

Kellton Tech Solutions Limited
Q3FY 2019 Results Conference Call
February 15, 2019

Moderator: Good day, Ladies and gentlemen and welcome to the Q3FY19 Earnings Conference Call of Kellton Tech Solution Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing '*' and '0' on your touchtone phone. Please note that this conference is being recorded. I now hand over the conference to Anuj Sonpal from Valorem Advisors. Thank you and over to you, Mr. Sonpal.

Anuj Sonpal: Good morning everyone and a warm welcome to you all. My name is Anuj Sonpal from Valorem Advisors. We represent the investor relations of Kellton Tech Solution Limited. On behalf of the company and Valorem Advisors, I would like to thank you all for participating in the company's Earnings Conference Call for Q3 FY19 as well as 9 months FY19.

Before we take this forward, I would like to give a short cautionary statement. Some of the statements made in today's concall may be forward-looking in nature. Such forward-looking statements are subject to risks and uncertainties which could cause actual results to differ from those anticipated. These statements are based on the management beliefs as well as assumptions made by and the information currently available to the management. Audiences are cautioned not to place undue reliance on these forward-looking statements in making any investment decision. The purpose of today's earnings conference call is purely to educate and bring awareness about the company's fundamental business and a financial quarter under review. I would now like to introduce you to the management participating in the Earnings Conference Call and give it over to them for open remarks. We have with us Mr. Niranjana Chintam, Chairman and Whole-time Director. Without much ado, I request Mr. Niranjana Chintam to give his opening remarks. Thank you and over to you, sir.

Niranjana Chintam: Thank you Anuj. Good morning everybody and welcome to our conference call for Q3 FY19. We have announced the results yesterday. As you are aware, we have circulated earnings presentations as well as the press release. Hope all of you have got that information. Here we will be talking about the numbers as well as financials. During the last quarter, we have delivered revenue of about 208 crores. There was a marginal decline of 1.4% on a year-on-year basis and EBITDA stood at 29.4 crores for the Q3 which is a decline of about 6.3 on a year-on-year basis. The EBITDA margin stood at 14.2 for Q3 and PAT was about 18.5 crore

which is a growth of about 8.4 year-on-year basis. Also, the PAT margin stood at 8.9% for this quarter.

Coming to the nine month's performance, the total revenue was about 624 crores which is an increase of 9.7 year-on-year basis. EBITDA stood at 93 crores on a 9-month basis which is a 9.9 year-on-year growth. EBITDA margin stood at 14.81 for the 9 month FY19 and a PAT was around 57.4 crores which is a growth of 24% year-on-year basis. The PAT margin was 9.14% for the 9 month which is an improvement of about 107 basis points.

Coming to the operational highlights, this quarter was exceedingly good as we added 13 new clients. We thought we had lost them to our competitors, but they came back because they were not happy with them. These 13 clients are key names in the industry. With their addition, there is a huge pipeline and we are hiring aggressively this quarter beginning in January. We have added close to 100 people already during the last one and half month and what I have been told by our operational team is that this will continue. So, all-in-all, we are seeing a lot of growth coming in from both the new customers as well as existing customers giving us additional revenue. Hopefully, this quarter is going to be great for us.

Overall the decline in margins in the financials of Q3 was primarily due to seasonality. Typically in Q3, the December quarter in the US, the number is less as compared to the other quarters. This year was also the same. Unfortunately, unlike the last December quarter of 2017, where we had the Mauritius Phase-I contract the decline of revenue due to seasonality in the US was not as much as opposed to the Phase-II of the project we did this quarter. With that said, I would like to open up the call for questions.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Priya Shah, an Individual Investor. Please go ahead.

Priya Shah: Just wanted to inquire that are you witnessing any pricing pressure due to employee-related expenses or client related issues?

Niranjan Chintam: We are not experiencing any price pressure at all. Like I was saying in my introductory message, we thought we lost some of the business to our competitors but they came back to us. 7-8 big IT companies both in India and the US are giving us revenue. They are coming to us for their specialized needs that they are not able to fulfill themselves. They are looking for specialized digital transformation skill-sets that even the big boys do not have. So, we are demanding a premium and we are getting it in many cases. Our prices are higher than our competitors even then we are winning it because we have enough credibility built-in with the existing customers as well as the prior experience that we have. So to answer your question, no we are not facing any margin pressure or price decline because of our competitors.

Priya Shah: Are you planning to bring down the percentage of onsite delivery down?

