"Quick Heal Technologies Limited
Q3 FY2020 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, good day and welcome to the Quick Heal Technologies Limited Q3 FY2020 Earnings Conference Call. We have with us today from the management, Mr. Kailash Katkar, Managing Director and 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 – Chief Financial Officer. Thank you and over to you!

Nitin Kulkarni: Thank you, Steven. I am pleased to welcome you all to our Earnings call to discuss our Q3 and 9M FY 2020 earnings 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, or which could be construed as a forward-looking statement must be reviewed in conjunction with the risks that the company faces. Let me now hand over the floor to our MD and CEO, Mr. Kailash Katkar to talk about major developments and key initiatives for this quarter. Over to you, Kailash!

Kailash Katkar: Thank you, Nitin. Good evening, ladies and gentlemen. Thanks for joining us today to discuss the Quick Heal Technologies Limited financial results for Q3 and 9M FY 2020. I would like to take this opportunity to update you about the major developments and initiatives for the quarter.

We have started to develop and strengthen our human capital. We have CHRO Ms. Reetu Raina who has joined us this quarter & who will be responsible for driving the HR function and steering the company's people, operations, culture and recruitment initiatives. On the same lines, we are adding a few experienced people at the senior management level to focus on specific business functions as well as to devise a long-term strategy and growth path for the company. We hope to complete some of these key hiring in the coming quarters. This quarter we have been recognized as a 'Cyber Security Product Pioneer in India' by NASSCOM DSCI. This is a testimony to our commitment & it reaffirms our position as a domain- leading cyber security company in India.

We completed our investment in Israel based company L7 Defense recently and are pleased with the progress so far. We are also looking at a few more inorganic opportunities to drive our business growth. I will let Sanjay speak on this in detail.

Finally, I am happy to inform you that the Custom Excise Service Tax Appellate Tribunal (CESTAT) has set aside service demand issued by the Additional Director General

Commissioner of Service Tax, Delhi, on Quick Heal Technologies Limited. Nitin will explain more on the same. I would now handover the floor to our CTO. Over to you, Sanjay!

Sanjay Katkar: Thanks, Kailash. Good evening, everyone. Q3 and 9M performance has been muted as we continue to see pricing pressure in the market due to overall slowdown in the economy which has dampened consumer sentiments as well as challenges faced on the distribution side. Even though we see some sluggishness in the market, cyber attacks continue to grow in scale and sophistication along with the rapid digital adoption in India. So, Quick Heal detected around 1.1 billion windows malwares in 2019 which is up +11% as compared to 973 million detections made in 2018.

On enterprise side, 2019 ended with a staggering 48% increase in Malware as compared to 2018 and the threat trend does not show any sign of slowing down and therefore I reiterate that we believe that the market slow down can impact only to the level of delayed decisions on cyber security products purchases and the overall demand for cyber security products and solutions will still be there in long-term. We see cyber security needs permeating all users given the rise in Internet penetration, growth in connected devices and an overall greater move to transacting digitally.

To elaborate more on inorganic opportunities as Kailash mentioned, even though we are actively looking for opportunities in the cyber security space and the investment in L7 Defense is a testament to the same, we want to highlight that we remain cautious and calibrated in our approach. This is a time-consuming process and too many discussions do not result into a transaction. So, Quick Heal adheres to very high standards of technological practices in our domain and evaluate every opportunity at such high standards. So, we also need to invest significant time and research in valuating and testing solutions and their applicability in an Indian context and with respect to in combination with our products. So, all of which makes us very conservative in our approach. We will continue to evaluate opportunities and make announcements as and when relevant. With this, I now hand over the floor to Mr. Nitin Kulkarni, our CFO for his comment on the financial performance.

Nitin Kulkarni: Thank you Kailash and Sanjay and good evening to all of you. Let me take you through the financial highlights for the third quarter and nine months ended December 31, 2019.

I will start with 9M FY20, Consolidated revenue from operations stood at INR 2,219 million, down 3.1% as compared to INR 2,289 million in 9M FY19. Our EBITDA stood at INR 838 million down 6.1% compared to INR 892 million in 9MFY19. EBITDA margins were slightly down at 37.8% as compared to 39% in 9MFY19. PAT for nine months stood at INR 664 Million up 3.7% compared to INR 641 million in 9MFY19. PAT margin stood at 29.9%, up ~190 bps from 28% in 9MFY19.

