

Kellton Tech Solutions Ltd
Q3 FY20 Earnings Conference Call
February 17, 2020

Moderator: Ladies and gentlemen, good day and welcome to the Kellton Tech Solutions Ltd Q3 FY20 Earnings Conference Call. As a reminder, all participant lines will be in listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If you are seeking assistance during the conference call, please press '*' then '0' on your touchtone phone. I would like to thank you all for participating in the company's earnings call for the third quarter of the financial year 2020. Before we begin, I would like to mention a short cautionary statement. Some of the statements made in today's concall may be forward-looking in nature and such forward-looking statements are subject to risks and uncertainties which could cause actual results to differ from those anticipated. Such statements are based on the management's beliefs as well as assumptions made from the information currently available. Audiences are cautioned not to place any undue reliance on these forward-looking statements while making any investment decisions. The purpose of today's earnings conference call is purely to educate and acquaint you of the company's fundamental business and our financial quarter under review.

Now, I would like to introduce you to the management team participating in today's earnings call. We have with us Mr. Niranjana Chintam – Chairman and Whole Time Director and Mr. Karanjit Singh – Chief Executive Officer, India. I request Mr. Niranjana Chintam to give his opening remarks. Thank you and over to you, sir!

Niranjana Chintam: Thank you, Ayesha. Good evening everybody. Thank you for joining our earnings call for Q3 FY20. I would like to start this call with the highlights of the quarter and then open the floor for questions and other things that you might have for us. The total revenue for the 9 months quarter ending December 31st, 2019 is about 567 crores and EPS came down to 5.86 per share. The company has an EBITDA of about 90 crores for 9 months and EBITDA margin is around 16%. The net profits are about 56 crores in the first 9 months of the financial year. Please note that the numbers are not comparable to the last year. The reason why I'm saying so is that we sold out Supreme Soft Global with revenue of about \$12 million. So, every quarter there is a \$3 million deficit that we have to make up. So, we are looking at a difference of probably around 22 crores to 23 crores per quarter because of the sale of Supreme Soft Global.

Now coming to the quarter ending December 31st, 2019, the total revenue was about Rs.192 crore compared to Rs.187 crore in the last quarter. There is a slight increase of about close to

3% quarter-on-quarter. EBITDA margin in this quarter is about 15.7 %.Thenet profit is Rs. 19.3 crore compared to Rs. 18.7 crore in the last quarter again a quarter-on-quarter growth of about 3.2%. The dilated EPS for this quarter is at Rs. 2 per share compared to Rs. 1.94 per share in the last quarter. There is also an increase of around 3.1% quarter-on-quarter basis. In this quarter, we have won 13 new clients and received 'Integration Partner' award from Software AG in London. We were also the Silver Sponsor for Digital Transformation Conference 2019, held in Boston. These are the broad highlights of the quarter. Let us now open the discussion for Q&A

Moderator: Thank you. We will now begin the question-answer session. The first question is from the line of Agastya Dave from CAO Capital. Please go ahead.

Agastya Dave:

Sir, can you give us some details of the sale that you have done of one of your companies? When exactly was it done? What was the consideration? What exactly were the capabilities? I mean are there any capabilities that we have sold or is it just any business? Second question is on the debt numbers, what are the current long-term and short-term debts? And the third question is on growth. So, I believe this is the second company we have sold and again if this is the reason why the growth numbers are not very apparent? Then, when will we stabilize and when will we have proper comparable numbers? What is the outlook for the growth going forward?

Niranjan Chintam:

First let's start off with when this was sold. The company was sold around March 2019. But it was effective from January 01, 2019, so that means that we did not have revenue from SupremeSoft from the last quarter of last year. So it's beginning last quarter of the last year and going forward. So for the last four quarters we do not have any revenue from Supreme Soft Global. Now answering the last question, I am sorry, Agastya you had a question on that?

Agastya Dave:

No, I just wanted to figure out when was the effective overlap? So, I believe now the overlap will be in Q4. So, Q4 onwards it will be like-for-like.

