Kellton Tech Solutions Ltd
Earnings Conference Call
Feb 15, 2023

Moderator:

Ladies and gentlemen, hope you're having a good day. Welcome to the Q3 and FY23 Earnings Conference Call of Kellton Tech Solutions Limited. All participants will be in listen-only mode, and there will be an opportunity for each one of you to ask questions after the presentation concludes. Should you need any assistance during the conference call, please signal an operator by pressing "*," and tap on "0" on your touch-tone phone.

Before we begin, I'd like to add a short cautionary note. Some of the statements made in today's conference call may be forward-looking in nature. Such forward-looking statements are subject to risks and uncertainties that could lead to results different from what's anticipated. These statements would be based on management's beliefs and assumptions made from the information available currently. The audience is cautioned not to place any undue reliance on these statements while making any investment decisions. The purpose of today's earnings conference call aims to educate and build awareness about the company's fundamental business and the financial quarter under review.

Now, I'd like to introduce you to the management participating with us. We have Mr. Niranjan Chintam, Chairman and Whole-Time Director of Kellton Tech, Mr. Karanjit Singh, Chief Executive Officer (CEO) - India, and Mr. Srinivas Potluri, Chief Executive Officer (CEO) - the US. I now hand over the conference to Mr. Niranjan Chintam. Thank you. Over to you, sir!

Niranjan Chintam:

Good evening, everyone! Thank you for joining us today. We will begin with the financial highlights, followed by the operational highlights. Afterward, we would be delighted to address any queries you may have. Speaking of the financial highlights, our consolidated revenue stood at 231 crores with an EBITDA of 26 crores. With 16 crores of profit, the earnings per share were between 1.75-1.8 rupees. The revenue showed a 5.3% increase on a year-on-year basis and an approximately 2% increase on a quarter-on-quarter basis. Looking at the past nine months, we achieved a revenue of 676 crores, indicating nearly 6.6% year-on-year growth, with an EBITDA of 77 crores. The net profit was 49 crores, and the earnings per share were 5.39 rupees.

Coming to operational highlights, Kellton was recognized as a leader in Zinnov Zones ER&D 2022 report in the last quarter. This marks Kellton's first foray into ratings-related activities, and we are happy to inform you that we have scaled tremendously as a digital transformation company of choice. In other developments, we hired Vividh Baru as our Digital Practice Head and launched Elite, which is a new learning initiative for Kellton employees. I'd request Srinivas to explain what value Vividh brings to the table for Kellton and Karanjit to speak at length about the Elite initiative, respectively.

Srinivas Potluri:

Thank you, Niranjan, and good evening, everyone! I'm Srinivas Potluri, joining the Q3 FY23 call from the US. Vividh joined us in November 2022 as the SVP and Global Head of Digital Practice. He comes to Kellton from Harmon, a division of Samsung, and holds over 20 years of experience in delivering exceptional digital transformation results. His unwavering focus on driving customer-centricity, top-line, and bottom-line growth, client acquisitions, and operations makes him an ideal fit for Kellton. We aim to leverage his industry experience and his professional network to secure large accounts and deals. We have had planning sessions with Vividh in India as well as the US to figure out our market strategy in 2023 and land some large deals. Thank you, Niranjan. I would be pleased to add anything here if you wish.

Niranjan Chintam:

That concludes it well unless any questions arise later. Thank you, Srinivas. Now Karanjit, could you speak about Zinnov Zones recognizing us as a leader and what kind of impact it has on our organization as well as our customers?

Karanjit Singh:

Hello, everyone! I'm Karanjit, CEO of the Asia-Pacific region, and I'm based in Gurgaon, Haryana, India. As you all know, industry analysts assess many IT companies across various categories. For us, to get featured as a leader in Zinnov Zones ER&D 2023 under the small and medium service providers and in the leadership zone was a major accomplishment. We were featured with the likes of Cognizant, Infosys, and Persistent, which reflects our track record and the market maturity we built over the years. This was the first time we participated, and we were listed in the leadership zone straight. This was a major win, providing validation and comfort to customers regarding our capabilities. This will help in our growth journey and achieving the kind of growth we're targeting. We created a new learning initiative, ELITE, and modeled it as an internal TEDx for Kellton. Our entire crew of experts will come together to impact learning about various topics and address the questions later. This is aimed at sparking collaborative learning and knowledge-sharing among peers.

Niranjan Chintam:

Thank you, Karanjit! Operator, we are ready for questions. Could you for a queue, please?