Niranjan Chintam: See that is our long-term goal. But due to the pressure of employment or lack of enough qualified people in the US; we were not able to achieve it. I think you are aware; the unemployment rate in the US has come down dramatically. I think it is below 3% or around 3%. This is automatically leading for companies like us to increase their offshore revenue because we are able to outsource. Earlier the customers were not willing to outsource but now they are as they are not able to find enough talent in the US. There are many customers; I can give you examples, which are not able to find people. That's why we have started hiring in India and have added about 100 people in the last 1 month to cater to the pipeline.

Priya Shah: And sir, what are your plans to reduce debt going forward.

Niranjan Chintam: Priya, let Parminder Bhatia, our Financial Controller answer this question. As you know, we do not have other management team members here; I would like to introduce Parminder Bhatia. She takes care of all the global financial and accounting needs.

Parminder Bhatia: Hello Priya. This quarter, we have repaid debt around 5 crores and our debt-equity ratio is improving quarter-on-quarter and year-on-year as well. The year-on-year went down to 0.54 and Q-on-Q went down from 0.44 to 0.4, so you can see an increase there. I would also like to add a few more things here. In this quarter, we have repaid earn out around 9 crores. So, in that case, we have done very well in this quarter.

Niranjan Chintam: To answer your question, Priya we have reduced the debt or long-term obligation by about 14 crores in this quarter.

Priya Shah: Sir, last question. What is the update on the pledge shares and do you have any plans to reuse them in the near future?

Niranjan Chintam: The percentage of the pledge is around 6.85% of our shares. But unfortunately our bank, I guess, is not releasing shares. They are in fact asking for additional shares that we are refusing to give. We are looking to change our banker too as it is affecting us even though we have not defaulted a single payment till today. We are getting affected because of the fault of others. So to answer your question, we are trying hard but we cannot make a commitment to reduce this pledge. Again I want to reiterate that this pledge is primarily to do with the company need and is not a personal need. So whatever we have pledged is going to be the working capital for the company. While we are growing, we need cash and the only way to get cash is either through equity or debt and we have to go to the banks to get this.

Moderator: The next question is from the line of Agastya Dave from CAO Capital. Please go ahead.

Agastya Dave: A very nice commentary although the results were slightly below power. Can you describe a bit more about the 13 new clients that you won, what is the nature of work, are these just like accounts where you have already made a big entry or is it something that will grow over a

period of time, and how will this ramp up. The second question is you mentioned that the pipeline is looking very healthy now so if you could somehow quantify that or if you can give some qualitative information on it as compared to the last year that how big is it and what the nature of work is. Obviously, it seems that the pricing is no longer a problem and you are getting old clients back. Can you tell me what exactly has happened?

Niranjan Chintam:

First let me talk about Karanjit. Karanjit, unfortunately, could not join the call because there was some emergency. Typically he takes care of all the operational stuff. However, in his absence, I am taking the operational questions and Parminder Bhatia will answer the financial stuff. So coming to your question of the new clients that we have acquired, all the 13 clients are from various industries. In the press release, we have mentioned about 7 customers and the type of work we are doing for them. The customers are from manufacturing, product-based to a health insurance related and telecom industry. To answer your question, we have noticed that in the last quarter the ticket size has gone above a million dollars for us. While we got a little bit of smaller contracts initially to start off but some of these 13 contracts themselves are above a million dollar. This is the kind of change we have seen. This is probably a combination of two things. One we have made huge investments in the brand and we continue to make them and the other is the sales effort we have been doing over a period of last, I guess, 2-3 years and the change in strategies. I think some of the stuff that Agastya we have spoken in our AGM. So all these are paying dividends now and we are able to get a customer with a larger ticket size. The last question that you asked about is what would be the future of the pipeline. Without talking numbers, I would say we have hired 100 people and I was told that we would require 100 more people probably within the next 1.5 to 2 months or maybe 3 months' timeframe. So, we are adding very aggressively given what we see in the pipeline. There are plans for hiring good talented people and fresher's. Out of 100, there are about close to 70 lateral hires which are experienced. While we have probably about 30-40 openings still left, we also have done fresher hiring of about 30 people. So we would be running out of space Agastya in both Gurgaon and Hyderabad and will probably be looking for new space shortly.

Agastya Dave:

Sir in terms of the billability of this said people and of these accounts do we start immediately I mean will we see probably a poor fourth quarter in terms of cost and then we see the revenues coming in the first quarter or will we see the momentum pick up immediately?

Niranjan Chintam:

So there is some momentum picking up immediately because as you are aware that once you hire people it takes a little bit time before they become productive. So probably I would say the first half of the quarter, we may not be getting the momentum that we want to, but the second half of the quarter we will get. So there is already some billable hours that we guard for this first half of the quarter but the second half will be much better.

