"Kellton Tech Solutions India Q3 FY '18 Earnings Conference Call"

February 6, 2018

MANAGEMENT: **MR. NIRANJAN CHINTAM –CHAIRMAN AND WHOLE-TIME DIRECTOR, KELLTON TECH SOLUTIONS LIMITED**
MR. SRINIVAS POTLURI– CHIEF EXECUTIVE OFFICER, USA, KELLTON TECH SOLUTIONS LIMITED
MR. KARANJIT SINGH – CHIEF EXECUTIVE OFFICER, INDIA, KELLTON TECH SOLUTIONS LIMITED

MODERATOR: **MS. ASHA GUPTA, CHRISTENSEN IR**

Moderator: Ladies and Gentlemen,Good Dayand Welcome to Kellton Tech Solutions India Q3 FY'18Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If you would need assistance during the conference call, please press '*' and then '0.' Please note that this conference will be recorded. I would now like to hand over the conference to Ms. Asha Gupta from Christensen IR. Thanks and over to you Asha.

Asha Gupta: Thanks, Stanford. Welcome to the Q3 FY'18 earnings call of Kellton Tech Solutions Limited. We have mailed the results and earnings presentation to you and the same is also available on the website of Kellton Tech. In case, any one of you has not received the presentations, write to us and we will be happy to send them to you.

To take us through the results and answer your questions today, we have with us Mr. Niranjan Chintam, Chairman and Whole-Time Director; Mr. Srinivas Potluri, Chief Executive Officer, USA; and Mr. Karanjit Singh, Chief Executive Officer, India. We will start the call with a brief overview of the quarter gone by Mr. Niranjan and then we will throw the floor open for Q&A session.

I would like to remind you that everything that is said on this call represents an outlook for the future andcan be construed as a forward-looking statement.It must be viewed in conjunction with the risks and uncertainties that we face. These risks are included and not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual reports which you can find on the website. With that said, I would now like to handover the call to Mr. Niranjan Chintam.

Niranjan Chintam: Good Afternoon everybody.Thank you for getting on the call to listen to the management, the numbers as well as the quick highlights of what we have done in the last quarter. To start off, the revenue of the company was about Rs. 2,107.8 million which is about 32.7% growth year-on-year and 14% growth quarter on quarter. EBITDA is around Rs.316.0 million which is about 44.5% year-on-year growth and 14.5% quarter on quarter growth. EBITDA stood at around 15% this quarter, net profit is at Rs.170.5 million which is about 23.6% growth year-on-year and 17.1% quarter on quarter. PAT margin is about 8.1%. EPS is Rs. 3.40 which is about 29.3% year-on-year growth and 7.3% quarter on quarter growth.

In addition to this, I want to quickly throw some light on the last quarter:

We have signed seven new clients from various industry verticals. However, the biggest highlight of this quarter is that Kellton Tech has launched an innovative IOT, artificial intelligence-based platform for energy sector. This platform will enable the businesses in the energy sector to leverage our analytical ability and domain expertise to provide meaningful data as well as predictive and prescriptive analysis to employees. Also, Kellton Tech has launched a cloud-based analytics solution for SAP S/4HANA.This solution is SAP qualified partner packaged solution built using SAP S/4HANA. We are also the NASSCOM mobile app partners.

We have signed up this prestigious, long-term partnership with NASSCOM. These are our high-level highlights and numbers, I would like to now open up for questions.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, we will now begin with the question and answer session.We take the first question from the line of Agastya Dave from CAO Capital. Please go ahead.

Agastya Dave: I was just wondering,if there is anything inorganic this quarter as I do not remember any acquisitions?

Niranjan Chintam: That is correct Agastya.Everything is organic and there is nothing inorganic, this quarter.

Agastya Dave: You have mentioned two business highlights—one is the IOT-enabled AI platform and the second one is S/4HANA.Is the solution built on S/4HANA?Is this a strategic sales tie-up?Will you guys be using their sales infrastructure or your sales team will accompany them when they are going to the clients, how deep is this integration? Is it just a service or a product offering where they tell the clients that they have this or is it integrated?

Srinivas Potluri: Thanks for the question, Agastya.Yes, it is an integrated approach with SAP and Analytics from a provisional services standpoint as well as from a solution standpoint. Kellton Tech has partnered with SAP and we have developed this partner packaged solution.The understanding with SAP is that we will go-to-market together. SAP will open their books and their client list for us,where they would require this kind of a service or a partner packaged solution.We are working with the inside sales team of SAP, so it's a go-to-market strategy along with SAP for Kellton Tech.