Moderator:

We will now start the question-and-answer session. The first question is from Ankur Agrawal from RC Wealth Solutions. Please go ahead.

Ankur Agrawal:

So, there are two questions from my side. Firstly, why does the promoter reduce state from the last two years consecutively? And secondly, why were they not given any dividends?

Niranjan Chintam:

There was a one-time reduction, I believe, which happened last year during the COVID crisis. And I did explain at that time that the step was towards building some liquidity for the family and the corporation. We took that action for a specific purpose. The decrease in our shares is not due to any reduction in our shares but rather an effect of the employee stock options we issued. As these options were distributed proportionately, the number of shares outstanding reduced, but it wasn't a result of dilution.

Talking about the dividend, we did give out some, and then we wanted to preserve cash, given the uncertainty going on within the industry as well as the economy. We want to employ the cash internally towards growth objectives as opposed to distributing it outwardly. We will revisit our decision as necessary. We believe that the cash equation we have is positive, and we'd be happy to reallocate and provide dividends again. However, at this point, we'll wait until the economy is stable.

Moderator:

Thank you! We have our next question from the line of Purushotam Savlani, an individual investor. Please go ahead.

Purushotam Savlani:

I have a couple of questions. I keep track of mid-cap and small-cap IT organizations and the geographies they operate in. Despite ongoing discussions about a potential slowdown or recession, it's worth noting that your peer-level competitors have actually achieved impressive sales growth of approximately 25%. Our focus areas are digital transformation and enterprise solution consulting, and we aim to achieve nothing less than a 25% to 30% operating margin (OM), which is the industry norm. However, we have been delivering results similar to those of infrastructure services, staffing players, or business process services (BPS) providers. I want to understand where we face difficulties and how to improve our OM to meet industry standards. Additionally, I am interested in learning about the demand outlook for emerging technologies like blockchain and AI, particularly in India.

Niranjan Chintam:

I'll take up the first question, and Karanjit, as a technical expert, will answer the second question. You're correct that our growth hasn't been as great as our peers. However, it's important to consider that we've made significant changes along the way, such as implementing a major consolidation and reorganization of our business. These changes required us to take a pause last year and focus on our "One Kellton" initiative, which is now complete. So, although our absolute numbers may not reflect it, we have been making important strides in restructuring our company for future growth. We are nearing the end of our brand strategy overhaul, with the one Kellton initiative expected to be completed within the next quarter. Despite some headwinds in the global economy, particularly in Europe and the US, where growth is struggling, and inflation is rising, respectively, we believe that our restructuring efforts have put us in a strong position to achieve our goal of 20%-25% growth. While next year's growth projections are uncertain, we anticipate that we will begin to see growth again in the 2024 calendar year as we focus on leapfrogging ahead of the competition. Now, I'd request Karanjit to take over to answer the second part of your question regarding technology.

Purushotam Savlani:

Pardon me, but my first question regarding the struggling operating margin (OM) was related to the domains in which we operate - digital transformation and enterprise solution consulting. It is our belief that these domains should yield an OM of no less than 25%-30%, which is the industry norm. However, we have been delivering results similar to those of staffing companies, infrastructure services, and other similar organizations. While we can understand that the demerger and other factors have impacted sales growth, we are still left wondering why our OM percentage is so low compared to industry standards.

Niranjan Chintam:

Compared to our peers, our on-site and off-site delivery methods differ significantly. While most other companies tend to deliver primarily offshore, we have found that approximately 80% of our delivery, in terms of dollars, occurs in the US and Europe. This is largely due to the fact that we place a greater emphasis on on-site delivery. As a result of this approach, our operating margin levels have been lower than our peers. Although it has become somewhat challenging, given the size of our organization, we are making efforts to change our approach. This is where the One Kellton initiative comes into play. We have now established a global delivery model that leverages the benefits of low-cost centers like India and Poland. In the past, we had pockets of delivery and excellence in different geographic locations, but this new model enables us to focus our resources better. As a result of these changes, we anticipate seeing a jump in revenue and operating margins for 2023.

Purushotam Savlani:

Ok. So, we're saying that once we have these offshore centers, we'll be able to increase our margins by 25 percent?

Niranjan Chintam:

We have had those centers in place, but we were not leveraging them as effectively as we are now. We have completely changed our model, which should result in improved margins. While it may be an incremental process, we are confident we will eventually achieve the 25% target. Karanjit, could you now address the second part of the question regarding blockchain, AI, and more technologies?

