“Quick Heal Technologies Q3 FY21 Earnings Conference Call”

February 4, 2021

MANAGEMENT: **MR. KAILASH KATKAR – MANAGING DIRECTOR & CEO**
MR. SANJAY KATKAR – JOINT MANAGING DIRECTOR & CTO
MR. NITIN KULKARNI – CFO

Moderator: Ladies and gentlemen good day and welcome to the Quick Heal Technologies Limited Q3 FY21 Earnings Conference. We have with us from the management Mr. Kailash Katkar – Managing Director & CEO, Mr. Sanjay Katkar – Joint Managing Director & CTO, Mr. Nitin Kulkarni – Chief Financial Officer.

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. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Nitin Kulkarni from Quick Heal Technologies Limited. Thank you and over to you Sir.

Nitin Kulkarni: Thank you Lisa. Hello and good evening everyone. I am pleased to welcome you all to our earnings call to discuss our Q3 FY21 and 9MFY21 results. Please note a copy of all our disclosures are available on the investor section of our website, as well as Stock exchanges. Please note anything said on this call which reflects our outlook for the future on which could be construed as a forward-looking statement must be reviewed in conjunction with the risk that the company faces.

Let me now handover the floor to our MD and CEO – Mr. Kailash Katkar to talk about major developments and key initiatives. Over to you Kailash.

Kailash Katkar: Thank you Nitin. Good evening Ladies and Gentlemen. Thanks for joining us today to discuss the Quick Heal Technology financial result for Q3 and 9 months. I would like to take this opportunity to update you about the key developments for the quarter. We delivered good revenue performance in the third quarter; Nitin will cover our financial performance in detail in his commentary.

On the R&D front we have accelerated our new product development efforts, we are working on new innovations that will help us to capture a bigger share in the enterprise segment in coming future. On the M&A side, we have signed definitive agreement to make additional investment of $ 2 million USD in L7 Defense, an Israel based cyber security company. In the last financial year, we made an initial investment of $ 300,000 USD in L7 Defense, since then L7 Defense has proven its unique capability in the area of API security and next generation web application firewall, which led us to further increase our investment. This investment reiterates Quick Heal's commitment to invest in destructive technology and shape the future of cybersecurity while supporting innovative startups.

I will let Sanjay discuss this in detail. Over to you Sanjay.

Sanjay Katkar: Thanks Kailash. Good evening everyone. Kailash just mentioned our investment into L7 Defense, I would like to provide a further update on how the company is doing. So, L7 has two products, API (Application Program Interface) Security and Next Gen Web Application Firewall and both the products have been deployed by in US and European markets. According to Gartner, by 2021 90% of web enabled applications will be exposed to attack due to API weaknesses and therefore API Security has become one of the top security concerns for enterprises. Now, when you talk about expected synergies, Quick Heal will facilitate L7's entry into India and other countries in APAC and MENA region, whereas the investment will enable Seqrite foray into application security, strengthening our solutions stack for enterprise customers.

On the product front ICSA Labs and AV Test have been testing our products on a regular basis and I am happy to inform that our products continue to feature at par with the protection and performance provided by global players.

Coming to the trends in cybersecurity market, most of 2020 infiltration attempts see a noticeable shift on a newer attack surface formed due to remote working model and changing modus operandi of business worldwide. At Seqrite we observe that the total number of malware attacks dropped by 35 million compared to 2019 but this mainly due to reduction in threats like Adware and PUA that are the least harmful in nature. Simultaneously dangerous threats like Trojan, ransomware and infectors have also escalated further, primarily because of new vulnerabilities that have popped up due to work from home and virtual learning culture. We believe the trend of lower less detrimental attacks and higher targeted dangerous attack will continue in 2021.

Now I would like to conclude my remarks by stating that demand will continue to remain strong for security products and solutions as we become more and more reliable on digital infrastructure to solve our day to day needs such as being connected to work remotely, digital learning and payments. I would like to handover the floor to our CFO Mr. Nitin Kulkarni to discuss our financial performance with you.

Nitin Kulkarni: Thank you Sanjay. Let me take you through the Financial Highlights for the Third Quarter and Nine Months ended December 31, 2020.

As Kailash mentioned in his opening remarks, traditionally Q3 has always been a weak quarter for us but still we are able to deliver good growth in Q3 FY21. In Q3 our consolidated revenue from Operations grew by 6.3% to Rs. 699 million compared to Rs. 657 million in Q3 of last year, driven by strong growth in the enterprise business and higher renewal rate on consumer segment. 77% of our revenue for the quarter came from the retail segment, whereas 23% came from enterprise and government segment. Enterprise segments contribution this quarter has been higher compared to quarterly average of 20%, this is because enterprise business has seen a robust 18% YoY growth in licenses and 19% YoY growth in revenue this quarter. The growth in the enterprise segment imitates the starting of recovery of Indian economy from the pandemic and slowly things coming back to normalcy.