Niranjan Chintam:

Yes. From Q4 onwards, you will see like-for-like. This is the second company that we have sold. We have spoken about it earlier as well Agastya. Although we cannot disclose the amount that we have received, I would like to say that we have sold it for an amount a little more than what we had bought it for. The reason why we sold it is that we are bundling and selling all the low margin businesses that are in single digits because the cost of maintaining them is high. Albeit we want to keep Supreme Soft Global's customers, at the same time, we would want to get rid of low margin businesses and focus more on higher margin businesses. So, that is the reason why we sold the company. Now coming to the growth point of view, right, like I said Q4 of last year and Q4 of this year would be like-for-like comparison and that will soften the growth. Having said that we have been getting a lot of traction in India and we are going to see growth going forward. But, at the same time, the debt has been constant in the last quarter and this quarter. While we did pay out some debt, we also borrowed

additional money. We have been growing and I think we talked about in the last quarter as well where we said the banks haven't been as helpful as what they used to be a year back. So, we have to put a lot of cash margins or in some cases 100% cash margin for Bank Guarantees that we have had to give out for the FCI contract that we won in the last quarter. So, we have begun that project, we already have some revenue that we booked this quarter from the FCI project. The project is taking up a lot of cash and we had to borrow more funds. The debt which we talked about last time is also a little over a million dollars that is to be paid every quarter for the term loans that we have. But at the same time, we will have to borrow for the growth that we have.

Agastya Dave: And would it be a decent assumption, if I say that receivables are more or less constant, Rs. 184 crore was the number last quarter. Do you have a number for this quarter?

Niranjan Chintam: Are you talking about Q4? Yes, we will be around the same and I would say that the India revenue probably would be higher than this quarter because the FCI is bunched up to the fund probably for the first 9 months. So, you will be seeing a jump in the Q4 India revenue. As far as the US revenue is concerned, we are having challenges in hiring. The costs have gone up because skilled people are in demand. People, I guess, are getting absorbed at a quick rate. We have to increase some of the benefits that we are giving, from commissions to bonus, and all that stuff.

Agastya Dave: And sir, any breakthroughs in Europe?

Niranjan Chintam: Yes, Karanji will answer that.

Karanjit Singh: Yes. So the year before we acquired our first two set of customers and this year which is 2019, we were able to grow all these accounts to about 2-3 million. And now, we are making the next set of push. With GDPR and outbound issues, outreach to customers has become difficult but we have created a robust pipeline in the last review. We are hoping that we will have the next few customers for growth this year.

Moderator: Thank you. The next question is from the line of Saurabh Soni, Retail Investor. Please go ahead.

Saurabh Soni: Why there are cash flow issues? We are showing a lot of cash flow from operation on year-on-year basis. Why there is an issue in this particular debt?

Management: It is a good question Saurabh and I would like to throw some light on it. Just to give a perspective for this year, there was about close to Rs. 15 crore of liability that was paid off. There are some obligations that we are paying off apart from quarterly interest payments that we had paid off earlier. I am not talking about interest; I am talking about our term loans that we are paying off. So, every quarter we have a close to a little over million dollars that we are

paying off. So keeping all these in mind Saurabh, we have not taken a single penny from the market, in the sense that I have not raised any money from the market so far. Like I was telling you that for the FCI Project, I have to put in 100% cash to give a BG. So these are the challenges we are facing with cash flow. I am always upfront and honest when saying that there are cash flow challenges in the company. Whatever money we are making, we are spending it out.

Moderator: Thank you. We will move to the next question. The next question is from the line of Nikhil Shankar, Individual Investor. Please go ahead.

Nikhil Shankar: My first question is regarding trade receivables. So, could you just throw some light on that and also DSO?

NiranjanChintam: We are doing at 88 days when it comes to trade receivables. This is a global number. In India, since we are doing some government contracts, trade receivables are a little bit more than the global 88 days.

Nikhil Shankar: And what is the amount if you could throw a light on that as well?

NiranjanChintam: One second, I will pull it up. In the meanwhile, you can ask me the next question.

Nikhil Shankar: My second question is on cost of material consumed compared to the last year. So, the last year amount was north of Rs20 crore and this year you are showing it as Rs. 73 lakh only. So, what changed?

NiranjanChintam: So, last year we did a contract with the Government of Mauritius (EdCIL) and there the hardware component was higher. This year, I guess we don't have a renewed contract on that and this is the reason why the cost of material is low. For the Government of Mauritius, we provided solutions that included hardware as well. So, the FCI order, yes there will be some hardware sales, the same as we did for the Government of Mauritius. And as far as the amount of trade receivables is concerned, we are around Rs. ,180 crore.

Nikhil Shankar: So that includes India as well as global?

NiranjanChintam: That's correct, everything together. This is consistent but I think we are a little bit higher in the last quarter. We are now at Rs. 180 crore.

Nikhil Shankar: Just the follow up question on your Mauritius contract. So, the contract was for 2 years?