Agastya Dave: Is there a profit share or something like that or is it like an add-on service or an integrated package where they will share profit?How exactly would the economics work in the deal?

Srinivas Potluri: This would be an add-on service.It will not be integrated.

Agastya Dave: In case of IOT-enabled AI platform and SAP analytics solution, when do we see revenue visibility? I mean when would you start adding to the order book and when do you see first revenue hitting the P&L?

Niranjan Chintam: We are in active discussions and commercial negotiations with some of our clients, both for S/4HANAand IOT AI solutions. Our business head for the IOT platform is travelling tomorrow to Indonesia for commercial negotiation with a couple of clients there.

Augustya Dave: Final question, at least for the time being, how is the pipeline, the funnel, and the order book looking, how many deals are you working on, do you have any revenue visibility? Even qualitatively can give some sort of a flavor, how are things looking, any improvement from last quarter. Last quarter you had positive thoughts and that is reflecting in your quarter numbers. So, is the momentum sustainable or how do you look at it? Thank you very much.

Niranjan Chintam: From the funnel point of view, it is looking extremely good. As you probably heard the job market in the US has tightened dramatically, the available people in the US have shrunk with the growth in the job market.This is one of the reasons why stock markets all over the world are taking a hit.So there is an anticipation that the interest rates will also go up.US economy is extremely bullish from a job and contract perspective and we see that the pipeline from our side increasing.To answer your question, is this number sustainable, we believe these numbers are sustainable, so we should be able to provide you hopefully on par numbers of what we have produced so far.

Moderator: Thank you. We take the next question from the line of Harmish Desai from ULJK Financial. Please go ahead.

Harmish Desai: I am looking at the presentation mailed to me by Christensen. In the 16thslide, the revenue by industry shows that 12% share of the revenue is from Aviation and NGO as compared to Q2 which was only saying 1.3 percentage contributions. So can you elaborate what this contribution exactly is?

Niranjan Chintam: The 12% is actually coming from the education sector, which we announced, a quarter or two quarters back based on the sizeable order from EDLP—an initiative we are implementing in Mauritius.That is why; you see a jump this quarter in that particular industry vertical.

Harmish Desai: Do you expect this to continue in Q4 as well?

Niranjan Chintam: Yes it will continue inQ4 and I will let Karanjit answer on what is the potential of the project. We have been asked to do a follow-on work in Mauritius asours is the first successful implementation by an Indian company. The project was successfully implemented in a very short span of time. The work has been appreciated both by the Mauritius Government as well as the Indian Government because we have represented the country well and they are asking us to do follow-up work.The contract negotiations are going to take place between Government of India and Government of Mauritius. After the negotiations are over, we will get in and we are hopeful that we are going to sign up more from this particular entity.There are otherinteresting opportunities as well in the pipeline.

Moderator: Thank you. We take the next question from the line of Rahul Parekh from CR7 Securities. Please go ahead.

Rahul Parekh: I have three questions for you.My first question is what is the market size of the IoT solution for the energy sector, what is your outlook, what percentage of the market are you going to capture, and how are you going to prepare yourself? My second question is on the bonus issue. What are the reasons for a bonus issue as the share price is already low and it is just a normal accounting thing. My third question is, in Jan quarter earnings, all the IT companies are focusing and moving on digitalization. Even the large companies and midcap companies are focusing on digitalization which is the next area of focus. So are you ahead of the curve or the competition is improving from their end?

Niranjan Chintam: Let me answer one question at a time.The market size will be $60 billion for IoT in the Energy and Utility sector by 2022. I would love to get a billion-dollar out of that, which is a wishful thinking.We are poised well to acquire a market share in this space. What I am trying to say is that in the next three to five years, we should be getting 15% of our revenue from this particular vertical. To answer your second question, yes, everybody is talking about digital transformation nowadays.But we are the pioneers when it comes to digital transformation as we were the first ones to coin this word in the market. We were doing work related to digital transformation of voice calls today years back.There are others coming along, but they are providing what we call as point solutions, whereas we are providing end-to-end digital solutions. Now we have added IoT on top of the existing digital transformation services we provide, which acts as a catalyst to enable the transformation efficiently. We are continuously enhancing our capabilities through investments in new emerging technologies, partnerships, and skills to deliver exceptional customer value and operational excellence and drive industry disruption. We have successfully implemented a few projects where we are using IoT as part of our digital solution.