So, we are confident to continue this growth trajectory in the coming future while the economy continues to recover. EBITDA for the quarter was down 29% YoY at Rs. 165 million compared to Rs. 232 million in Q3 of last year. With economy slowly recovering, we increase our investments in advertisements and continued focus on R&D innovations have affected our margins for the quarter. This quarter we launched advertising campaign which increased our overall selling and marketing expenses, while employee benefit cost was up due to mix of increased head count, change in pyramid structure of organization and higher outsourcing cost, coupled with annual increments which were effective from 1st October 2020. PAT for the quarter stood at Rs. 135 million, down 24.3% YoY, PAT margin was at 19.3%. PAT for the quarter was also affected due to lower other income because of lower returns on our mutual fund investments compared to last year.

For nine-month financial year 2020 consolidated revenue was at Rs. 2,278 million, up 2.6% compared to Rs. 2,219 million for the same period last year. For the nine months of this year 81.5% revenue came from retail and 18.5% from enterprise. EBITDA for nine months was at Rs. 877 million versus Rs. 838 million in last year. Due to higher operating cost in Q3 for the reasons mentioned above, we were able to deliver marginal 4.6 % YoY growth in EBITDA. Our G&A cost remains lower compared to last year, mainly due to the reversal of the doubtful debt of around 20 million upon collection in the previous quarter and higher G&A expenses last year due to buyback expenses of Rs. 20 million. Even though now G&A cost is lower for nine months but with business activity coming back to pre-COVID levels, we expect some of the variable costs may increase slightly in coming quarters. Our EBITDA margins continue to remain strong at 38.5% for nine months, versus 37.8% in last year nine months. PAT was at Rs. 673 million, versus Rs. 664 million. PAT margins for nine months were 29.5% versus 29.9% in last year.

Licenses sold in the retail segment during the nine months were up 19.3% compared to nine months of last year. While the revenue from the retail segment is up only 8.6% YoY. This is primarily on account of change in the product mix and on account of higher demand for lower price products observed during the last few months. On enterprise side, licenses sold during nine months were down 4.4% YoY, while revenue for nine-month were almost flat compared to last year, mainly on account of higher price realization. We notice the green shoots of the demand recovery on the enterprise side in the Q2 with economic growth bottoming out, while Q3 saw a good demand in line with economic recovery.

Now coming back to balance sheet items, due to better working capital management the overall net working capital days have come down to 77 days versus 108 days in December 2019. The lower working capital days was the result of the drop-in receivable days from 143 days to 127 days. This is in line with our commentary during the previous conference calls where we have noted that the rise in receivable days was due to sudden stress in economy and specifically in the MSME sector because of lockdown and pandemic and we have pointed out that this will normalize once business activity gets back to normal. We will continue to maintain our financial discipline and expect the debtor days to remain around 130-135 range level.

Our current cash and cash equivalent stand at around Rs. 4,787 million including investments in mutual funds, tax free bonds and fixed deposits. I would like to highlight that again that we were cautiously looking for opportunity to better utilize the cash on our balance sheet. On the M&A we again remain very cautious and calibrated in our investments and we are looking at smaller and medium size investments. Our current investment in L7 is a testament of the same. We continue to monitor the progress of our investee companies and we are satisfied with the progress so far.

To sum up we expect the demand environment on the enterprise side to remain good and supported by higher business activity and sharp economic recovery. Demand for the consumer segment will be aided by strong demand for PCs and laptops due to work from home and virtual learning trend. Overall business activity has started coming back to pre-COVID levels and we are confident to end this year on a positive note. With this now we will open the floor for questions. Thank you.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question-and-answer session. The first question is from the line of Ankush Balani from AD Capital Advisors. Please go ahead.

Ankush Balani: Sir I have a few questions, first question, as a percentage of revenue, what is the total advertisement and R&D cost for nine months?

Nitin Kulkarni: So, if you look at R&D cost for the quarter it was at 21% and sales and marketing cost which includes advertising and other sales and marketing related activities which was about 32% for the quarter.

Ankush Balani: And for the nine months sir?

Nitin Kulkarni: So, nine months R&D cost was about 20.27% and sales and marketing cost which including advertisement was at 21.72%.