For the quarter, consolidated revenue from operations stood at INR 657 million slightly down as compared to INR 667 million in Q3FY19. In terms of segmental performance, the retail segment revenues for the quarters stood at INR 540 million slightly lower than INR 545 million in Q3FY19.

Our enterprise segment registered a revenue of INR 151 million slightly lower as compared to INR 155 million in Q3FY19. EBITDA for the quarter stood at INR 232 million up 12% compared to INR 207 million in Q3FY19. EBITDA margins for the quarter stood at 35.4%, up ~430 bps compared to the same period last year. Net profit for the quarter stood at INR 178 million up 12% as compared to INR 159 million in Q3FY19. PAT margins stood at 27.1%, margin is up by ~330 bps from the same period last year.

As Sanjay mentioned earlier that the overall revenue is muted for this quarter and nine months due to slow down in the economy and the challenges faced on distribution which has resulted in lower number of licenses sold this quarter. But despite degrowth in licenses sold, our average revenue for license in both retail and enterprise segment has improved. This has improved given our strong product portfolio across various price points.

On margin sides, we are able to deliver on better EBITDA and PAT margins for this quarter, owing to our continuous efforts on cost optimization coupled with lower depreciation and tax expenses. We exercised the option permitted under section 115BAA of Income Tax Act 1961 which has resulted in lower corporate income tax during the quarter and going forward, we expect the tax rate to be in the range of 26% to 27%.

Our current cash and cash equivalent stand at around INR 4 billion including investment in mutual fund, tax free bonds and fixed deposits. Kailash has referred to this earlier, but I would like to highlight this again that we are cautiously looking for inorganic opportunities in order to better utilize the cash on our balance sheet. The cash equivalents also include IPO money of INR 734 million invested in fixed deposits. The utilization of proceeds is as per the object as stated in the IPO.

On the working capital side, as of December 31, 2019, our overall networking capital was 108 days with receivable days of 143 days, a little higher than last quarter. Since retail business is stock and sale model, we expect debtor days to remain in this range.

Now I would like to give a very important update from our point of view on service tax case. Just to give a little background, a show cause notice dated February 2, 2015 was issued by the Additional Director General (DGCEI), New Delhi on Quick Heal Technologies demanding service tax with interest and penalty on supply of Quick Heal brand packaged antivirus software to end users through its dealers and distributors.

The Delhi Additional Director General had confirmed the demand of service tax of INR 561 million by order dated January 28, 2016. Quick Heal has always maintained its approach that supply of 'Quick Heal' brand packaged antivirus software falls under Central Excise Tariff attracting Central Excise duty as goods. Therefore, service tax was not applicable. The Honorable CESTAT Principal bench, New Delhi, compromising of Honorable Member, Justice Shri. Dilip Gupta, President and honorable Justice Shri. Vijay Kumar has set aside the service tax demand with interest and penalty issued to Quick Heal Technologies on January 9, 2020. With these updates, now we will open the floor for questions. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Sonia Bindra, an Individual Investor. Please go ahead.

Sonia Bindra: Thanks for taking my question. Sir, if you could just give us some more information about the performance of the government segment this quarter and the breakup of government and enterprise?

Nitin Kulkarni: This is, Nitin. We do track this internally about the progress of government segment on a regular basis, however, because of confidentiality reasons, we will not be able to share the details.

Sonia Bindra: Okay. Anything if you can speak about the mobile segment of this quarter?

Nitin Kulkarni: Mobile segment contributes a very small portion to our pie of revenue; however, with new challenging threats, targeting mobile users, this business is definitely expected to pick up in future.

Kailash Katkar: But I would like to add here that Quick Heal Mobile Device Management is picking up and quarter-on-quarter we have started getting a good number of enterprise customers on this mobile device management and if I have to tell you about the consumer mobile security, the consumers who are using it are also growing, number of licenses are also growing in two-digit number actually.

Sonia Bindra: Thank you Sir. I will get back into queue for any follow up questions on the same. Thank you.

Moderator: Thank you. The next question is from the line of David Potter from HSBC. Please go ahead.

David Potter: I have a question regarding your distribution model on the retail side, can you give me percentage ratio of what sales are generated through stock and sale versus what percentage is direct to consumer?

Sanjay Katkar: Our distribution model is such that 100% sale goes through channel partner to the consumers. Our online sale which happens through our website contributes around 3% of our revenue which is direct.

David Potter: If you just help me understand, at the end of the year when the subscription comes to an end, do you expect a consumer to go back into a retail distribution outlet, in your subscription or does he do it online?