Moderator:

The next question is the line of [17:40]. Please go ahead.

Participant: Sir just a couple of questions I was doing a quick check on our revenue numbers. Though we compare it to the same quarter last year but if we do the comparison with the revenues of the corresponding quarter 2 years back, the growth rate was roughly about 14% and the number I usually hear is an organic revenue growth rate of about 20%. So is there some sort of aberration here, do you think there is a slightly reduced growth rate as we grow in our size?

Niranjan Chintam: Thank you for the question. So there is always going to be a base effect. As we get larger and larger, getting that 20 odd percent is going to be tougher and tougher because the base effect is there to answer your question, there is a slight aberration because we sold the subsidiary and the subsidiary was giving close to \$10 million. So that effect is also showing up in this quarter along with seasonality. The second thing is there is a onetime effect when it comes to the Mauritius project which I think we told in December that the follow on order is only 50% of what we guard in December' 17. So, the subsidiary sale, as well as the, follow on order is not equal in size.

Participant: Going forward do you still maintain that 20% for the rough number?

Niranjan Chintam: I think we talked about it that we are going to be closer to 20%. Historically we have done our 20+ percent, but because of the base effect and if you subtract the subsidiary, I think we should be getting close to 20.

Participant: The second question is more about housekeeping. The tax rate this year has been pretty low relatively and I see some stark events, any reason as such?

Niranjan Chintam: There are three important factors. We have European revenue which has taken off. The US tax rate has come down from 30 odd percent to 22.5%. In India, we are called SMEs, so our tax rate is 25%. Other than these three things, we are also doing tax planning things that are giving us this benefit.

Participant: So it is structural then, is that correct?

Niranjan Chintam: Yes, It is a structural thing.

Participant: Just one last question sir, you spoke about getting 13 new clients, any idea as to how many clients would have exited the system or the projects got over?

Niranjan Chintam: See typically what happens, if I have to go into the specific number we get 80% of the business from the same customer and many of our customers are start-up companies that continue to grow. Yeah, there will be some customers where we have finished the project and they do not have anything else for us to do. I do not know the numbers of customers that

we have lost in these 9 months, but I would be happy to look at that and get back to you at a later time.

Moderator: The next question is from the line of Agastya Dave from CAO Capital. Please go ahead.

Agastya Dave: Some commentary on the working capital side we have paid down our debt, but can you give us some numbers on what are the receivables looking like now, any situation which is getting worse or any particular account which is getting better in terms of rates payable?

Niranjan Chintam: The number is slightly higher this quarter, Agastya, because of the seasonality in the US. Typically what happens is, let us say, 1 week before Thanksgiving till January 15 most of the US does not operate at 100%. There are collections as well as billable hour's challenges that we have to face. So all of these combined add up to a slight increase in receivables when it comes to the December quarter. But they are getting better. I think we talked about this when you were there in AGM. The bigger the customer size the longer it takes in payment. So that is something that we are getting into. All the large customers without naming the second largest shipping company in the US have now put a 120 day for us. So that is a challenge that we have to deal with and then we also have to service our employees and our vendors. Employees have to be paid on time and the vendors have different terms. So these are the challenges that we have and we will continue to have that. Though we have not increased our working capital needs at this time there could be a scenario where the working capital requirement might go up while we are paying down the debt because as we spoke about this earlier we are not sitting on huge pileup cash. The cash is being used to retire debt and pay out. We have paid 13 crores, no actually 14 crores in the last quarter. So a big chunk of cash went out of the system while we are making investments in technology and new hires. This is the challenge that we will have to fight and we will continue to do that and hopefully like I was saying earlier by September we should have all our earnout obligations paid out. Then, our cash reserve will improve dramatically.

Agastya Dave: So this is my next question. Are the earnouts completely out or have we paid out everything?

Niranjan Chintam: By September they will be completely paid up.

Agastya Dave: On the people side you are hiring 100 people I guess all of them would be on the operations side. So can you give me a breakup of how many people do you have now, what is the sales post looking like, and how much are the coders so to speak?

Niranjan Chintam: So it varies from geography to geography, but I would say on an average.

Agastya Dave: On an aggregate.

Niranjan Chintam: About 25% are support staff and about 70% are delivery people. 25% - 30% again ballpark number, Agastya, is support staff—admin, management, salespeople, lead generators, and proposal writers in Hyderabad and Gurgaon. We have immigration attorneys that add up to between 25% - 30% of our overall count of employees.