Ankush Balani: What kind of percentage as a revenue do you expect in FY 22, for next financial year, considering the situation would be more normalized?

Nitin Kulkarni: Correct, so things have come back to normal and on R&D side we have been saying in last few calls that since we are working on new products, we are making lot of investment in R&D and as a result of that we expect the R&D cost to remain in the range of 20-22% and sales and marketing cost on an annual basis would be in the 20-23% range.

Ankush Balani: Okay sir that was helpful. And what is the current revenue through online sales for Q3 and nine months?

Nitin Kulkarni: So, if you look at, online sales which includes sale on our website as well as sale through e-commerce portals, it is about 26% at YDT level.

Ankush Balani: This is for Q3?

Nitin Kulkarni: Q3 was about 23% and if you look at nine months it is 25-26%.

Ankush Balani: Okay sir and what kind of margins are there on online sales, is it similar to the retail ones?

Nitin Kulkarni: These are more or less similar margins.

Ankush Balani: Okay, sir want to understand the penetration of Quick Heal products in the market and how much market share do we hold and who are the closest competitors in this segment currently, domestically?

Sanjay Katkar: We do not have definite data but what we have analysed over the period of couple of years and looking at lot of other information that is available around, in retail we have more than 30% of market share and in SMB we are less than 10%, in large enterprises we do not have big market share but we have started getting good customers after we launched good enough scale products. But at the same time we are focussing to increase our market share in SMB as well as large enterprises that is where our investment into new products is going in.

Ankush Balani: Actually, I am asking do we have pricing power in the market in the retail segment where we hold almost 30% market share?

Nitin Kulkarni: So, for pricing there are various factors, so we cannot say it as a pricing power but since we hold more than 30% market share and we have variety of products in the retail segment, yes, we command pricing but there are various factors and pricing depends on many factors, so it is very difficult to generalize this statement.

Sanjay Katkar: So, across India we can say market is divided among different price segment, so Quick Heal is the only product in Anti-Virus that is available in all the price points actually. If we see from the lowest to the top end product like Total Security, we have almost four different products in the different price range and almost all of these four products have good enough market share and price point and all that depends on the market response because many a times some new competitor or any of the competitor might launch a product scheme which can disturb the market and that is how those things are addressed, as and when things happen actually, so these are more dynamic in nature.

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

Mayank Babla: I had a question, so following up with all the IT companies results, the cybersecurity demand has shot up massively in the last 9 months, so taking cues from that I am wondering sir why our company's growth is in mid-single digits, should it not be in high double digits and what are we doing to propel this sort of double-digit growth?

Sanjay Katkar: Yes, rightly said but you have to look at the cybersecurity market in all different areas. Quick heal is primarily into consumer retail as well as we have products on the SMB. So I will say products that are there in the market are targeting the customers who had really got impacted in the pandemic. Very large enterprises and mid-size organizations are the ones who have been still spending on cybersecurity for the work from home culture and making sure that their IT infra is up and running. And we have been launching products on those fronts of large enterprises. So more than 80% of our revenue comes from the market which was impacted by the pandemic. SMBs is something that contributes more than 80% of our enterprise revenues and retail is almost 80% of our total revenue, so that is where we saw the impact actually.

Kailash Katkar: I just wanted to add one more point here, but of course, yes when it comes to the cyber security demand in this Pandemic situation, which has definitely gone high but there is a lot of cash flow challenges in the market and without having a proper purchase order or a proper documentation, we just cannot keep on selling the product without having a confirmation from the partners or the customers. So, there is a lot of cash challenges in the market, even with the government, they have cash challenges.

Moderator: Thank you Sir. We will take the next question from the line of Jay Ganesh, an individual investor. Please go ahead.

Jay Ganesh: So, my question is regarding, we have added one customer in this quarter, about more than 5000 user bases, If I am right, so can you please highlight on that and what steps are we taking to get these kinds of customers in future.

Nitin Kulkarni: Yes, so we have added one customer in enterprise segment which is for more than 5000 end points, we will not be able to disclose the name but there are lot of efforts that have been made and we have been talking to mid and large customers in last few quarters and since things have started coming back to normalcy, we definitely hope to add few more names in quarters to come. We are continuously talking to the customers as things are slowly getting back to normal situation, we hope that we will be able to add few more customers in coming quarters.

Jay Ganesh: We have a 30% retail market share, right? So, if you, say about license base, so what will be the life span of that license we sell, maybe average of the license span

Nitin Kulkarni: So you are talking about average realization per unit or ...?