Karanjit Singh:

If you've been on our previous calls, you might recall that we developed a comprehensive NFT-based platform utilizing blockchain and crypto technology, along with a crypto wallet, about a year ago. We have significant expertise in this area and a sizeable team that has been trained in various blockchain and crypto-related technologies. We have a couple of clients that are leveraging our capabilities and building on them. Moreover, we have created a platform that utilizes blockchain and NFT for rapid deployment and is available at an economical price. We continue to work in that area, but the market demand is currently low due to funding sentiment. As for AI, we often apply it to data engineering and work with customers to develop insights and personalized products for their customers. We have also been examining charge equity, which has recently gained a lot of excitement in the market. We are conducting internal initiatives, including a Hackathon, encouraging idea generation and problem-solving.

Niranjan Chintam:

Let me add to what Karanjit has said. We have worked with startups and developed blockchain platforms for NFTs. However, it has been a while since NFTs arrived on the scene, so we can repurpose the platform to provide other blockchain solutions to our customers. Our focus in AI is on extracting meaningful intelligence from the vast amount of data generated daily, which is exponentially increasing. We have built internal platforms to provide faster solutions to our customers and enable them to get meaningful information quickly. Our niche area in AI is on the data side, where we work extensively with our customers to provide solutions that extract insights from data. We have formed a hackathon to come up with industry-specific use cases and work with our customers to address their needs. While some use cases have been published above, we are trying to get more specific use cases within our customer base to provide meaningful solutions to them.

Purushotam Savlani:

I’m a new investor. So, all the information shared helps me understand what we are doing. Regarding India, I have a specific question about the demand outlook for blockchain and AI. How is the demand pipeline looking for India specifically? I understand there is demand for blockchain in Dubai and the US, but I'm curious about the situation in India.

Niranjan Chintam:

I guess I misunderstood the question there. Karanjit, could you please elaborate on the demand for blockchain technology in India?

Karanjit Singh:

To answer your question, the demand for blockchain in India hasn't been as high as we see in the US or Dubai. In India, most of the focus is on building digital products, essentially the whole digital-side mobility, and there isn't much demand for blockchain per se.

Moderator:

Thank you! We have our next question from the line of Bhowmik Shah, an individual investor. Please go ahead.

Bhowmik Shah:

I recall you mentioning the One Kellton initiative on a previous conference call. In today's call, you mentioned it again, stating that it's nearing the finish line and will be completely rolled out in one quarter. Could you clarify whether this means the current quarter ending in March or the first quarter of the next financial year?

Niranjan Chintam:

We're referring to the quarter ending this March.

Bhowmik Shah:

Once the initiative gets rolled out completely, how are we planning to leverage it to improve the company's overall performance? Can you elaborate?

Niranjan Chintam:

In the previous call, we discussed this initiative, and I believe Karanjit can provide more insights into it. Essentially, the initiative was aimed at breaking down the walls between the technology verticals and providing our customers with an expanded suite of digital solutions across geo lines. Now, everyone is on the same page and understands the full range of capabilities Kellton offers, allowing us to provide a complete bouquet of solutions to customers across the globe. This has benefitted not only the customers but also the employees, who can now grow within the Kellton organization with new roles available globally. This has led to renewed efforts in employee retention and career growth. The One Kellton initiative is all about doing what we said before and providing complete end-to-end solutions to our customers. Karanjit and Srinivas, if you have anything else to add, please do.

Srinivas Potluri:

I believe you covered the topic pretty well. The One Kellton initiative has three main objectives, as Niranjan stated earlier. Firstly, it promotes customer centricity by providing complete end-to-end solutions, incorporating a wider range of services. Secondly, it eliminates barriers to growth, such as geographical or business unit-based restrictions. Lastly, it offers employees consolidated opportunities for career advancement at a global level. These are the three key points we started with on the One Kellton journey to overcome any growth impediments.

Moderator:

Thank you! We have our next question from line of Rajesh Mundra from Anubhav. Please go ahead.

Rajesh Mundra:

Can you share your projected timeline for achieving revenue of 1500 crore rupees?

Niranjan Chintam:

I prefer not to give a specific timeline for achieving the revenue goal of 1500 crore rupees, Rajesh. While we are eager to reach that goal, our current focus is on smaller targets, similar to how cricketers work towards achieving their next set of runs. Our current target is to reach 100 million in revenue within the next three years organically. We are not actively seeking inorganic growth at this time. As we continue to build our capabilities, we will become more confident in pursuing larger customers and revenues. We are currently working on 10 million plus revenues, but we aim to reach 30 million plus per customer eventually. This requires pumping in significant investments in capital and leadership capabilities, creating a skilled workforce, and building the needed scale. We understand the importance of staying focused on smaller targets to avoid losing focus or being tempted to pursue unwise opportunities.