Agastya Dave: And final question from my side. You spoke about the pipeline that it is looking much better now, but on the horizon, how is the demand looking like because the word recession is being used frequently with respect to the US economy. Especially in the second half, are you seeing any kind of progress in terms of the demand beyond what you already have in your order book? I am pretty sure execution will be pretty soon for at least one year even if the worst thing happens to the US economy, but beyond that what is your visibility?

Niranjan Chintam: See I am not an economist. So let me just talk about the operational part or what we see as a pipeline. We have plans to grow both internationally and domestically in terms of hiring people. In this year, we plan to grow but what happens next year due to the recession I do not want to predict that. We will be entrenched in some of the customers and like you said the execution probably would happen in one year. So I do not have any visibility on the recession side. But this year based on whatever pipelines that we are seeing we are bound to grow organically and aggressively.

Moderator: The next question is from the line of Mahesh Desai an Individual Investor. Please go ahead.

Mahesh Desai: So I will follow up on the tax question that was asked earlier. Is it safe to assume that the current load will sustain if there is no change in the US or India tax bracket from 20% -25%?

Niranjan Chintam: Mahesh could you just repeat that question again. I guess I did not understand the question properly.

Mahesh Desai: Yes. I was just following on the tax question. Earlier this quarter, the tax bracket is lower compared to the last year the same quarter. You mentioned, it is because of the tax bracket in the US as well as in India. So is it safe to say that we will sustain its lower tax bracket around 20% -25% going forward as well?

Niranjan Chintam: Yeah I think so because like I said that we are doing tax planning. You must be aware that Europe when it comes to Ireland are looking at probably around 12% - 13% tax bracket so that is an advantage that we are trying to take. While for US operations, US revenue has to be there and India taxes will be there. So the average is going to be around that number. We are targeting below 25 and I think we should be able to achieve that.

Mahesh Desai: The second question is about the pledged shares. Did you mention that they are for working capital or is it for a loan?

Niranjan Chintam: It is for working capital. Whatever shares we have pledged is primarily for the working capital.

Moderator: The next question is from the line of Ashwin Jaiswal, an Individual Investor. Please go ahead.

Ashwin Jaiswal: So my first question is regarding the consulting income segment which contributes roughly to the 10% of our revenue today. What kind of services are we offering in this segment and how scalable is this segment going ahead?

Niranjan Chintam: So Ashwin what happens is when we have customers; we sometimes have to do what we call as Me-too services. This is the strategy. I think some of the analysts have told us. However, I do not know if you are an analyst since you said you're an individual investor. The reason why they told us is when you have to defend your customers no matter what you try to do, they will undercut your price and they will do whatever it takes to retain their customers. So just like big companies, we want to defend whatever customers we have. We do not want others to come in when we have a foothold. I guess like everybody we also use the land and expand strategies. When we do land and expand, we are also supposed to do territorial protection. During the territorial protection, we have to do some of the stuff that we normally do not do. Our primary competency is into digital transformation and we do a lot of enterprise related solutions also, but sometimes the customer says can you help me with this small need. We honor that because we want to protect our turfs. Otherwise, some other company like Kellton might go in there and start to use the same strategy we are using i.e. land and expand. So we are not looking to scale these services but we are just trying to keep our customer happy.

Ashwin Jaiswal: Sir I have another question. Looking at the robust digital transformation across different sectors, what are the strategies that you are looking at to get maximum benefit on an overall basis?

Niranjan Chintam: We were born digital. Ashwin, we have been saying that as we originally started in 2009. So it is in our DNA. When we meet our customers, we have enough logos and solutions that we have already done for other customers. So we always say that we have done similar stuff. We tell our customers what are the challenges while doing these whereas others may not have the experience that we possess. So that is one strategy.

Digital transformation means many things for many people. Right now we call it ISMAC that was originally called SMAC and then later IoT was added. Today it has become our Dal Chawal or in other words, it is our bread and butter. So this is our mainstay for our business. Then you have this new-age technology coming in—AI, machine learning, the robotic process automation, and blockchain. We are also breaking entries into it. They are not mainstream yet but as early adopters, we are doing POC's when it comes to these technologies. We are doing a lot of POC's for our customers, but they are not huge implementations or going to production yet. We believe that probably 2-3 years down the road when these new

technologies become what we call as mainstream, we will start reaping a lot of revenue and margins there. For that, we are ready now as we are making a lot of investments when it comes to doing R&D and working with early adopters. Early adopters of technology are typically startups. These companies are coming up with marketing initiatives to see what these technologies can do because they want to stay ahead. We are working with such companies and while we are working with them we are learning a lot. AI is now being talked about all over the world. Do I need to develop a product in AI? No. I do not need to develop a product in AI as Google, Facebook, and probably Apple will have AI expertise just like IBM has deep analytics expertise. We have to use this technology to provide solutions—that is our strategy for growth in this direction.

