarks. Please note that this call is being recorded. I will now hand over the call to Svetlana Joshi from Fractal's Investor Relations team. Thank you and over to you Svetlana.

Svetlana Joshi: Thank you, Inba. Good morning, everyone, and thank you for joining us today. We will be discussing Fractal's performance for the first quarter of FY2027, which ended on June 30th, 2026. Our results, investor presentation, and fact sheet have been filed with the exchanges and are available on our investor relations website. Joining me on the call today are Srikanth Velamakanni, Co-founder and Group CEO, Pranay Agrawal, Co-founder and CEO, Ashwath Bhat, Chief Financial Officer, and Satish Raman, Chief Strategy Officer. Before we begin, please note that certain statements made during this call may be forward-looking in nature. These statements are based on our current expectations and are subject to risks and uncertainties that could cause actual results to differ materially. Such statements or comments are not guarantees of future performance, and Fractal undertakes no obligation to update them. Please refer to the cautionary statements in our investor presentation and regulatory filings. Today, we will hear from Srikanth on the business update, from Ashwath on the detailed financial performance and then take questions. With that, let me hand it over to Srikanth.

Srikanth Velamakanni: Thank you, Svetlana. Good morning, everyone. Let us get straight into the quarter.

Revenue for Q1 was INR 912.5 crore, up 20% year-on-year. In constant currency terms, revenue growth was 9%.

Here is how that breaks down by industry. Vertical-wise, our Healthcare and Life Sciences business continued to be a growth leader, growing at an exceptional 69% year-over-year. It is now our second-largest industry vertical. Banking and Financial Services grew 36% year-over-year. CPG and Retail, our largest vertical, grew at 19%. Our worst performance was in the Technology, Media, and Telecom (TMT) vertical, which declined by 22% year-over-year, dragging down our headline growth this year.

Two things are worth mentioning regarding the TMT vertical. Firstly, our overall growth excluding TMT would have been 37% year-over-year. Ideally, we would like to grow at that kind of pace overall. Secondly, the TMT performance is bottoming out and we expect healthy sequential growth in TMT the next quarter.

Let us look at it geographically. Europe led revenue growth with 25%, where Americas were close behind, with revenue growth of 24%. APAC and others were down by 2% year-over-year, largely impacted by the TMT industry issue, as well as the conflict in the Middle East.

Let us look at some of the other metrics. Here are three numbers underneath that matter as much, if not more.

First, our Net Promoter Score was 77 in Q1, up from 73 a year ago.

Two, our Net Revenue Retention was 117% in Q1, up from 108% last year. Revenue from new clients contributed to 3% of revenue growth during the quarter and 0% churn came from client base in Q1.

Three, clients kept buying more from us over time. Here is what it looks like. Number one, the number of clients contributing more than $20 million in TTM revenue was 5 in Q1, up from 4 at the same time last year. The number of clients contributing more than $5 million in TTM revenue was 19 in Q1, up from 18 the same time last year. The number of clients contributing to more than $1 million in TTM revenue stood at 58 in Q1, up from 54 the same time last year.

We are also de-risking as we deepen. Our top 10 clients contributed 51.8% of revenue in Q1, down from 55.9% a year ago.

Now, let us look at profitability. On profitability, Ashwath will go deeper, but here are some headlines. Net income grew 92% for the quarter to INR 72 crore. Our gross margin was 46% in Q1. Adjusted EBITDA grew 35% on revenue growth of 20%. Q1 adjusted EBITDA margin reached 17%, up 189 basis points year-over-year.

Set side by side with Q1 last year, adjusted EBITDA margin moved from 15% to 17%, and Net Income margin from 5% to roughly 8% in a single year. Those are the numbers behind this quarter

Here are three highlights I want to mention.

First, this quarter, we won one of the largest single programs in Fractal's history. We are building the AI foundations for a large healthcare player and modernizing their data estate using AI. We will share more details within a few days.

Second, in July, we signed a MoU with Mumbai's municipal corporation, the BMC, to pilot Vaidya.ai, now also called as Cogentiq Health, our healthcare AI platform, across several of the city's public hospitals. It is a pilot for now. The BMC will evaluate it on staff training, citizen feedback, and doctor experience before deciding on a citywide rollout. If this pilot leads to a citywide rollout, it becomes a blueprint for other states and cities to follow.

Third, momentum on our own platform. We have started AI-led transformation deals with Cogentiq across CPG and financial services clients. This is very important for us, and it is a great revenue engine that we expect will keep growing. That is the quarter for now.

Ashwath will take you through the financials in more depth. I will come back and talk about demand and where this market is headed after that. Over to you, Ashwath.

Ashwath Bhat: Thank you, Srikanth, and good morning, everyone. Before I get into the details of our Q1 performance, a few highlights:

- In Q1 2027, year-over-year, we expanded our margins meaningfully with gross margin at 46%, adjusted EBITDA at 17%, and net income at 8%.
- Q1 Net Income grew by 92% year-over-year to INR 72 crore or close to $8 million.
- Year-over-year, revenue grew by 21% in Fractal.ai. Of this 21% growth, 17% growth came from existing clients. The number of clients with $1 million plus revenue went up from 54 in Q1 of last year to 58 in Q1 of fiscal 2027.

Coming to the details of our performance. In Q1 2027, our revenue from operations grew by 20% year-over-year and by 3% quarter-over-quarter to INR 912 crore or $97 million. On a constant currency basis, growth was 9% year-over-year and negative 0.4% quarter-over-quarter.