Moderator: Thank you. We take the next question from the line of Jayesh Shardha from Kelly Gamma. Please go ahead.

Jayesh Shardha: I had a couple of relatively minor questions. One is what is the nature of the cost of materials is in this quarter, is it around 10% of the top line?In the results you have shared, I see that in this quarter the EBID margin for the digital transformation segment in particular has gone down a little bit even the rest is pretty high, so is that a trend that you expect will continue?

Niranjan Chintam: Let me answer the last question first.The margins of the digital transformation segment typically are very high.This quarter we have provided a solution using a tablet.This is the reason why you are seeing less margins in the digital transformation space.Hardware along with the solution has squeezed our margins squeeze.

Jayesh Shardha: Again just a follow-up to this, which industry was this offered to, is it possible to share?

Niranjan Chintam: This was education industry.

Moderator: Thank you. We take the next question from the line of Harsh Kapadia, an Individual Investor. Please go ahead.

Harsh Kapadia: I just wanted to ask you about the bonus issue. I think the whole focus of shareholder value creation is to drive growth in EPS per share.Do you think expanding the equity base would be a right move to go ahead?

Niranjan Chintam: The primary reason was to increase the liquidity and participation from retail investors.

Harsh Kapadia: In terms of margin, if it is compared to similar companies of your size or even a little bit bigger companies, margins are on the higher 20+ side EBITDA margins, but we are still at 15%, is that because of some kind of revenue mix of the work that you are undertaking, which is different from others?

Niranjan Chintam: The reason why the margins are lower in our case is because we are investing in the growth of the company .Like I said earlier in the last quarter or earlier quarter calls, we are making investment to get to the next level of growth. I do not know if you were part of the earlier calls, but let me just restate what I stated there. At one time we had the people and the infrastructure and the team that could take us to $100 million, but now we are hiring people who can act as a catalyst to drive the vision. We are investing in the infrastructure as part of our strategy to take us to the $300 million.This is the reason why you see the margins squeeze.We are also placing our foot in Europe. Though Europe is giving us revenue but we are still pumping in lot of money for growth. In addition to that, we just launched this AI IOT-based solution for energy sector, which requires a lot of investment upfront before we start making money. I do not know who you are comparing with, but that is why we have a less margin maybe compared to others.

Harsh Kapadia: Can I assume if at some point when the investment phase is over, you can see an EBITDA margin in the 20% range?

Niranjan Chintam: Yes, absolutely. What timeframe that will be I don’t know. I will continue to invest till we achieve our goals, because like I said earlier we have built up a team and infrastructure for $100 million and now we are building up for a $300 million.

Harsh Kapadia: Sir, in terms of the market size that you also mentioned earlier that everyone is investing in IOT and digitalization, so considering that the market itself is growing at such a high rate, do you see where the revenue and profit growth will be? Will it be in the 30% range for a long period of time for Kellton Tech in the recent future?

Niranjan Chintam: Probably beyond FY2021, we believe that margins would be at that level because that is when we will ata steady state and will not require any investment for growth. We have pockets where we are already getting +50% gross margins, however, when it comes to digital transformation side we would have to have huge 60% gross margins to get that.

Harsh Kapadia: I was trying to ask whether the revenue growth can start moving towards the 30% growth rate?

Niranjan Chintam: We are a little conservative when it comes to our growth. We are saying 20% growth as of now but it is difficult to answer when we would achieve 30% growth.

Harsh Kapadia: Last question, any update on the QIP?

Niranjan Chintam: No, that is still work in progress. We have taken a backseatand we are only taking incoming calls and not making any outgoing calls.

Moderator: Thank you. We take the next question from the line of Mayank Babla from Dalal & Broacha. Please go ahead.

Mayank Babla: I wanted to know what the free cash flow was for this quarter and in the nine months of FY'18 as compared to the previous year.

Niranjan Chintam: I do not have the numbers handy; let me get back to you on that. If you have any other questions, let me answer that.

Mayank Babla: What would be the accounts receivable days?

Niranjan Chintam: 75 days

Mayank Babla: Sir, which vertical would you focus on for M&A or are you thinking of the inorganic route?

Niranjan Chintam: I am not focusing on M&A as I mentioned earlier Mayank. We always make strategies for our inorganic growth either to build capability or for the customer base. Whenever we will see that we have a particular capability and would need larger bench strength or talent pools, we will merge with a company that has talent. We also do acquisition when we want to foray into a vertical and get more customers in that vertical. Today, I cannot give any specific space which we are targeting as it is always driven by the requirements of our business growth strategy.