NiranjanChintam: Two years, yes that has ended.. When I say ended, we are still in the maintenance phase. We have successfully deployed Phase-I and Phase-II. And now we are in the maintenance stage for the next two more years. The first contract we should be finishing by January 2021. The second phase will be ending by January 2022.

Nikhil Shankar: Just the last question on growth. Could you give us a picture on what do you think in the next financial year 2021 the revenues will be or the growth that you are expecting?

Niranjan Chintam: At this time I am more on a consolidation phase. Whatever winds that we have, we are not looking to grow aggressively. We want to first control our cash constraint. So our goal for 2021 is that we will try to reach in a cash-rich position.

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

Agastya Dave: A part of the question was actually asked by the other participant. Sir, 2021 you are saying that the cash crunch will ease, what do you mean by 2021? Is this financial year 21? I mean June of financial year 21 or that would be like 6 months down the line, not even 6 months, 4-5 months.

Niranjan Chintam: I am talking about the calendar year, June 21. Let me tell you why I'm saying this. All our term loans will end by the March-April timeframe. Our earnout obligations whatever we have will be paid off. So then we would be having enough cash. Instead of servicing debt and earnout payments that I am servicing per quarter, I would be sitting on that cash.

Agastya Dave: Sir, what is the total amount of earnouts which are still to be paid out as of this quarter?

Niranjan Chintam: Around Rs. 38 crore.

Agastya Dave: Are you saving any money on the earn outs because EBITDA or growth targets were not met? I mean, why do you have to pay the entire amount? This amount was Rs. 60 crore two years back. So it has come down but, right so why, I mean, is there any saving that you are doing because of this?

Niranjan Chintam: No, there is no saving. It has been paid off.

Niranjan Chintam: There is no saving. This is stock that we talked about earlier too, where there is some guarantee that is upside and downside. So, in many cases they have met a minimum amount that is required. Anything above that, there is only one, I guess in this financial condition only that has gone up and we would have to place slightly more. We have put in a guaranteed amount that could be a potential upside if they achieve the numbers. The latest acquisition, the Poland acquisition, is doing very well for us and we may have to pay a little bit more.

Agastya Dave: And sir, I asked for the borrowing numbers. So last quarter we had some Rs. 100 crore of borrowings if I am not mistaken?

Niranjan Chintam: See,, we were around Rs. 130 crore and now we are at Rs. 128 crore.

Agastya Dave: 128?

Niranjan Chintam: 128, right.

Agastya Dave: Rs. 128 crore and Rs. 38 crore of earn outs are over and above that.

Niranjan Chintam: Correct, yes.

Agastya Dave: And, sir do you have the split between term loans and short term loans in this?

Niranjan Chintam: Yes, long term is around 37, short term is 72.

Agastya Dave: So, Rs. 37 crore of long term and Rs. 38 crore of earn out? These are the ones which will be paid out by next year?

Niranjan Chintam: Correct.

Agastya Dave: And sir, one final question. So, today the plants that you have added over the last 2 quarters let us say. Before that Rs. 180 odd crore of dues that you have, do you have any receivables which are over 6 months? Are you experiencing any bad debt issues?

Management: No, we do not. See there is always going to be in a year, right. Last year, just to give you a perspective, I think we wrote off about Rs. 50 lakh.

Agastya Dave: Yes, you had mentioned that. Yes.

Niranjan Chintam: The same number will be writing off this year too. There is nothing over 6 months. We will do it in 100 days but, not 6 months.

Agastya Dave: I haven't fully understood. The cash crunch, if we were growing at a particular pace, right then, we should have some trouble that I fully understand because the environment is very bad. And you are not the first or the last IT company which is facing this. But what I am slightly not able to understand is that there could be some problem. Are you experiencing problems? That is why I am asking? And is it like going forward ...

Niranjan Chintam: See, we do not have severe problems. Just give you a perspective, we were paying down liabilities in the last 9 months close to Rs. 20 crore worth of liabilities that we had were paid out, and the assets went up by about Rs. 4-5 crore. In addition to that we have earnout obligations and that also we have paid out. All of that is where the money is getting sucked up. On top of that the banks are not working with us and we have to give bank guarantees that have 100% margin. All these challenges are resulting in this and we would be getting out of this by the end of March. Some banks are working with us now and they have seen that we have been consistently performing. Once that is done then we will be out of this cash crunch.