As mentioned by Srikanth before, we had a robust year-over-year and quarter-over-quarter growth in HLS, BFSI, and other industry verticals. Revenue contribution from Must-Win Clients went up from 79% in Q1 fiscal 2026 to 85% in the current quarter.

To strengthen our AI for Work and Workforce pillar, we have integrated iqigai and EdTech-related teams from Fractal.ai into Analytics Vidhya, and our segment numbers for fiscal 2026 have been restated to reflect this change.

Moving on to profitability, I will start with gross margin. We define gross margin as revenue from operations minus direct costs, which include both employee expenses and other direct expenses. Our Q1 2027 gross margin expanded by 29 bps year-over-year to 45.7%. While weaker rupee drove 273 bps improvement, we had 75 bps of negative impact from annual merit increase and another 169-bps from increase in number of people to support future growth.

Moving to adjusted EBITDA. With revenue growth, operating leverage in SG&A continues to help us improve adjusted EBITDA margin. In Q1 2027, SG&A as a percentage of revenue reduced from 26.2% to 24.3%, which drove up adjusted EBITDA margin by 189 bps year-over-year to 16.8%. Adjusted EBITDA was up 35% year-over-year.

In Q1 2027, we invested INR 61 crore into research and development, 31% higher than the previous year. Out of the INR 61 crore, INR 41 crore or 4.5% of the revenue was expensed.

R&D spends are mainly for building Cogentiq, Asper, and Analytics Vidhya. These investments have resulted in following outcomes. Cogentiq has seen early wins with more than 10 clients across industries. Asper's ARR has gone up by 59% to $9 million as of June 2026 versus the same period last year. Analytics Vidhya revenue in Q1 2027 has grown by 42% in dollar terms.

Now, I will move more to Fractal Alpha segment. Fractal Alpha segment includes Asper.ai and Analytics Vidhya. On a like-to-like basis, Fractal Alpha revenue grew by 20% year-over-year in Q1 2027. Analytics Vidhya in that grew by 57% and Asper was flat.

As mentioned before, Asper's ARR grew by 59% in dollar terms versus the same period last year. There is a time lag between signing of contracts and revenue. Hence, we expect the second half of fiscal year to be much stronger for Asper. Asper is being used by 20 clients in the CPG industry.

The gross margin for quarter stood at 65%, and segment loss was at INR 14 crore. Increased loss is largely due to the integration of iqigai and EdTech teams from Fractal.ai segment into Analytics Vidhya, as stated earlier. As the integrated unit scales, the operating leverage will materialize with better profitability.

Now, moving over to net income. In Q1 2027, ESOP charges, including cash bonus linked to options and one-time retention bonus, declined to 1.2% of the revenue versus 1.4% of the revenue in the same period previous year.

Talking about Qure.ai performance, our share of loss went from INR 22 crore in Q1 fiscal 2026 to INR 23 crore in Q1 fiscal 2027. However, I am happy to report Qure.ai's revenue has grown by 160% year-over-year in Q1 2027 to INR 24 crore.

Net income for Q1 2027 for the whole group grew by 92% to INR 72 crore. Net income margin expanded by 296 basis points year-over-year to 7.9%. Excluding the loss of share of loss in the associate, net income for Q1 2027 is at INR 95.7 crore or 10.5%.

Diluted EPS is at INR 4.09, which is 78% higher than the same period in the previous year. Diluted EPS without share of loss of associate is at INR 5.39.

We covered gross margin, we talked about EBITDA and net income.

Now let us talk about cash. Our cash from operations was negative INR 103 crore because of the payment of variable pay for the previous fiscal year in Q1 2027. Cash from operations is 20% better versus the same period in the previous year. DSO has improved by two days from 73 days in Q1 fiscal 2026 to 71 days in Q1 fiscal 2027.

As of June 30th, 2026, we had cash and cash equivalents, including mutual funds and fixed deposits of INR 1,639 crore or $173 million, including IPO proceeds of INR 689 crore.

As mentioned in our previous earnings call, in April 2026, we fully repaid our long-term debt from the IPO proceeds. In summary, we delivered 20% revenue growth, 35% adjusted EBITDA growth, and 92% net income growth.

Before I hand back, this is my last earnings call with Fractal. It has been a privilege representing Fractal over these last five-and-a-half years. I would like to thank my incredible finance and legal team, Srikanth and Pranay, our executive team, especially Satish, with whom I have spent countless hours, 6,000+ Fractalites, and our Board of Directors.

Signing off with innumerable memories and gratitude. Now back to you, Srikanth.

Srikanth Velamakanni: Thank you, Ashwath. As Ashwath mentioned, this is Ashwath's last call with us.

After five-and-a-half years as a CFO, he is moving on for personal reasons. Ashwath has stewarded Fractal through multiple material events like its IPO, acquisitions, fundraisers, and through a lot of quarters like this one, where the job was to explain the numbers honestly and let the story speak for itself. A lot of what is disciplined about how we report to you is because of him. Thank you, Ashwath.

On behalf of everyone at Fractal and everyone on this call who has gotten to know you through these numbers, we wish you very well for whatever comes next. On the transition itself, we have made a ton of progress in identifying Ashwath's successor, and we will share more details once we have completed the full process.

Before we open it up for questions, I want to spend a couple of minutes on explaining to you where AI is headed right now.