Sanjay Katkar: Yes, there is an option for customers to do both, he can renew it online directly from his PC or he can also get it renewed from the local retailer.

Kailash Katkar: Retention rate of our customer is close to around 35% to 40%.

David Potter: Don't you find that strategy is difficult in the current environment where consumers will prefer to order and renew their subscriptions online year after year?

Kailash Katkar: They are doing it.

Kailash Katkar: The customers can renew it online as well as they can also go to retailers, it is their choice. So, at least 40% to 45% of the customers renew it online. Some retailers who go and push the renewal in advance proactively, only then it becomes retail. So most of the time, it depends on the customers on what to choose it. So, we have kept all the options open.

David Potter: One follow up question, if you look in the western world, a lot of internet cyber security products are usually bundled up by internet service providers when they install broadband, is this something that you are looking at actively to do that in the Indian market?

Sanjay Katkar: We are currently not doing that in the Indian market because it is mostly OEM deals at very negligible prices and most of the ISPs that are bundling, the products are having the least featured products. What we have seen is that people still move to our full featured product once they realize the difference. So, currently we are not doing any OEM deals in India for ISPs.

David Potter: If you can you just give me a flavour on who are your main competitors in the retail market?

Sanjay Katkar: In retail market, our competition is with Kaspersky and in some regions, it is with the regional players like K7, NPAV.

David Potter: Thank you very much.

Moderator: Thank you. The next question is from the line of Kranti Bathani from WealthMills Securities. Please go ahead.

Kranti Bathani: I want to know how the sales of Quick Heal products are directly related to sales of PCs that are sold in India. Can you just give a figure on how the market is looking forward in the next six months to nine months period and how the sales of PCs are directly impacting the sales of Quick Heal Technologies?

Nitin Kulkarni: There is a some correlation between the PC sales to our sale and if the PC sale goes down then that will also have some impact on our sale.

Kranti Bathani: How is the market looking going ahead?

Kailash Katkar: At present, PC sale is down. At times, Quick Heal's sale keeps on growing because the antivirus subscription is either for one year or three year and PC life is at least five to six years in India. So, based on that, you cannot exactly correlate with the PC sale.

Kranti Bathani: Suppose if you are selling ten licenses for one year, what is the quantum of the second-year renewal that you will be getting?

Kailash Katkar: It is close to 35% to 40%.

Kranti Bathani: What are the steps you are making to increase this percentage? Do you have any backup plan to increase this percentage of renewal?

Sanjay Katkar: We have already taken lot of steps. This percentage grows as the number of days passes after the expiry. So, if you calculate the retention after three months or four months after the expiry, the percentage reaches 50% and beyond, the renewal percentage. The gap is of about the unprotected period of the person once the expiry is done and the time when he renews the product. So that gap we are trying to fill by aggressively pushing the users to renew before expiry or even during the week of expiry, that push we are constantly doing.

Kranti Bathani: Thank you.

Moderator: Thank you. The next question is from the line of Vibha Sharma, an Individual Investor. Please go ahead.

Vibha Sharma: Are you on talks with any companies for new acquisitions? Are we looking to close any acquisition this quarter?

Nitin Kulkarni: We are continuously evaluating opportunities in the Cyber Security space both in India and at a global level and this is more of a continuous activity this is what I can comment.

Kailash Katkar: We have completed the strategy investment in L7 Defense in last quarter and we see that the progress is going on and we are also looking for more companies from inorganic growth point of view.

Vibha Sharma: Thank you. If I could also ask that you mentioned something about the top-level hiring. If you could give us more information regarding that, any details about the hiring at top level?

Nitin Kulkarni: Basically, as a part of our capability building exercise, we are looking at strengthening the overall team and this hiring will happen over next few quarters.

Vibha Sharma: Thank you.

Moderator: Thank you. The next question is from the line of Nirav Dalal from Maybank. Please go ahead.

Nirav Dalal: Thank you for the opportunity. In terms of the acquisitions that you are looking at what is the size of the acquisition and second is the investment that you did last quarter, how are you looking at using that? What is the strategy ahead?

Nitin Kulkarni: Basically, we have to find a right candidate which is in the Cyber Security space and it is very difficult really to put a real number to what is going to be the acquisition size. There are many variables when you look at M&A and for us it is very difficult to comment on what kind of size we are looking at and the question on L7, so L7 acquisition it was more of strategic investment which just happened two months back and we are tracking the progress and so far, we are pleased with the progress of L7.

Sanjay Katkar: The idea is to take their products into Indian market and their products are yet to get released but trainings and product demos are happening.