Jay Ganesh: No, average life span of the license, I am saying.

Nitin Kulkarni: So, it is one year, three years, five years. We have various products, but it is mostly one year and three years.

Jay Ganesh: Okay and final question will be regarding this Ad spend, so I think as economy is recovering right, so this is a good time to spend more on Ads spend also, so what is your strategy?

Nitin Kulkarni: Yes. I think now things have started coming back to normalcy, we are also seeing uptake in economy, so it is a right time where we should make the investment whereby, we can get benefits in subsequent period, so it is a right time for that.

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

Mayank Babla: Extremely sorry Sir. I got disconnected earlier. The part B of my question was that can you give us a timeline of the new product launches, by when can we expect the new products to be launched?

Kailash Katkar: Almost three to four quarters, actually.

Nitin Kulkarni: So, see work is going on, on development of new products and so far the progress is good. So, products will be ready in the next three to four quarters and after that, it will take some time to monetize these products. So, if you have to take any kind of estimated timeline from a revenue perspective, it will be more than a year, maybe one to two years.

Mayank Babla: Okay, sure Sir. And my second question is, if you could throw a little more colour on this L7 Defence, so this would be in the enterprise or retail segment and what are the plans going ahead with this acquisition?

Sanjay Katkar: Yes, so L7 particularly is in a large enterprise segment, it caters the API security market and web application Firewall for the next generation. So particularly, organisations having large network and cloud presence and lot of customers, so that is the market we are focusing actually and it is pretty new and disruptive technology we have, it is like addressing completely new challenge and in a completely new way using AI. We are very bullish about the product's potential in this API security market.

Moderator: Thank you, we will move on to the next question, that is from the line of Gautam from Nine Rivers Capital Please go ahead.

Gautam: Good afternoon sir, good to see the company investing more in R&D. My question was on the sales strategy, do we see some opportunities for marketing channels like hardware bunding or bunding with ISTs, Telcos and as well as the large consultant systematic data on the security side, so is that something that we are pursuing and where are we on that, some colour there, is that relevant to us?

Sanjay Katkar: Yes, we are exploring those opportunities. It depends on product mix actually, particularly for consumer we do not feel the need because it is a very low cost market if we go with any kind of telecom vendor or an OEM because we already have a very good presence across India with the right price point that we demand actually. But in terms of other product mix like mobile or even for enterprise products like EMM and all, we are exploring those opportunities and at small pockets we are getting orders on those lines as well but it is not a very large opportunity as such, but yes, we are exploring them actually.

Gautam: Sir around the FI consultant side, is that a big challenge for our kind of products? SMBs would be more vendor driven, I assume but when you get into the large enterprises.

Sanjay Katkar: Yes right, so for large enterprises in fact, it is a completely different product mix that they look at and end point security, our product, is doing very well in that market. At the same time, we are focusing on our other products as well, which started giving good revenues like EMM as well as this L7 defence products that we have started demonstrating and doing TOCs with our customers, as well as we are trying to plan a solution with a combination of multiple products. So, this is what our team has been exploring.

Gautam: Sir last question, if I may? I remember we are on the GEMS platform, anything you can tell us about the response from that platform.

Sanjay Katkar: So currently GEMS we are there, in fact almost 80% of the partners on GEMS are pitching our product for different government department but at the same time what we have observed is, on government side spending on cyber security, importance is being shown but at the current gesture the spending is not there because of liquidity crunch or slower decision making on those front. But we have started seeing interest coming back in this quarter and we hope to get some good government orders in this quarter.

Moderator: Thank you. The next question is from the line of Ankush Balani from AD Capital Advisors. Please go ahead.

Ankush Balani: I wanted to understand what is the main reason for decrease in EBITDA this quarter?

Nitin Kulkarni: Yes, so as I said in my opening remarks since economy has started coming back to normalcy, we are also seeing quite an uptake in a revenue traction. So, we have launched some advertising campaigns during the quarter, this was more from a sales and marketing and that is the main reason for increase in cost. Plus additionally we also have hired few resources on R&D side, which we have been saying that since we are working on new product development, we will be investing a lot in R&D and slowly on sales side also. So, main reason for reduction in EBITDA is this advertising cost and basically increase in employee cost. These are the two main reasons.

Ankush Balani: Okay sir can it also be attributable to any change in product mix for this quarter?

Nitin Kulkarni: No, not really. So, I think anyways we have shown growth in this quarter if you compare it with last year Q3, so no impact on product mix. Margin is impacted purely because if these two cost reasons which I just mentioned.