AI has become mainstream. It is part of the core budget in almost every large company we see today. However, the changes in AI are also creating enormous opportunities for companies like Fractal.

Number 1 is trust. Companies want to make sure that they have control over the AI, and the AI is doing exactly what they want, and there is no gap between their expectations and the performance of AI. Especially, they want to make sure that their knowledge stays within the enterprise. This is an enormous opportunity for companies like Fractal.

Secondly, companies have incredible amount of data assets, but the knowledge and the context that comes from these data assets is critical for how the AI performs and building that context layer and the knowledge layer and the ontological layer is an enormous opportunity for companies like Fractal again.

Three, because of these enormous AI foundations that are being built in companies will be able to transform not just a part of a process, but their entire workflow end-to-end with AI. This is a multi-trillion-dollar opportunity. We have organized Fractal to make sure that we are able to address these opportunities like AI-led transformation, AI foundations, and AI to help you re-imagine work and workforce.

AI is compressing work significantly as well. When AI compresses work, it means that the cost of running AI will come down. Not just the token costs, which are currently going out of hand. They will come down automatically in the next few quarters, but also the cost of building AI, cost of running AI, and cost of the entire process with AI, because labor cost will also be avoided, will come down dramatically.

Now the first order effect of this is to feel like maybe that means the revenue opportunity shrinks. In fact, it is quite the opposite. Companies are going to spend more and more on tech, and it will create enormous opportunities for companies like Fractal to not just re-imagine every workflow with AI, build the foundation, but also to help companies re-imagine their work and workforce with AI.

How companies buy also is changing. Partnerships decide who is even in the room for the biggest deals now. We have created some really solid partnerships with companies like Databricks, OpenAI, and Anthropic. Five of our largest deals this quarter came through a partner. A year ago, AI was just an experimentation budget spent in pockets. Today, it is the core budget. That is what we work with, and that is what Fractal was built for.

We feel our future is bright, and we have a long way to grow from here to the next level. With that, I will stop here and hand it over to you, Inba.

Moderator: Thank you. Ladies and gentlemen, we will now move to the Q&A segment. To ensure we provide space for as many participants as possible, we request you to limit yourselves to two questions per turn. Participants connected on Zoom, we request you to please use the raise hand icon located at the bottom toolbar on your screen. When called upon, you will receive a prompt to unmute. We will wait for a moment while the question queue assembles. Our first question is from Gaurav Rateria of Morgan Stanley. Please go ahead.

Gaurav Rateria: Thank you for taking my question. Best wishes to Ashwath for the future endeavors. It has always been a pleasure talking to you, interacting with you. I have couple of questions. I will just maybe say them all in an order and then you can answer as per your convenience. The first is around the visibility that you highlighted in the TMT vertical of healthy growth sequentially in 2Q. What drives that visibility? Is it from the same existing clients, or have you won certain new clients or new deals which drive that visibility? Second is the Cogentiq pipeline. Really good to see the qualified pipeline number that you shared. Could you also highlight the nature of the deals in terms of the kind of engagement, whether it is going to be more like a product-led kind of a deals, whether it is kind of having a services component? That would be helpful. The last is that, from a visibility perspective, I understand that we start always small with the clients, then we scale up, and that reflects in your multimillion-dollar clients going up in numbers year-after-year. But at the same time, there has been a kind of volatility in the business, right? Maybe because the nature of the business is like we always start small, and these are small engagements, and it can be volatile between the quarters. Is there anything to think about, like what can be done in order to create more consistency and visibility? Is it the nature of the business automatically will evolve with the larger engagements with AI-related work, which automatically will provide more visibility? Thank you.

Srikanth Velamakanni: Thank you, Gaurav. Firstly, you are absolutely right that we are seeing the TMT issue bottoming out, and it is coming from new deals from existing clients. We have a pretty significant pipeline in that, and we know that our next quarter is going to look better because of what we already have in the bag. That is mostly newer deals from existing clients rather than completely new clients.

Secondly, on your question around the Cogentiq pipeline and Cogentiq deals, we see these as product-led. Most of these revenues are product led. There could be some FDE or implementation component to it in some ways, but these are completely product-led. We have built Cogentiq for underwriting, which is seeing a pretty solid traction. We have built Cogentiq for e-commerce. That is also seeing some really solid traction and Cogentiq as a platform being used to build, is also seeing some traction as well. This is a very important part of our business, and we expect it to become significant. As the value of building the ontological knowledge layer on data becomes very, very crucial, platforms like Cogentiq are seeing a lot of interest from clients because these are built for the enterprise. They can use a multiple set of models. Like you have seen, people really want to control their outcomes inside the organization, regardless of whether they have or lose model access. That creates a very large opportunity for companies and products like Cogentiq, so that is really on the second one.

Third, on how business evolves from here, certainly, the deal sizes are going up. We are seeing some changes in dynamic. Number one, certainly there is competition, and there is RFPs. There are much larger RFPs coming through right now than we have seen in the past. The size of the deals are bigger and the ambition of what they want to get done are also much larger. As Fractal becomes more public, becomes more visible, and has a phenomenal track record behind us, we become very capable of addressing those very much larger deals that come through. You have not seen that yet in the numbers, but I expect that we will see them in the numbers in the coming few years.

