Kellton Tech Solution Limited
Q2 FY 2019 Earning Conference Call
November 15, 2018

Moderator: Good day, ladies and gentlemen. And a very warm welcome to the Kellton Tech Solution Limited's Q2 FY 2019 Earnings Conference Call. 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. If you would need any assistance during the conference call, please press "*" then "0" on your touchtone phone.

I now hand over the call to Mr. Anuj Sonpal from Valorem Advisors. Thank you and over to you, sir.

Anuj Sonpal: Thanks, Ali. Good evening, everyone and a warm welcome to you all. My name is Anuj Sonpal from Valorem Advisors. We represent the investor relations for Kellton Tech Solutions Limited. On behalf of the company, I would like to thank you all for participating in the company's earnings conference call for Q2 FY19.

Before we begin, I would like to mention a cautionary statement. Some of the statements made in today's earnings conference call 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. Such statements are based on management's 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 before making any investment decisions. The purpose of today's earnings conference call is to purely educate and bring awareness about the company's fundamental business and financial quarter under review.

Now, I would like to introduce you to the management participating in today's earnings conference call with us. 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.

Without much ado, I request Mr. Niranjan Chintam to give his opening remarks. Thank you and over to you, sir.

Niranjan Chintam: Thank you, Anuj. Good evening, everybody. Thank you for getting on the Q2 earnings call. I want to quickly go over the numbers and then talk about the qualitative stuff. Quickly for people who have not seen the results, we have a top-line of around Rs. 210 crores, which is on a quarterly basis year-on-year 14% growth and a six monthly basis 16.6% growth. Profit, we have a PAT of around Rs. 19.8 crores for this quarter which is 32% year-on-year quarterly growth and for six months 33.8%. EPF is Rs. 2.06, again, another 29% growth on a year-on-year quarterly basis and a 32% growth on a six monthly basis.

Coming to the qualitative stuff, we have added 16 customers this quarter, some of them are marquee names and we are very excited about the additions we have made. We will see an impact of the type of work that we do in the next coming quarters. This is something that we have been talking about that IoT is becoming mainstream and there are a number of IoT clients that we have signed up with in this quarter. We would be happy to explain that as we go on in the earnings call.

Coming to the obvious question regarding the currency fluctuation and foreign exchange gains from last quarter to this quarter, the average rate is almost the same. So there is no significant or material impact when it comes to revenue and the foreign exchange gains or losses between the last quarter and this quarter. There is an impact on the balance sheet side of it, because it is a six monthly number. However, when it comes to top-line and bottom-line, on the revenue and profit, there is no material or significant impact on the numbers.

With that, I want to open up for questions. And as we go on we will be happy to answer some of the client wins that we have made as well as any other questions that you might have.

Moderator: Thank you very much. Ladies & gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Agaustya Dave from CAO Capital. Please go ahead.

Agaustya Dave: Sir, I just wanted to understand a little bit.

Anuj Sonpal: Agaustya, see if you can reconnect. Your line is not clear.

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

Mayank Babla: I want to know that the cost of material consumed has increased from 3 lakhs to 170 lakhs, can you just explain that figure?

Niranjan Chintam: Sure. So, I think we have already stated this in the AGM meeting and since you did not take part in the AGM so you don't know. In the AGM, we announced that we have won the follow-on order of $5 million from the Government of Mauritius. There is a hardware component attached with that project which will cost us 1.7 crores worth of material that we have purchased in the last quarter and that is what is showing up there.

Mayank Babla: And my second question pertains to your Lenmar group acquisition, can you just give us an update in the outlook on the acquisition?

Niranjan Chintam: Lenmar now has been merged with other entities. For the last one year, we are not tracking it separately. Mayank, like I told you a few quarters earlier when we had conversations, that it is one of the best purchases that we have made when it comes to both the top-line and the bottom-line growth.

Moderator: Thank you. Our next question is from the line of Raju from DLL. Please go ahead.

Participant: My question is, even when we look at the front-line IT companies, they are making a good growth on the digital space. On your smaller base you can go even bigger, even if it comes to revenue you can grow a little bit more than what you have shown? Because the dollar itself is giving whatever, and at the same time the environment is also good. I just want to know, even though year-on-year basis we can see some growth, but quarter-on-quarter we really could not see growth.

Niranjan Chintam: You are right. When it comes to the front-line companies that you are talking about, the big boys, they are getting more digital revenue as a percentage of their existing revenue space or bottom-line. Close to 70% is already digital and since we are a small company we are fighting with the big boys for many of our clients. There is always going to be a long lead time. Despite that we are winning contracts. We have added 16 new clients this quarter. This is probably one of the best quarters that we had in the last few years where we were able to add a long list of new clientele. Some of these contracts are very exciting and is validating the investments that we have made.