Ashwin Jaiswal: Sir I have a couple of financial questions also. I was going through the numbers and saw that the cost of raw material has increased substantially from about 1.5 crores to about 18 crores in this quarter. Any reason why is that increased?

Niranjan Chintam: This is because of the Mauritius government contract that we had talked about earlier. If you look at it, during the same quarter, in December there was a substantial increase as we were supposed to provide hardware to the Mauritius government. So this is the reason why the cost of material is going up.

Ashwin Jaiswal: Sir last question from my side. Looking at the volatility in the foreign currency right now, what are the measures that we are taking to safeguard our interest?

Niranjan Chintam: I guess that is a good question. Initially, we were brainstorming as do we need to hedge. But later on, we decided not to hedge because rupee was always depreciating right and it has appreciated a little bit from Q2 to Q3. So there is hit of about 62 lakh when it comes to the currency fluctuation loss. This loss we have to book in pure number so that it is not lost. Our strategy, today, continues to be wait and watch. For us, it is a natural hedge. Our 80% of revenues come from the US and expenses in the US are also in dollars. In India, we get dollars and we spend in rupees. So the number of dollars coming to India is not material. It is probably under \$5 million. So we did not want to hedge for that at this time, but we can change our strategy in the future. We are talking to experts and everybody so far has advised not to hedge at this time. Because of natural hedging, we are also borrowing in dollars so that is offsetting any loss that we may, let us say, have because of volatility.

Moderator: The next question is from the line of Neha Shah, an Individual Investor. Please go ahead.

Neha Shah: So I just wanted to know what is the revenue from the IP-based capability for this quarter and what is the sign of visibility that you have going forward in this specific segment?

Niranjan Chintam: Right now, we do not have any specific IP-related ones but we do have what we call as framework. So frameworks are something that we have learnt, let us say, for multiple

customers. I can pick examples of mobile commerce or e-commerce or whatever you want to call it. We have done many mobile-based or e-commerce-based solutions. Around 60%-80% of the work that we do is the same for most of the customers. So, we try to come up with a framework that caters to 60%-80% solution and then make customization as needed for that customer. Currently, we do not have any IP other than the IP for the IoT-based solution for the energy sector. We have probably a couple of million dollars yearly when it comes to IP-based revenue, but our strategy is to increase it. This calendar year, we are making a lot of progress when it comes to our energy IoT solution and we would want to make investments for more IP solutions. However, at this time, due to cost constraints, we are not able to make too much investment in the IP-based solution.

Neha Shah: I have another question. How much revenue is contributed through organic as well as inorganic growth or overall company-wise?

Niranjan Chintam: It is very difficult to break up the organic and inorganic because after 6 months we do not track it separately. We have a day zero strategy, day 30 strategy, day 180, and within 6 months all the companies that we acquire and all the different business units are merged together. So, it becomes very difficult. We do not track it separately but like I was saying earlier our growth has been historically about 20 plus percent inorganic. However, it varies based on when we have done an acquisition.

Neha Shah: The reason that the domestic revenue increased from 6% to 14% this quarter, could you tell us what is the reason for that?

Niranjan Chintam: That is the Mauritius project that I was talking to you about. Just like December of last year, this year also we had a onetime increase when it comes to the Mauritius government project. If we get a follow on order because we were told that we were getting many more follow on orders like this, we may get one more norm by December of this year. Typically what happens, Mauritius government schools shut down, I guess in late December to early January. So they would want us to implement our solution before the school restarts. In December quarter, if we get another follow order with Mauritius there might be a bump up when it comes to that.

Moderator: As there are no further questions in the participant, I now hand over the conference to Mr. Niranjan Chintam from Kellton Tech Solution Limited for closing comments.

Niranjan Chintam: Thank you, ladies and gentlemen, for joining the call. We appreciate your presence and your interest in our company. As said in the last quarter, I would be happy to meet each one of you one-on-one to talk about what we do in Gurgaon or Hyderabad offices. If you want to come down and meet us, we would happy to meet you. So please reach out to Anupam, she would be happy to set-up a meeting with me or other senior members, if you are traveling to

Gurgaon. So again, thank you and looking forward to chatting with you in the next quarter, if not sooner. Thank you.

Moderator:

Thank you. On behalf of Kellton Tech Solution Limited, we conclude this conference. Thank you for joining us and you may now disconnect your lines.