Agastya Dave: So the key trigger that you are saying is just your business with the bank. It is nothing to do with the operational side. It is the funding side because the cash margins have gone up effectively. Why receivables are not getting funded properly? So, that is why you are experiencing that crunch, right. Am I right in my understanding?

Niranjan Chintam: Absolutely right. See, like you said margin is one thing and the other thing is that my limits have not gone up in India. May be some short-term borrowing, I used this to make some purchases but other than that there is no challenge at all.

Agastya Dave: So again just to repeat. The receivables have not gone up. Earlier you had an easier time funding those receivables because of banks. But now banks are asking for 100% cash margin. So, effectively you have to fund the entire Rs. 180 crore from your balance sheet other than from what ...

Niranjan Chintam: That is correct. That is right, yes.

Agastya Dave: So, whatever cash is coming, a part of it is going for addressing the long-term repayments, earn outs and long-term debt and the short-term side also effectively. You have to repay everything because they are asking for 100%.

Niranjan Chintam: Correct Agastya.

Agastya Dave: So you are saying March of this year? From next quarter, you expect this to ease?

Niranjan Chintam: Correct.

Agastya Dave: Sir how confident are you on that because banks have been acting fairly strictly, overly strictly with everyone? So, how ...

Niranjan Chintam: I would say 90% confident that I am going to solve this problem by end of March. There is a 10% chance that I do not want to say 100% ever.

Moderator: Thank you. The next question is from the line of Nikhil Shankar, individual investor. Please go ahead.

Nikhil Shankar: Just the follow up on the question asked by the CAO Capital about subsidiary. So you have sold two subsidiaries so far, so any more in the pipeline?

Niranjan Chintam: See, I do not want to say never, but at this time we are not planning anything else. Nikhil, we do get contracts that have low margins and we continue to do a little bit of low margin business because the customers ask us to do so. But when we don't get a certain size we think of bundling and selling them out. Nikhil, I do not know if you were there in the earlier calls. When we have a low margin business from one company or new customers who give us

low margin business,we then think of bundling them to one entity and get rid of it. It is not one company that is doing badly; it is all the low margin businesses that we are working with. Anytime there is a contract, we try to put it into the Kellton brand so that new contracts are signed under that name. So, when we spin off these low margin businesses we take out all the low-end businesses and sell them out using one of the subsidiaries we have and move the higher value contracts to the Kellton brand.

Nikhil Shankar: So right now no clear picture about any company that you are planning to sell. I mean that there is no company in the pipeline that I can assume.

Niranjan Chintam: There is nothing in the pipeline as of now. I do not anticipate what will probably happen in the next 6 - 9 months. But usually by now, we would usually anticipate what kind of low margin business we can bundle then. However, I do not see that now.

Nikhil Shankar: One more question. What about cash crunch? So, what I understand is that post March you will not have any cash crunch,I mean what you are facing right now and you are trying to solve it.

Niranjan Chintam: See, I want to make sure it is clear right; whatever the current problems we are having we would be solving that. And would I be cash-rich? No, I will not be. I would be cash-rich starting March of 2021 or June of 2021.

Nikhil Shankar: So, can we expect dividends?

Niranjan Chintam: Five years back Nikhil, I explained this but I do not know if you were a shareholder then or not. I said probably 2021-2022 is when I would be thinking of dividends as right now I need to fund for the growth of my company. How will I fund for the growth of my company if I will start giving out cash? We will revisit that in 2021 June calendar year. I will revisit this situation when we will have excess cash which I would really want to give.

Nikhil Shankar: In your previous conversation with a caller, you said you are not looking for growth. You are currently looking to generate cash as much as possible. So, we are ...

Niranjan Chintam: Yes, understood but Nikhil, right now we are not looking at excessive growth but at conservative growth. We will try and sell but not aggressively as probably in the next 1 quarter to 2 quarters we are thinking of consolidating what we have.We have a very strong pipeline. I am not going to say no for business if it is not going to cause a huge cash crunch. But I have passed on a few businesses also because I was worried about the cash flow.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to Mr. Niranjan Chintam from Kellton Tech Solutions for his closing comments.

Niranjan Chintam:

Thank you Ayesha. Thank you all for getting on the call and asking us all sorts of tough questions, I hope I have answered all the questions that you were looking for. There are some challenges, I am not disagreeing on that but things are looking better and brighter so we will be coming out of this by March of this quarter. Keep your faith onus. Thank you very much for getting on the call. Bye-bye.

Moderator:

Thank you. On behalf of Kellton Tech Solutions Ltd, that concludes this conference. Thank you for joining us and you may now disconnect your lines.