Secondly, on the volatility part, one has to sort of also understand that the shape of demand is dramatically changing. This is the largest opportunity in front of us. There are some things that are expanding like crazy. There is an insatiable appetite for helping companies re-imagine their workflow, building their AI foundations, and helping them re-imagine their workforce with AI. Those are just growing very rapidly. On top of that, any existing work, anything that feels like it is not as, let us say, relevant today than it was before, that could be completely vanishing as well. Things like ad hoc analysis, building dashboards, these are the kinds of things that are going to go to zero anytime soon. If not already zero. There is demand that will be vanishing as well, which will be a much smaller component, but it will go.

The third thing is that if the kind of work that we do, which is really interesting and important, can also be done faster, quicker, and cheaper, which means that overall work can shrink in terms of compression. We will see compression, everyone will see compression. Everyone will see some work vanishing. But the work that is coming through is so huge that it more than makes up for that. That is really the way to process the change. There will be some changes in deal by deal, because there is something that we may be doing which is not relevant today in a much more AI-first world where things are much easier to do. Something that we would have taken a year to do could be done in a month, which means that that per se looks like it shrunk, but there are now 1,000 such deals rather than 10 such deals earlier. That is the kind of way in which we have to process this change overall.

Gaurav Rateria: It is quite ironical, right? The deal sizes are also increasing, the kind of engagements that are coming our way is also of the nature where the work can be done much faster and better.

Srikanth Velamakanni: Yes.

Gaurav Rateria: Which also creates larger workflow, but probably a smaller kind of work to be done in the beginning. Thank you really for your detailed answers and great explanation. Very helpful. All the best for future.

Srikanth Velamakanni: Thank you, Gaurav.

Ashwath Bhat: Thanks, Gaurav.

Moderator: Thank you. Our next question is from Aditi Patil of ICICI Securities. Please go ahead.

Aditi Patil: Thank you for the opportunity. My first question is on the technology vertical. Was there any unexpected client-specific issue which may have come up during the quarter apart from the ones which we had called out in the previous quarters? On the annual wage increment, can you again explain, have we done the annual wage increment for FY 2027 in Q1, or it was of the previous year, which had some impact in Q1?

Srikanth Velamakanni: Thank you, Aditi. Really appreciate this. Number one, on the TMT vertical, it is not that it was unexpected or something. One thing that we have sort of told ourselves is that we are no longer going to talk about client-specific issues unless something very dramatic has happened. There are client-specific issues that happen all the time in every client relationship, and therefore, we have chosen to not talk about that in future because it is distracting. We have to sort of take more accountability for our own performance. Having said that, the quarter TMT did perform worse than we expected, for sure. We think that the worst is behind us. Now TMT will start to look better, at least on a sequential basis for the next quarter and thereon.

On the second question was on the wage increase. It has been done. It is effective June 1st. You are only seeing one month of impact on that in this quarter, April, May, June, but we have done the overall merit increases for the year as of June 1st. This is sort of slightly unexpected. Normally, we do it on April 1st. This year, we made it effective June 1st, but one month of that is already in play.

Aditi Patil: Okay. Got it. Can you share contribution of Cogentiq revenue, or how big you expect it to become by end of FY 2027?

Srikanth Velamakanni: Yes. Our overall license revenues are 3% of revenue. We expect that to go north of that. We are seeing a lot of interest, just remember that the deal sizes are much smaller when it comes to product revenue versus services revenue, and therefore you are seeing some of that. As a fraction of overall revenue, it's still at only 3%. We want it to go up. It will go up soon. Number one.

Number two is that specifically within Cogentiq, we are seeing a lot of pipeline and a lot of interest. We have to convert them significantly in order to make that a much larger part of the pie. What we are seeing is the need for something like that becomes stronger and stronger as the need for trusted AI, where you are not completely dependent on a model, becomes more important and your organizational context, your organizational data, and the ontological layer becomes very, very crucial as well. In that context, when people are trying to re-imagine their workflow, they need a platform that they can rely on and Cogentiq fits in really nicely with that. So, we expect this to become even more crucial for clients in the coming few quarters. What we are doing is, apart from building the Cogentiq platform, which can help you solve any problem with and re-imagine workflows with AI. We are building specific products on top of the Cogentiq platform which go to a certain industry and solve a certain problem.

For example, what we have done with Cogentiq Underwriting is, it helps insurance companies underwrite better using Cogentiq, and we are seeing a few clients sign up for that. Similarly, our Cogentiq e-commerce product is helping companies re-imagine how they grow their revenue with e-commerce. Similarly, we are doing it for supply chain, we are doing it for customer service, and a few other places. These are now, we have identified our top leaders to come and take charge of those products that are being built on Cogentiq platform.

That build-out has happened over the last year or so, and now we are beginning to see the rollout and some traction because of that. We expect this number to go up, and become a more significant part of our revenue going forward. We will come back with a Cogentiq revenue number every quarter, but we are just figuring this out exactly how to do. Cogentiq revenue, license revenue, Cogentiq revenue might have license revenue and some of the FDE revenue, so exactly how we will report it, we will figure it out and come back to you next quarter with the Cogentiq revenue, as well as the overall license revenue for Fractal.

Aditi Patil: Okay, got it. Thank you for answering my questions, and all the best, Ashwath, for your future endeavors.

Srikanth Velamakanni: Thanks, Aditi.

Moderator: Thank you. Our next question is from Pritesh Thakkar of PL Capital. Please go ahead.