Coming to the growth, yes, there is going to be ups and downs when it comes to quarter-on-quarter, but look at it from a year-on-year basis. It is a true reflection of the growth that the company is making. In addition to that, we are also doing a little bit of restructuring within the organization for the next level of growth. So, there are some short-term gains. We do not see large gains right now as you are expecting. But in the long-term, we will get there.

Participant: And my next question is, can you please explain the current consolidated debt level, because in the last AGM I remember you tried a resolution for pledging the shares of the subsidiary. I just want to know, are we going through a tough level of debt, which is the reason we are not able to raise further debt?

Niranjan Chintam: Raju, we were a small company when we started taking loans from the US banks. And the way the smaller banks deal or collateralize is different from the larger banks. Now, we are able to approach larger banks and they are willing to fund us. Their requirements of collateral, legal requirements, pledges and guarantees are much more strenuous than the smaller banks. So, in case of larger banks we pledged the shares of the company so that they can give us the loans that we were looking for. Please be mindful that in a country like the US no hard collateral is given, other than the receivables and the company shares if you want to call it. Whereas, in India typically, there is real-estate and other kind of pledges that happen as collateral. In western world, there is nothing like that. We don't give personal guarantees, whereas in India we have to give personal guarantees. So, these are some of the things that weigh in. And as we grow bigger and bigger, we will have to do things that we were not doing earlier.

Participant: Great, sir. But can you just explain a little bit about the current debt level as well as the pledging percentage as of today?

Niranjan Chintam: Sure. Be mindful that the total debt that we have on books may look huge because of the foreign exchange gain or loss. It is about Rs. 133 crores in rupees. However, if you look at it in USD terms, it is $1.1 million more than what we had in March. I guess because of the huge dollar appreciation; you might feel that the number is higher. But when it comes to ratios, the debt to equity ratio is almost flat; it is 0.44, which is same as what it was in March.

Participant: And one more question from my side, I could see account receivable was more like around Rs. 200 crores of trade receivable. For me, it is huge. I just want to know what the debtor days for our revenues are.

Niranjan Chintam: The absolute number looks big because remember our revenues are growing up , Raju. The debtor days are 78 days, which is in line with the industry where it is around 90 days. At 78 days we are doing pretty well.

Participant: But why the receivable percentage as of revenue is little higher, that is what my perspective is.

Niranjan Chintam: Receivables are 80 days. That is about 78 days as compared to the revenue of 210. So, that is not much. Like I said, the industry average is around 90 days.

Moderator: Thank you. Our next question is from the line of Abhijeet Avasthi, an individual investor. Please go ahead.

Abhijeet Avasthi: Sir, my question is an extension to the previous question. The trade receivables is around 180 something, which is three times of net profit, it is actually more than the industry norms, not in terms of days but if you look at the absolute number. It has decreased a little bit this time but it keeps increasing year-over-year we have seen. So, is it one of your concerns that it might get out of hand? Is there something that you are trying to solve?

Niranjan Chintam: No, it is not a concern at all, Abhijeet. I will give you a few names just to give you a perspective. The larger the customer, the longer it takes to collect. I will give you two examples. The first one is Novartis. We are looking at 80 days before we collect money from them and IBM it is a little over 70 days. So, larger the customer the larger will be the contract and the longer it will take because that is what they have in their ERP systems, they do not even look at payments. IBM, a little over 60 days is when they start looking at payments. By the time we get it, it is little over 70 days. Novartis, it is about 75 or some days, before they will start paying us, once we raise the invoice. But it is an automatic system which gets the money; there is no issue there at all. Coming to your question regarding profits, looking at receivables, I do not think that this is a realistic metric that you should be using, because typically the debtor days are what the industry thing is.

Abhijeet Avasthi: Not only net profit, even if you compare it to the revenues, I get your days about debtor days. My next question is, what is your biggest concern, I mean, the company is growing almost every quarter and it is always a good performance year-on-year. So, what is your biggest concern right now, what keeps you up in the night?

Niranjan Chintam: See, I keep saying that talent is always a concern. I think you must have noticed that people were expecting that IT hiring would reduce, but in fact it has gone up. In Hyderabad, we are trying to hire around 30 people and there is a drive going on. So, within the next one week, I will have 30 more people in Hyderabad. So, for me talent is the biggest concern, if you want to call it. The ability to hire and keep them up-to-date with technology is a task. And, so far, we have been doing a good job. Hiring right people that stay with us are some of the other concerns that I have. But, we are addressing this concern constantly on this hiring curve. We are doing a regimental training. We may not give big boys kind of training, but we do have our own regimented training. This is helping us mitigate risks by constantly hiring.