Mayank Babla: Sir, please comment on the performance of the Lenmar Group in the BFSI segment?

Niranjan Chintam: The BFSI segment is the largest segment and Lenmar has now been merged completely into the Kellton Tech group. Like I stated in the last quarter, Lenmar has been the best acquisition till date. As it has completely merged into Kellton Tech we do not track it separately.

Moderator: Thank you. We take the next question from the line of Augustya Dave from CAO Capital. Please go ahead.

Augustya Dave: Sir, I think two or three con-calls back you had mentioned that strategically you are looking at reducing some of your not-so-profitable customer accounts, so what is the progress there, what is the current count, and what are the retention rates?

Niranjan Chintam: I have never said that we want to close the non-profitable customers. I said I want to increase per customer revenue and reduce the number of customers that we have. In the digital transformation space, multimillion dollar revenues are few. We are actually signing up tens of millions dollar proposals but the process is slow. This is not because of lack of prime from our side, it is because the industry is not mature enough.

AugustyaDave: Retention rate, Sir?

Niranjan Chintam: We are able to retain 80% of our clients.

Augustya Dave: Sir, you have a fairly decent exposure to the US. 80% of the revenues if I am not mistaken are from the US and there has been a fairly substantial tax cut there, so what is the impact for us going forward, when do we see that, is that going to be a FY '19 of CY '19, how does it flow into our P&L?

Niranjan Chintam: Since you are well aware of the revenue, numbers, and tax, effective from January 1, 2018.So effective this quarter, you will see some impact in the US and India revenue will go up to Rs.100 crore., Starting next quarter, you will get add-on benefit of the India tax cut too.

Agastya Dave: Sir, I was thinking of taking this offline, but people have already mentioned about the bonus issue. Bonus issues came out one day before the announcement of the budget and the budget has changed long term capital gain and its treatment. So, bonus issues are no longer tax neutral, so I was just wondering if you have taken that into consideration and what are your views? We can probably take it offline if you want.

Niranjan Chintam: Let us take it offline; we have not taken taxation at all in the consideration. However, it is a good point .Let us take it offline during our discussions.

Augustya Dave: Sir, one final question for the day from my side. You have entered into what seems like the first tentative steps for a tie-up with SAP, are you trying to do similar things with HSBC and Oracle or some other product that can open big ticket doors for you?

Niranjan Chintam: We have strategic tie-ups with not just SAP but also IBM, SoftwareAG, Mulesoft.These have been long-term tie-ups.It has not have started now.We have been SAP partners from seven to eight years.The solution is something new that we signed up.

Augustya Dave: How loose or tight this association is, is it bringing a lot of business for you or is it something like a certification for you?I am just trying to understand how much business can we get from all such tie-ups?

Niranjan Chintam: Let Srini jump in and answer your queries as he knows about the relationship much more than I do .Some of these partnerships are very tight where we are the only provider of the analytics solution. When we provide a unique offering, we become tight. Srini will be able to better answer this question as he is well-versed with the day-to-day activities.

Srinivas Potluri: Thank you, Niranjan. To answer the question, the relationship with SAP is tightly integrated. It is at a strategic level. With the demand for digital transformation rising, the Ice max space is getting big and Kellton Tech's reputation is rising as a premier player in that region. Vendors or actually software vendors such as SAP, SoftwareAG, IBM, and Mulesoft are approaching us to say how do we build, how do we update, or upgrade our applications to meet the digital transformation demand.SAP, for instance, is looking at S/4HANAand cloud applications. Kellton Tech is a strategic partner and value-added reseller of SAP for almost 10 years now. We have been working with them on new technologies within SAP and are among the three vendors of SAP that was invited to do build something unique. We are working with the application of these vendors and their growth within the digital space. The reason why they are coming to Kellton Tech is because of the reputation we have as a pioneer and leader in the digital transformation space. To simply answer the question, these are extremely strong relationships. We are helping these vendors get into the digital transformation phase and move their applications upstream into the cloud and even with Fioriand so on which have helped with the mobility space of SAP.

Augustya Dave: Just to get a further flavor here, what percentage of the next Rs. 100 crore revenue will come from such association?, I mean how useful are they?