Pritesh Thakkar: Thank you so much for taking my question. I have a first question on the vertical front. Again, we have a weakness coming in on the TMT side of the vertical. At the same time, I am seeing HLS growth has been decelerating, if I look at over the last two to three quarters now. How should we anticipate FY 2027 growth trajectory there, and which verticals would likely to contribute meaningfully to that growth?

Srikanth Velamakanni: Thank you for that. Pritesh, thank you. Firstly, yes, our growth rate in HLS is very impressive, but it is lower than the previous quarter what we reported to you. One thing I should mention is that the overall growth, excluding TMT, is 35%. Because of TMT, it has come down to 20 because TMT is showing negative growth. As soon as the negative growth gets arrested, we will start to see the overall growth rate go up. That is really the expectation, that every other part of the business is growing nicely as of today. If the TMT vertical solves for itself, it should address the overall growth and improve our overall growth rate in the coming few quarters.

Pritesh Thakkar: How we should anticipate which vertical should contribute meaningfully to the growth for FY2027?

Srikanth Velamakanni: It will be across all verticals. We are seeing growth all across. HLS will be a very important part of that. Our Banking and Financial Services continues to grow very nicely. Some of these places, we have also brought in new leaders. We have Leandro, who has taken on the role of the Chief Practice Officer for Banking and Financial Services. We are also finding a new head of Europe. We are making some progress on that hire. This new head of Europe also might help us expand our Europe growth even faster. Today, Europe is growing at 25%, and we expect that growth rate can be meaningfully accelerated with some additional new leadership that we hire. In a similar way, we are hiring new leaders in parts of the business where we feel like we have significant growth opportunities. But growth opportunities are across verticals. AI is not doing well in one industry or the other. It is creating opportunities in every vertical. It is our execution that has to improve so that we are growing across all verticals. I will say that the opportunity exists across each and every vertical for Fractal. As we execute better, we will see our growth rate pick up.

Moderator: Mr. Thakkar, do you have any more questions?

Pritesh Thakkar: Yes. I just have a question on the partnership that we called out in our PPT. We are calling out 42 TTM joint engagements. Are we also calling out the revenues that we are fetching out of this partnership?

Srikanth Velamakanni: We do track the revenues that we generate through our partnerships with the most impressive foundation model companies as well as some of the AI foundation layer companies that we work with. We look at that internally both in terms of what revenues are we originating because of our partnerships, and what are the joint work that we do, either because we have brought the deal to them or otherwise. We have not yet reported that to you, but we will consider bringing some of that information to you.

Suffice it to say that the overall partnership-led revenue for Fractal has been small. Like I have said in the previous quarter also, it is a new muscle that we are building. As the market shifts to more partner-led kind of growth, and partners become very crucial to how companies are making their overall decisions. This is something that is a growth vector for us. It was not a big part of our revenues overall. Most of our revenues used to come from direct client relationships. What we are seeing is that these partnerships create a very nice window of additional growth, and it has become very strategic to us. We are building out our partnership capabilities and overall partnership execution muscle, and you will see some of that coming through in the next few quarters.

Pritesh Thakkar: Understood. Lastly, on the expense side, I heard Ashwath calling out we had integration cost this quarter, which led the incremental cost to fall in this quarter. What is that one-off cost, if I just want to understand?

Ashwath Bhat: Srikanth, I will take that. Pritesh, sorry, it is not really an integration cost. What we have done is, we have re-classed or restated between the segments. We are building this product called iqigai. It is going to be Cogentiq iqigai. [We have moved it] from the Fractal.ai segment to Fractal Alpha segment under Analytics Vidhya. It is just movement of investments from one side of the segment to the other side.

We have restated last year to reflect the right numbers year-on-year. It is not a one-time cost. It is an investment that we have been doing in Fractal.ai side of the business, which has been moved over to now Fractal Alpha under Analytics Vidhya. Hence you see higher investments in Fractal Alpha under Analytics Vidhya, hence the increased loss in Analytics Vidhya.

As that Analytics Vidhya, which is mainly AI for Work and Workforce, grows, and we have seen pretty good growth there, then operating leverage will kick in and that loss will go down. It is not a one-time cost, it is a restatement of costs or investments from one side of the P&L to the other.

Pritesh Thakkar: Understood. Lastly, a question on the merit cost that we incurred this quarter. Is it a full quarter on our cost that we incurred across company-wide, or are we expecting any residual impact coming in quarter two?

Ashwath Bhat: We gave merit increases as of June 1st and across the company. It was not limited to a part of the company. It was across the company. Since it was done effective June 1st, in the next quarter, there will be three months impact. The 75 bps that I called out was gross margin-related impact in Q1. The full P&L level, it will be more close to 120 to 130 bps impact. It is for one month in the first quarter. Again, it is effective 1st of June, so it will have three months impact in the second quarter.

Moderator: Mr. Thakkar, we would request you to return to the queue. There are several participants waiting for their turn.

Pritesh Thakkar: Thank you so much. All the best to Ashwath.

Ashwath Bhat: Thank you. Thanks, Pritesh.

Moderator: Thank you. Our next question is from Moez Chandani from Ambit. Please go ahead.

Moez Chandani: Good morning, and thank you for taking my questions. First question in terms of industry growth. Any qualitative sense in terms of how you are seeing industry growth shape up?