Ankush Balani: And sir what kind of growth do you expect in the enterprise segment, considering this strong quarter by enterprise, in coming year like FY22 and 23?

Nitin Kulkarni: See we do not give any guidance, but the way things are today after Q1, Q2 we definitely have seen a lot of uptake in enterprise segment which is evident in our quarterly numbers also and we see a lot of positivity in Q4, so definitely we would like to show higher growth in enterprise segment but at this point of time putting a number would be difficult but we are targeting growth in enterprise segments.

Ankush Balani: Okay sir and what kind of revenue mix do you wish to attain in the future to get improved margins?

Nitin Kulkarni: See margin is a different point but if you ask for company aspiration, which we also said in our earlier calls, maybe 4-5 years down the line we would like to be at 50-50%; at enterprise 50 and retail 50 that is something which is our aspiration.

Ankush Balani: Okay sir and just sir last question you have a good cash in your books, so, any plans for further acquisitions in coming year or any dividend payment?

Nitin Kulkarni: Yes, we have been definitely looking at few target companies for M&A and the only thing in M&A there are lot of variables, We have to get right candidate which fits into our corporate and business philosophy and we have been looking at few target companiesand in last one year we invested in Ray Pte as well as L7. And depending on the opportunity, we will be further investing into this.

Ankush Balani: Okay and any plans for dividend in coming period?

Nitin Kulkarni: Dividend decision will be purely taken by Board members. Board will see organic and inorganic opportunity requirement for the company and given that we are just getting out of the COVID-19 situation, we also have to keep some flexibility on cash and we have to also conserve some cash. So after considering all these points Board will take an appropriate decision and we will go by that.

Moderator: Thank you. The next question is from the line of Monika Arora from Share Joint Wealth Advisors. Please go ahead.

Monika Arora: My question is more from the industry point of view, so I wanted to know that how do you see the retail market for Anti-viruses in India and do you really feel that we have space to grow in the retail anti-virus market in India?

Sanjay Katkar: I think yes, at least we are quite bullish on retail market and looking at the changes, the pandemic has brought in, there is lot of increase in the use of technology and everybody has to have their own laptops and connectivity and also internet has taken a very prime position. So I feel there is still good enough market for retail, and it will still grow at least in upper single digit figure.

Monika Arora: Okay and sir what is the approximate overall size of the cybersecurity market in India and how much proportion of that do you feel that our company can capture?

Nitin Kulkarni: See if you look at our investor presentation based on the DSCI report, I think we have captured information from there and overall cybersecurity market by 2022 it will be $ 3 billion and out of $ 3 billion, $ 1.6 billion is for cybersecurity products and rest for services. So, this is about India based on the available database.

Sanjay Katkar: It depends on the product mix actually, because on retail front we are catering with almost everything except VPN and all but on enterprise segment there is a huge range of products which we are still yet to cover. We just cover end point security and gateway securities for SMBs and on the mobility front we have a product. But on enterprise front, cybersecurity market also includes lot of other products based on data privacy and DLT and even the Data Centre security and there are so many different verticals where the security products are different, so all this is counted in that $1.6 billion.

Nitin Kulkarni: So, the point is $ 1.6 billion the number that I mentioned by 2022 is overall cybersecurity product market, so this is what is the potential, we may not be available in all these segments at this stage but this is what is a number which is potential cybersecurity market.

Monika Arora: Okay and is there any number available for especially L7 products like what is the current market size and what is the potential?

Nitin Kulkarni: So, L7 I think it is quite a niche product and as market size, a big market is available.

Sanjay Katkar: It is a totally new technology and first of its kind technology. We will be creating a market for the product; it is not replacing existing products, but it is going to be addressing a challenge in a different way and so, we can look at the market at Next Gen Firewall or API Security. But this is something that can be the base. So, the current market size is about $ 1.2 billion USD which is a global market, which is growing and is expected to grow to $ 5 billion by 2023.

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

Nitin Kulkarni: I thank everyone for attending the call, hope we have been able to address all your queries, in case if you need any further information, you can get in touch with E&Y who is our Investor Relations advisor. Thank you very much for attending the call. Thank you.

Moderator: Thank you. Ladies and gentlemen on behalf of Quick Heal Technologies Ltd. That concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.

The transcript has been edited for reading purpose.

Contact details:

Registered Address: Marvel Edge, 7th Floor,

Office No.7010 C&D, Viman Nagar,

Pune, Maharashtra, 411014

Email: cs@quickheal.co.in; info@quickheal.com

Website: www.quickheal.com

CIN: L72200MH1995PLC091408