Niranjan Chintam: I cannot exactly comment that how much it is going to contribute because these are long-term associations. When we build such things, it takes time for the sales team to strategize it. Probably we will experience lot more traction in the beginning of the next year and then we will be able to comment on it in terms of monetary gains.

Augustya Dave: Sir, what will make you happy? I mean you must have some expectations going into these dealings, right?

Niranjan Chintam: Agreed.For each of the vendor we have a certain target, which is based on our business strategy.In some cases, we target tens of millions per year from seach of these vendors.So it all depends on which partner andat what level we are in partnership with them.

Moderator: Thank you. We take the next question from the line of Sumanto Kunda, an Individual Investor. Please go ahead.

Sumanto Kunda: I would like to know that the financial cost is growing so can we expect each to come down or will it increase more in future. My second question is I can see that you have developed an IoT-enabled platform, is it like any other product in the pipeline?

Niranjan Chintam: The first question I did not understand Sumanto. Please repeat that as your voice was low.

Sumanto Kunda: I can see the finance cost is growing, so can we expect it to grow more in future or how you can play with that?

Niranjan Chintam: Sumanto, we have done a big EDLP project for which we need working capital. Typically what happens is we build a solution that includes both software and hardware and then we deploy and install it to make it go live. So there is a lead cycle for some of these. Once you start building a solution to raising he bill to the government or the NGTs that we are working with, there is usually a 60 to 70 day lag there. So in order to support the cycle, we need working capital to purchase the products or the hardware .Hence, you see increase in the finance cost. Whereas for any normal services we provide, you do not see that kind of requirement for finances because it is just goes into the cycle of 60 to 90 days where we get paid and we are done with. When it comes to solution offering, we see a little bit of lag time before we get paid. So that also requires a little bit more working capital. The solutions which require lot of R&D, the financial cost goes up but that also depends on the customer. Some of the big companies sometimes delay the payment. They pay us sometimes in 90 days plus. So as the size of the contract goes up, the payment cycle or the cash requirement also increases.

To answer your second question, we always have R&D going on as part of the technology evolution. To name a few, we are doing R&D on an AI application for a specific industry, crypto-currency—Bitcoin Blockchain.We have a separate team who is involved in the R&D work so as to help customers create a platform that they can plug and play. R&D helps us provide around 60% to 80% readymade solutions, which ensures that the implementation is faster and the efficiency is more. We do not sell the platform; we sell it as a solution, which is why we do constant R&D.

Moderator: Thank you. We take the next question from the line of Rahul Parekh from CR7 Securities. Please go ahead.

Rahul Parekh: Actually, I have two follow up questions. The first one is that could you please re-explain your vision of where Kellton Tech would be financially at FY2021, what are your financial goals, and what will be the business mix by industry, do you have specific targets or business mix by the services that you provide? For example, the institutional transformation is around 60% plus, so do you see that being constant. My second question is, this is just a thought from my head, because digital transformation is in focus right now, did any of the big midcap IT companies come out looking for an acquisition or whether Kellton is open for it?

Niranjan Chintam: Let me answer your question regarding numbers first and then take up the M&A question. The ambition is to be a $300 million company by FY2021.We are also planning to raise the money to achieve the growth we are targeting. We have been continuously working on our goal to meet the target of $300 million by FY20-21. Now coming to your acquisition question, I do not think we are ready for an acquisition. We are only focusing to achieve our FY 20-21 mission. If you talk to me around FY20-21, maybe,I would give it a thought.

Moderator: Thank you. We take the next question from the line of Akshay Sachdeva from Adrem Consulting Services. Please go ahead.

Akshay Sachdeva: Sir, you just mentioned about the Blockchain technology you are working in, so can we expect a new product development in the Blockchain technology in the near future like one year or two years?

Niranjan Chintam: We do not do products Akshay. We work on building platforms, so that the platform can enable us to do faster implementation. We are building platforms so that we can provide 60% to 80% of the solution to the client, as mentioned in one of my comments.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the conference over to the management for closing comments.

Niranjan Chintam: Thank you, Stanford. Thank you,gentlemen for getting on the call. Appreciate your time to listen to our quarterly results and our go forward strategy. Looking forward to meeting you, again. Some of you who volunteered to have a discussion, please reach out to Asha and we can setup a call to have an elaborate discussion. Also look forward to talking to you gentlemen for the year end close numbers as well as auditor results on our next call. Thank you and appreciate you getting on the call again.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, on behalf of Kellton Tech Solutions India, that concludes this conference. Thank you for joining us and you may now disconnect your lines.