Because you did mention that while there could be some volume compression due to AI that would be more than compensated for by the huge multiplication of use cases. Is there any sort of slowdown in terms of the broader industry while volume compression works its way through, but the new use cases take time to show up? Is industry growth still, say possibly at high levels of 16%, 17% that was expected earlier?

Srikanth Velamakanni: I think overall, the demand for AI-led problem-solving and AI-led transformation is enormous. It is growing very fast. It is sort of taking share from many other industries. Management consulting, market research, advertising, technology services, business process services. They are all being influenced by AI. The total addressable market is increasing. It is growth rate. Companies are increasing their tech spends. They are going from 4.5% of revenue to maybe up to 6% of revenue, if you look at the overall tech budgets. That has its own momentum. But if you see the AI addressable part of that, it is dramatically changing. From Fractal's standpoint, the addressable spend that we can chase is just going up quite well. I think the key thing is how do we execute against that? It is not easy to execute well, because there are also many players who want a piece of this pie right now. Everybody is interested in this AI-led growth that is happening. It is not that industry is not expanding. Industry is expanding dramatically. It is also becoming more competitive. Therefore, our execution has to really get better to improve our growth. That is really the best way to think about this. I hope I have answered your question.

Moez Chandani: Got it. Yes. Thank you. That is very helpful. The other question that I had was also, on this TMT decline which we saw. Was this again maybe an impact of the competitive intensity that you just mentioned, or was this just particular clients may be pausing discretionary spends for their own reasons? Any specific reasons that you may want to call out?

Srikanth Velamakanni: I do not want to get into blaming anyone for our performance, right? Just one way to think about that is that companies, if you look at the big tech firms that we serve, they are very impressive, very big companies, and they have been spending tremendously on AI capex. You have seen that their AI capex has gone up, almost doubled. There is a lot of opex pressure when capex has gone up by this much. Therefore, you are seeing big adjustments taking place in the TMT industry in terms of how they look at the overall spends and allocating more of that to capex and less of that to opex. Some of that could be playing out in the way our performance is showing up in that vertical for now. Again, still the TAM is expanding there as well. I think it is about how we address this and how we re-imagine ourselves in order to become even more relevant to TMT. But there is definitely a massive shift happening in the way TMT companies think about their overall spends relative to other industries. That could be playing some role. I will take most of the blame on our own execution, but there is some of that playing out, as I explained. I hope that answers your question, Moez.

Moez Chandani: Yes. Thank you so much for answering my question.

Srikanth Velamakanni: Thank you.

Moderator: Thank you. Our next question is from Om Kavadi of Avendus Spark. Please go ahead.

Om Kavadi: Thank you. Could you guys hear me?

Moderator: Yes.

Om Kavadi: Thank you for the opportunity. A couple of questions. The first one is on TMT vertical. Sorry to pester on this. Just one clarification, when I look at number of clients beyond $20 million, it has come down sequentially from six to five. I am assuming it is in the TMT vertical, but please clarify on that. A connected question is, when you look at this TMT vertical, you have indicated that things have bottomed out, and you could see a good acceleration from second quarter, is what I understand. From that point of view, from the point you started this quarter, you would have thought about some outlook for the year, right? I am not asking of the guidance, but from a qualitative point of view, that outlook for FY2027, has it changed when you see at the end of this quarter? Or broadly, you feel because things are recovering from a full-year point of view, nothing would have changed drastically. Could you just comment on that? I would come back on the second question.

Srikanth Velamakanni: What is it? I forgot your question.

Om Kavadi: That on $20 million plus.

Srikanth Velamakanni: On the $20 million. Yes. That is right. Your guess is correct. The six, one of them which was $20 million-plus, a TMT client, is now less than that. Therefore, that is what it is. The only additional thing I will add to that is that taking a full-year view of this versus a TTM view of this, there could be some changes. Therefore, the best way to look at it is that at the end of this year, how many clients do we have which are $20 million plus, and is that gone up from six to seven, or stayed at six, or gone from six to five? That is best seen on a year-over-year basis. On a TTM basis, you are right. One client has slipped below the $20 million number, and that is part of the TMT vertical. That is correct.

Secondly, on the outlook for the year, certainly our first quarter, we feel like we have certainly underachieved what we could have achieved. Part of this is also because what we have seen is that the shape of the demand is shifting quite rapidly. Everything is changing at a very rapid pace. We are very competitive and very capable, yet we have to make sure that we move extremely fast to capture the enormous opportunity that is in front of us. That execution is crucial to us.

Part of the way we have done that execution is by reorganizing our own go-to-market, bringing it under a new Chief Commercial Officer, Matt, and then building these AIT, AIF, and AIW vectors. AIT for AI-led Transformation, AIF for AI Foundations, and AI for Work and Workforce Re-imagination, AIW. This change and bringing in the new leaders, and organizing ourselves to go to market much more rapidly, is playing out as we speak. Once this whole thing settles down, we think that our growth rate will dramatically accelerate from there. That is really how we are thinking of it. It is improving our execution in light of where the market opportunity is shifting.

The opportunity is very, very huge, and I will reconfirm that. It is completely left to our execution to become as big as we can be. There is no other law of gravity applying to us. We have an enormous opportunity in front of us. As far as the outlook for the year is concerned, of course, our quarter one is not as great as we would like it to be. We hope that some of that will start to get addressed in the coming quarters.