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

Mayank Babla: I just want to ask, sir, can you give me a planned profile of your 16 new clients that you have added this quarter?

Karanjit Singh: We have just presented the list. We are going to do a lot of IoT work, in fact, we will be building a disruptive IoT cloud platform for a leading US-based security and access control solutions company. We are doing some work in the financial industry for a leading commercial real-estate lending company, again in the US; payment and liquidity management company in Europe. If I come to India, we are doing a complete digital system for a leading education provider as well as another one is a B2B platform where we are going to do some deep analytics. So I hope you now have an idea regarding the work we will be doing in the next few quarters.

Mayank Babla: Sir, just if you could give us a bucket where they would fall, as in like a $5 million client or a $10 million, on a broad basis if you could give us that information?

Niranjan Chintam: So, the IoT-based solution that we are doing, like Karanjit was saying, is a marquee solution. The client is an old blue big company who is providing door locks. You might think this is a mundane industry that typically had a key to unlock it. But we are working with them to migrate all their old key-based locks and number-based locks without changing too much. We are not changing the levers and all and are not even doing a huge fork-lift upgrade. They have legacy systems and are expecting 1 million plus dumb devices to be connected using an IoT-based platform that we are building for them. This project is over million dollars' worth of contract. The value of this contract is going to be huge for us. So, to answer your question, all of them except for the India-based clients are million plus customers that we have. Would they be 5 million or 10 million? Today I do not want to project, but we anticipate that once we are in, we will do account mining and turn them to $5 million to $10 million clients for us.

Moderator: Thank you. Our next question is from the line of Raju from DLL. Please go ahead.

Participant: And going forward where you can see the growth drivers as per the geographical region?

Niranjan Chintam: Once again, while I pull those numbers up, here is what we are looking at when it comes to the US. This quarter 82% is coming from the US, India and APAC is about 6.5%, Europe is 11.2%, and rest is others. So, to answer your question where we see the growth drivers coming in, we feel it is Europe. We are very excited about the European growth, which we have been targeting for the last two years and finally we see some huge traction taking off. So we should have a huge amount of growth coming out of Europe.

Participant: And one small question, we could see any kind of margin pressures just because of the competition?

Niranjan Chintam: No, we do not see margin pressure at all because of competition. But you may have seen P&L wise, there might have been a slight drop that is because we are hiring and appraisals happened this quarter. So we do not see margin pressure from the competitors' point of view as we have been doing this for a long time and we always have a cutting-edge. What we were doing a year or two years ago is what some of the competitors are doing right now. So we are not worried about the competition putting margin pressures.

Moderator: Thank you. Our next question is from the line of Sonakshi.

Sonakshi Sinha: Sir, just wanted to ask about the visibility for the entire year and the order book? And any concrete plans in terms of inorganic growth in the overseas markets?

Niranjan Chintam: To answer your question about inorganic first, inorganically we always look out for growth. I will repeat my strategy just to be sure why we do acquisitions. We do acquisitions for two reasons. We acquire either for a capability or for the customer base. So, we have never done an acquisition purely for revenue, we only do for these two things. Capability is obvious; we feel that we are not that strong in a particular technology and we believe there is a huge future for it. Since we do not have that in-house, we go and acquire a company that gives it. Also, if we want to penetrate the European market, we look out for a company that already has customers. Sometimes acquisition is industry-specific. If we want to acquire customers in a particular industry that we want to penetrate in, we acquire. So those are the two strategies that we follow when it comes to acquisition. Sonakshi, can you please repeat the first part of your question.

Sonakshi Sinha: Sir, on the visibility or any order book that you have for the entire year?

Niranjan Chintam: We have about eight months worth of visibility when it comes to revenue. So that has been consistently the case for the last one year.

Sonakshi Sinha: And sir, any progress on robotic automation processes that you are having? And what are the kinds of opportunities you are seeing in this kind of segment?

Niranjan Chintam: RPA, the robotic process automation, has taken off in a way that nobody expected. And I guess we invested in that. We are seeing a lot of traction there, which is good. We are doing a lot of automation for a government-based customer and other industry customers when they are asking us to automate their processes. We have even done it in the service sector especially the insurance sector where we are able to automate the claim processing process. There is another one, machine learning. We are working with a number of businesses in various industries to identify defective parts by capturing images via machine learning. I guess after multiple iterations in deep learning, we are able to come with 80% solution where we are able to detect defective parts coming out of the manufacturing plants. So, we are very excited about this RPA and machine learning projects, because that is something in which we see a huge traction in the future.