Moderator:

Thank you. The next question is from the line of Shahnawaz, an individual investor. Please go ahead.

Shahnawaz:

I have two questions to ask. I won't ask about when we will increase our bottom line because it has been flat for the last five quarters. My first question is about our cash flow health as of December. Can you tell me how much cash we have on hand? And my second question is about our order book as of December 31st. What is the current status?

Niranjan Chintam:

I will address the second question first and wait to answer the first question until later. I need to gather the necessary data from the team. In regards to the order book, we typically have 8 to 9 months' worth of orders, which equates to approximately 800-900 crores in revenue for this year. This means that three-quarters of our revenue for the year comes from the order book. I will answer your first question once my team provides me with cash numbers.

Shahnawaz:

May I ask an additional question? During your presentation, you mentioned that we have a higher ratio of field employees than off-field employees, which is why we are experiencing pressure on the PAT. I would like to know how the employee ratio has changed from the previous year to now and what is the current total strength of our workforce. Additionally, I am curious if you have any forward guidance on hiring practices, particularly during this period of economic slowdown. I have read in the news about companies like Facebook, Google, and Amazon tracking people, and I am wondering if Kellton will be hiring similarly. I would also like to know the current employee ratio between the US and India and how you plan to adjust this in the future. As an investor, I am interested in seeing the share price rise, and this can only happen when the bottom line improves. I am sure everyone on the call is eager to understand how this will be achieved. In a recent call I attended for Axis Caps, they stated their intention to improve their EBITDA margin by 440 to 500 basis points over the next two to three years. Do we have a similar commitment or target?

Niranjan Chintam:

Certainly. First, regarding the number of employees, we currently have over 1800, with 1400 based in India and the remaining 400 spread across the globe. Of those, 400 are in the US, with others in Europe and Asia Pacific. As for hiring, we are selective and currently have around 200 open positions. We are listening to industry needs and customer feedback, with a focus on initiatives that are showing promise and avoiding those that may slow down. We are actively recruiting, but I don't have an exact number to provide at this time. Our goal is to achieve an EBITA of around 20% by FY 2024, and while we are experiencing growth in India, employee costs have risen, putting pressure on margins. We are monitoring the industry and being cautious in our hiring and growth strategies.

Shahnawaz:

How do you see Q4 performing, given that we are currently in the middle of February?

Niranjan Chintam:

I'm afraid I cannot disclose the information as it could potentially lead to some troubles.

Moderator:

Thank you. Nikita Bansal, an individual investor, is next on the line. Please go ahead.

Nikita Bansal:

I have two questions. Firstly, can you provide an update on how your Europe strategy is progressing? Secondly, in a previous discussion, you mentioned plans to write off goodwill and reduce the size of the balance sheet. Have you determined a course of action for this?

Niranjan Chintam:

Let me begin by addressing your first question about our Europe strategy. It was a challenging year for us in Europe, but we've recently made some leadership changes that we believe will improve our performance moving forward. Our goal is to continue to grow in Europe, but 2023 will likely be a difficult year for us. However, we anticipate that starting in 2024, we will be on a growth trajectory again after changing our strategy due to some unsuccessful initiatives last year. Regarding the second question about our balance sheet, we face this challenge every year. We're trying to come up with a strategy to deal with the heavy weight of goodwill on our balance sheet as well as its bloated size. We've brought in a consultant to help us explore our options. We're actively discussing the possibility of a one-time write-off of goodwill or other items on the balance sheet that is causing the bloat. We're also working with our CPAs worldwide to determine what we can do without causing any significant issues with our existing banking relationships. Our plan is to make a decision within the next month or two, and we're leaning heavily toward taking a one-time hit on the balance sheet to reduce its size. We want to do this below the line so it doesn't impact our income statement, but we're still exploring all of our options. Our consultants have been providing us with different scenarios, and we'll make the final decision soon. We believe this will help us improve our ratios, such as ROE and ROCE, and set us up for better performance in the coming years. So, please stay tuned, and we'll keep you informed of our progress.

Moderator:

Thank you. We have our next question from the line of Sanjay K, an individual investor. Please go ahead.