Om Kavadi: Sure. One other question is on the operating profitability front. How would we see R&D spends as a percent of sales over the medium term? Is there a possibility that it would increase? The second part to the question is, where are we in our journey in terms of increasing the mix of output/outcome/license? I believe that is roughly around 40-odd%. How are we seeing this number going in the next one or two years? Thank you.

Srikanth Velamakanni: Yes. We are at 42 right now. That outcome/output/license as well as license revenue is at 42, and 58 is the input-based pricing. We are inching gradually forward on that number, and we want to get it to 60 over the next few quarters. We are moving in the right direction.

What AI is also creating as an opportunity is to go and be very bold in looking at a process, reimagining the process, and doing it on an outcome basis, therefore crunching the overall budgets that are required to do so. Those will be output outcome-based deals, and we are seeing, as Fractal's appetite to do such deals and capability to do such deals increases, we expect this number to substantially go up.

Now, second question is on R&D as a fraction of sales. We have said that we will continue to increase R&D spends as a percentage of revenue, and we will take it to as much as 10% of revenue. We have also been very clear that we will do it only on the back of expanded margins. As gross margins expand, part of that expanded gross margin we will put into higher R&D. We have set up a system by which we will be pretty disciplined about that, and only expanded gross margins, a part of that will flow through to higher R&D spends the next quarter. Because of that system, while R&D spends as a fraction of revenue might increase, it will happen only on the back of higher overall gross margins. Our gross margins are expanding, and therefore, we expect that we will also be able to increase our overall R&D budgets in proportion to that.

Last point I will mention is that our R&D is getting more and more disciplined. One of the things that we have done in this space of AI, what we are seeing is R&D to revenue conversion should be faster. It should not be slower. That is a push that we are also saying, is that the enormous amount of R&D that we are doing should convert to revenues at a faster pace. Therefore, even with the R&D team, my conversation is that [you] work backwards from revenue, right? Yes, R&D is super important, but you have to have revenue in mind and work backwards from revenue, and you will see some of that alignment also kind of streamline and improve our overall R&D productivity as we go forward.

Moderator: Mr. Kavadi, we would request you to please join the queue back.

Om Kavadi: I am done with my questions. Thanks a lot.

Moderator: Thank you.

Srikanth Velamakanni: Thank you Om.

Moderator: Our next question is from Sucrit Patil of Eyesight Fintrade. Please go ahead.

Sucrit Patil: Hello, am I audible?

Srikanth Velamakanni: Yes, Sucrit.

Sucrit Patil: Thank you. First of all, my name is Sucrit Patil. My first question to Mr. Pranay is, just beyond the regular outlook, what are the top two and three priorities you are focusing on the next few quarters? Along that, what do you see as the biggest risk in client adoption and industry competition, and how are you preparing to manage them while sustaining the company's competitive position in AI and analytics? That is my first question. I will ask my second question after this. Thank you.

Srikanth Velamakanni: Pranay?

Pranay Agrawal: Yes, I am there. I am sorry. Could you please repeat the question once?

Sucrit Patil: Beyond the regular outlook that you have given, I just want to understand what are the top two and three execution priorities you are focusing on in the next few quarters. Along that, what do you see as the biggest challenge in client adoption or industry competition, and how are you preparing to manage them while strengthening the company's competitive position in AI and analytics? Just a forward guidance on this.

Pranay Agrawal: Okay. Excellent. Great. Firstly, we are approaching the market with a three-pronged strategy. One is AI-led business transformation, second is AI Foundations, and third is AI Workforce transformation. The first really implies that we are building specific applications to solve key business problems or improve key business processes, which could be on the side of demand, supply, operations, and which really depend on the specific industry. These drive your core metrics, whether that is revenue or profitability, customer retention, etc.

To ensure that these applications scale rapidly and securely at the scale of Fortune 500 companies, this requires very robust foundations. That implies strong data foundations, the ontology and knowledge layer, security layer, the orchestration layer, and the application layer.

The third is that ensuring that how does the workforce deploy and use this? For that, we do the AI workforce and workplace transformation. Again, we are seeing a lot of traction in that. Continuing to enhance what we are building and deploying for our clients across these three areas, that is one of the core initiatives.

The second big thing is around, as Srikanth mentioned, we are bringing in more leadership across industry verticals. Then the third, as Srikanth said, that the shape of the demand is changing quite rapidly, and that also has implications just operationally in the talent that we are bringing in and also the internal talent upgrade that we are doing to be able to meet the shape of demand.

Sucrit Patil: My second question to Mr. Bhat is, I know you are taking the exit, just want to understand a forward guidance on what you think about this. From a financial point of view, what key risks or challenges do you anticipate in the coming quarters, and what specific measures are being taken to manage margins, cash flow and balance sheet strength, especially in areas like data privacy compliance, cost pressures, or client payment cycles. Thank you.

Ashwath Bhat: Thanks, Sucrit. I think in terms of the overall balance sheet, balance sheet is in a pretty good shape. Our DSO has come down both year-on-year and even quarter-on-quarter to 71 days. Even within the 71 days, it is around 54 days is the billed AR, because a lot of companies do report only billed AR. That compares favorably to some of the industry benchmarks. The balance sheet has been in good position.

Again, our cash conversion to EBITDA of around 70% has also been in good condition. In first quarter of the year, we always pay variable pay for the previous year, hence you see a negative cash flow. Otherwise, all the ratios there are. ROCE is close to 13%. Overall, the balance sheet is in a very good place.