Sonakshi Sinha: What is the market scenario and what kind of growth we can see in the company in the next two years?

Niranjan Chintam: See, I do not want to project that out. We have been growing, both organically and inorganically in the last few years and I believe we will continue to grow in that fashion. But probably for next one or two quarters, like I was saying earlier, we may not see significant growth because what we are focused more on is to build up and get ready for the next phase of growth. If you followed some of the conversations that I have been saying, where I said we have built up this company with 100+ million revenue using a set of leaders, processes, and systems. Now we are gearing towards the next $300 million target that requires a complete new set of leaders, processes, and systems. That is what we are investing in and that is what we will be doing for the next two quarters. Once that is done, we will start seeing significant growth coming back.

Sonakshi Sinha: Sir, any new products in pipeline?

Niranjan Chintam: No, we do not have any products; we are not a product company. We develop platforms. Right now our IoT-based platform for the energy sector is getting a lot of traction. So that is an area where we are putting our focus on. And we will continue to build platforms which will help us in providing our customers with a faster solution.

Sonakshi Sinha: Lastly, any risks in this kind of business that you are in?

Niranjan Chintam: I am not aware, the biggest risk probably that everybody talks about is the US geographic concentration risk. But I do not see a big risk in that. Right now 82% of our revenue is coming from the US. Hence, we are trying to diversify into Europe as Europe is growing like I was saying earlier. So that is something that we can mitigate to an extent, but there will be a huge chunk coming from the US for sure.

Moderator: Thank you. Our next question is from the line of Abhijeet Avasthi, an individual investor. Please go ahead.

Abhijeet Avasthi: Thanks for the follow-up. I am new to the company, so I just wanted to get an idea of what are you thinking when you acquired new clients? I mean, you are a growing company, so does margin play a part in deciding the new client or is it just the scale part you are looking at? I know, it is a combination of both, but what will be the thing you are targeting, do you have any internal target that you see before acquiring a client.

Niranjan Chintam: So, I will let Karanjit answer because he does this day in and day out, these kinds of acquisitions. But primarily what we look at is the potential revenue that we could get from a customer.

Karanjit Singh: So, as Niranjan said, when we look at a client we look at the potential business that we can do with him over the next couple of years, so that is our primary driver. It does not mean that by default we will always go and drop our margin. We will obviously initially go in with our normal margin calculations. But based on potential, we may kind of adjust it as any business decision. The other thing that we possibly do not mind is selling it at a lower margin. Some of the newer areas that are exciting to us and will help us accelerate our capability. So, whatever Niranjan spoke about just now, like RPA or machine learning, now these are newer areas. Obviously, there are risks not outlined But in that case, the project size typically would be smaller, it would be a pilot, or it may be the first wave of whatever they are trying to do. And then of course you get into a relationship and sort of increase your footprint within the client.

Abhijeet Avasthi: And my last question is, is there any update on QIP you were talking about last year?

Niranjan Chintam: I do not have an update. We have stopped looking for a QIP, which is something that I have stated in the last few quarters. We are not actively looking for money. If somebody calls us, we are taking calls and talking to them, but we are not actively seeking money.

Moderator: Thank you. As there are no further questions, I now hand the conference over to Mr. Niranjan Chintam for closing comments.

Niranjan Chintam: Thank you, everybody, for getting on the call. Specifically, the people who come on line every quarter, really appreciate you coming on the call again and continuing to show faith in us. And, also the new comers that have joined the conference call. I would love to meet you in person, if given a chance for interaction. We had a great AGM after a long time. I can say this as there were interesting questions that came about and ofcourse the participation that has taken place in the last AGM was great. We were able to articulate all the way from how do we do selling to how do we hire, how do we market, and how do we retain customers. This had all the things that we talked about in the last AGM. I would love to have an opportunity to talk to more with you on a one-on-one basis or a group basis to tell our story and see how we do our selling and how we do our delivery. So, thank you again. Looking forward to seeing you in the next conference call or the earnings call or in person somewhere. If you happen to come to Hyderabad, I would love to meet you.

Moderator: Thank you very much, ladies & gentlemen. On behalf of Kellton Tech Solutions Limited, we conclude our conference for today. Thank you for joining us. And you may now disconnect your lines.