Sanjay K:

Let me first address your question about the Kellton initiative, which is now almost at the end of its cycle. Despite this being a revolutionary quarter for our IT company, the revenue has only increased by 2%, and the bottom line remains almost the same. While I understand your curiosity, I cannot disclose exact figures for confidentiality reasons. However, are you indicating that Q4 and Q1 of next year will perform better than Q3 in terms of revenue and bottom line?

Niranjan Chintam:

Typically, Q3 is not a favorable quarter for us due to the slowdown in the US and Europe and the number of holidays during the end of the year. Regarding margins, we conducted a standard appraisal cycle for all employees in January, and salaries have increased, which will impact this quarter. However, I cannot give any guidance on margins without getting into trouble. From a numbers perspective, I predict that margins will be roughly the same due to the rise in labor costs. Srini and Karanjit have tasked salespeople with increasing bill rates, which is still a work in progress. It will take time to see margin improvements, but Q1 of next year is when we should start seeing results. It has nothing to do with the One Kellton initiative and more to do with the cycle of salary appraisals and the willingness of customers to pay more in the current economic climate.

Sanjay K:

I have a follow-up question. You mentioned the annual appraisals for this quarter, but I was wondering if you are facing any hiring pressures and how many hires you typically make in a year.

Niranjan Chintam:

Regarding the question about hiring pressures, the salary appraisals have already taken place in January. As for the number of fresher hires this year, I will defer to Karanjit to provide that information. However, last year, we hired over 100 freshers. Karanjit, could you give an update on our hiring plans for this year?

Karanjit Singh:

As Niranjan mentioned earlier, we hired more than usual last year, with almost 150 new hires. We're currently in the process of absorbing them into various projects. As for this year, our plan is to hire between 50 and 75 new employees, with the exact number depending on how things progress throughout the year.

Sanjay K:

In previous quarters, there has been a press release that includes information about wins and highlights of the quarter, but I haven't seen one for the last quarter. I'm wondering if there were any significant order wins in the last quarter compared to Q2 and how the business is looking overall.

Niranjan Chintam:

I believe our team overlooked including the number of new customers added last quarter in the PR. We had seven new customers in total. However, the last quarter is typically not an optimal time to acquire new customers, as activity tends to slow down from November and pick up again in February. We expect business to start picking up this quarter compared to the previous one.

Sanjay K:

My understanding is that you are seeing consistent growth in our company. While the share price is not under our control, I'm curious to know if you're planning any discussions or investor meetings to increase coverage from an investor and analyst perspective.

Niranjan Chintam:

We used to have multiple analyst meetings before COVID-19, but we have not had any since then. However, we do plan to resume these meetings and get more external validation for our company. One of the initiatives we're working on is getting ratings and analysts from companies like Senova. Now that travel restrictions are easing, we plan to actively participate in marketing-related PR agencies and other activities to increase investor coverage. Several initiatives were planned for this year that we had stopped over the last 2-3 years, and we will be restarting those soon.

Moderator:

Thank you. Our next question is from the line of Debidatta Gouda, an individual investor.

Debidatta Gouda:

Based on your information, I understand that you read our annual report and noticed that we are projected to reach $200 million in revenue soon, but you believe it may take longer than expected. You also mentioned that despite gaining new clients every quarter, our revenue had not increased much in the last 3-4 years, and you wonder if we have any repeat customers or if clients are switching from us to other companies.

Niranjan Chintam:

Our primary focus is to increase revenue from existing customers, as 80% of our revenue comes from them. We aim to increase the per-customer revenue from X to Y or 2X. We are working on customer-based marketing initiatives and have categorized our customers into different buckets to identify where we can generate more revenue. We are actively pushing to increase revenue from existing customers through aggressive client-based marketing. In addition to that, we are looking at new customers, but it takes six months to a year to get significant revenue from them. Therefore, we are focusing on existing customers first as it is easier to sell to them. Srini, Vivid, and Karanjit are leading the renewed emphasis and focus to increase per-customer revenue from X to 2X. Though we aim to reach $200 million in revenue soon, we are taking steps to increase revenue from existing customers and identify potential new customers.

Moderator:

Thank you. As there are no further questions, I hand over the call to the management for closing comments.

Niranjan Chintam:

Thank you all for joining us on our Q3 earnings call. We look forward to speaking with you again in the future, and if you happen to be in Hyderabad or Gurgaon, please feel free to visit us and learn more about our company and our employees. We appreciate your ongoing interest in Kellton and ask for your patience as we work to improve. We are confident that we will see better results starting in Q1 of next year. Thank you once again.

Moderator:

Thank you on behalf of Kellton Tech Solutions Limited. The conference call concludes now. You may disconnect your lines.