We do hedge, only take the forward cover for cash flow hedge. That also, again, helps us with some of the cash flow management. I do not think of any additional financial risk. In terms of the data privacy and security-related stuff, yes, we take our, obviously, cybersecurity extremely seriously. We have invested a lot behind it. Recently, we were again rated by Black Kite in the highest category in terms of cybersecurity. That risk has been kind of addressed over the period of last three or four years by us.

Moderator: Mr. Patil, we request you to please return to the queue as several participants are waiting for their turn. We now move to our next question that is from Anish Khanal of Eternalis Capital Trust. Please go ahead. Anish, could you please ask your question?

Anish Khanal: Am I audible?

Moderator: Yes.

Anish Khanal: Hi, Srikanth. Thank you for the opportunity. My first question is on the Qure.ai. So how are you seeing the growth on the Qure.ai, given the Fractal Alpha segment loss has increased to Rs.14 crore in June 2026 from Rs.4 crore in June 2025? So how is the growth in that particular segment, and especially in Qure.ai segment, plus Vidhya Analytics segments? So that is my first question. Next question is on adjusted EBITDA margins. While we have grown from 15% to 18% on a Y-o-Y basis, though marginally declined from the Q4 FY2026 from 22% to 18%. Sorry, 17% I think June 2026. So how are you seeing the adjusted EBITDA margin growth trajectory? As Srikanth has mentioned that TMT has bottomed out, so can we see the EBITDA margin improvement also once that TMT segment will grow in upcoming quarters? Thank you. These are my two questions.

Ashwath Bhat: I will answer, Srikanth, on the segment profitability. Fractal Alpha, which includes only Asper.ai and Analytics Vidhya, that is the place where the loss is up from Rs.4 crore to Rs.14 crore. As I mentioned in my remarks, it is mainly because of the investments that we are making in some of the products within Analytics Vidhya. That is what is driving it. If you again look at the last four years, our loss in Fractal Alpha segment has come down substantially as the revenue has been scaling up. In this quarter specifically, as I mentioned, Asper revenue growth was flat, which should accelerate in the second half of the year because the annual recurring revenue has gone up by 59% in dollar terms in Asper. There is always a timing gap between the contract signing, and when the revenue starts getting recognized for the subscriptions. Once the Asper gets back to growth, Analytics Vidhya has also seen good growth in the first quarter, and that should continue. With that, we expect the profitability to kind of keep improving as, again, how it was done historically. That is a good indicator of what we can achieve in terms of the profitability in Fractal Alpha.

Qure.ai is an associate company. We only consolidate 31.5% of our share of the losses. There, as I mentioned, the revenue for Qure.ai went up year-on-year basis by 160%. Losses in Qure.ai was Rs.22 crore last year, our share of the loss. It was Rs.23 crore this year, same quarter. Qure.ai does have a big jump from first half of the year to second half of the year. We have also seen their backlog kind of go up quite substantially to Rs.100 plus crore right now where they stand, versus around Rs.20 crore at the same time last year. So we have seen a big improvement in the revenue and also big improvement in the backlog revenue that Qure.ai has as of now. With that, the Qure.ai profitability situation should also be improving.

Srikanth Velamakanni: Just last point I want to mention here also is that our profitability in the first quarter is always a little lower than the following quarters. Just from a sequential basis, it is not a great comparison. Our year-over-year is a better comparison, and we will see that year-over-year, our profitability will continue to improve. One of the most frequently asked questions at the time we went public was that, your margins are inconsistent and I always answered that by saying that we have very healthy gross margins. But over the last three earnings calls, we have also shown that our gross margins, our EBITDA margins, all of them are improving quarter-over-quarter. We have become much more steady in terms of managing profitability. It is a muscle that we have built now, and we expect that profitability will continue to improve over the next few quarters as we continue to expand our growth. That is really the best way to think about it.

Anish Khanal: Thank you and all the best Ashwath.

Srikanth Velamakanni: Thank you Anish.

Moderator: Thank you, everyone. That concludes the question and answer session. Before I hand the conference over to Anjali Garg from Fractal's Investor Relations team for closing comments, request Srikanth to share his final remarks.

Srikanth Velamakanni: Thank you, Inba. You know that the growth this quarter was not as high as we would like it to be. Excluding TMT, growth was much better. When you look past that number, you will see that our clients are growing with us. They are deepening their relationship with us. Our margins are expanding. Our revenue mix is shifting towards more outcomes as well.

Zoom out further and the tailwind gets better. We have seen that enterprises are moving AI into their core budget. The AI addressable spend is dramatically improving overall, which means that amazing days are ahead of us. We have never been more optimistic about where this business is going. The market in a lot of places is still making up its mind. What comes after that, we believe, is much bigger version of the business that you are looking at today. We look forward to building that and making you part of that growth journey for us.

Thank you again for your trust that you have extended to us. We look forward to building Fractal along with you in the future. Back to you, Anjali.

Anjali Garg: Thank you, Srikanth. Thank you everyone for joining us today. If you have any further questions, including any that we were unable to address during the call today, feel free to reach out to us at investorrelations@fractal.ai. We look forward to seeing you again next quarter. Thank you once again. We wish you a good day.

Srikanth Velamakanni: Thank you.

Moderator: Thank you, ladies and gentlemen, for joining us today. You may now click on the leave icon to exit the meeting. Goodbye.

Note: This transcript has been edited for readability and does not purport to be a verbatim record of the proceedings.