Nirav Dalal: This would be more towards the enterprise side of the business?

Kailash Katkar: Yes, it is all enterprise products actually.

Nirav Dalal: All of those will be enterprise products and what would be the investment that you have done in the company?

Nitin Kulkarni: We have invested about $300,000 USD.

Nirav Dalal: Okay. Currently you are sitting on a cash of about INR 400 Crores and in terms of distribution of the cash is there any plan on that side?

Nitin Kulkarni: We have earlier also mentioned that this was more of the strategic investment and we are definitely looking at few more opportunities and we will utilize this cash accordingly.

Nirav Dalal: In terms of the business, when do you see improvement happening and what are the difficulties that you are facing at the moment?

Nitin Kulkarni: Basically, if you look at the overall economy slow down, that is certainly impacting most of the players and if we have to talk about us, we continue to invest in growing and enhancing our core capabilities and work closely with the partner ecosystem and we definitely are optimistic about future. This is what I can comment at this stage.

Nirav Dalal: When you say that you are facing issues in terms of distribution that is entirely on the business environment nothing other than that right?

Kailash Katkar: Yes, you are perfectly right.

Nirav Dalal: Or is it that within the distribution network you are facing issues in terms of distributors going off your network?

Kailash Katkar: No, that is not the case. It is all about the economy slowdown.

Nitin Kulkarni: We have strong distributors so that is not the case. It is mainly to do with the economy slow down.

Nirav Dalal: Right and then in terms of the margin performance could you be able to manage the current margins despite the weakness in the demand, how should one look at it on a full year basis?

Nitin Kulkarni: If you look at nine months margin it is around 38%, so if I talk about near short term for the year, we should be able to hold on to this number.

Nirav Dalal: Okay and in terms of going ahead FY 2021-2022 what should one look at if the current scenario persists?

Nitin Kulkarni: We do not give any kind of formal guidance neither on revenue nor on margins. So, I think near-term, short-term, I told you that we should be able hold on to the margin of what we have for nine months. This is what I can comment.

Nirav Dalal: Not a problem. Thank you.

Moderator: Thank you. The next question is from the line of Sachin Kurade an Individual Investor. Please go ahead.

Sachin Kurade: What are your expectations on the growth of the company? this quarter you have profit of Rs. 657 mn so what do you think for next one or two years? Can I have clarity on that?

Nitin Kulkarni: So, I will just address this question. If you look at nine months, we have EBITDA of around 38%. Definitely we will be able to hold on to this number for the year but since we do not give any guidance, I have already said that we are optimistic about the growth in future. -

Sachin Kurade: Next question is, if you are sitting on INR 400 Crores of cash, do you plan any buyback offer to reward the investor?

Nitin Kulkarni: Sachin, we just concluded buyback six months back.

Sachin Kurade: What is the actual working capital requirement of the company?

Nitin Kulkarni: So, it will around INR 30-35 Crores per quarter.

Sachin Kurade: Per quarter and still you will be left with good amount of cash?

Nitin Kulkarni: Yes, we know that we have cash sitting in our financials, we are definitely looking at inorganic opportunities and inorganic opportunity is very difficult to time so we are actively pursuing for these inorganic opportunities and we will utilize the cash for that purpose.

Sachin Kurade: The tax notice which we have received, we had already provided for that and the INR 400 Crores cash is excluding that tax notice?

Nitin Kulkarni: See Sachin, let me give you some background, the total demand for various years 2011 to June 2017 was about INR 161 Crores, nothing has been provided for in the financials. We were confident about the facts of the case and this amount was shown as a contingent liability in the financials. Now out of that first 2011 to 2014 that INR 56 Crores that judgement has moved in our favour from CESTAT and this is definitely going to help us clearing the subsequent years so nothing has been provided in P&L. The biggest plus is that we will be able to remove the contingent liability disclosed in our financials.

Sachin Kurade: Okay. Thank you.

Moderator: Thank you. The next question is from the line of David Potter from HSBC. Please go ahead.

David Potter: I just wanted to ask that going forward in the next three to five years, where do you think in terms of segment whether it is going to be enterprise segment that you will be focusing on predominantly or is going to be more retail focused?

Sanjay Katkar: For the long-term perspective of three years, I can say that the focus is definitely on enterprise segment but the at the same time making sure that we do not lose ground on the consumer segment as well. Revenue contribution of enterprise segment will go beyond 20%. It should go at least 30-35% in next three years.

Kailash Katkar: So future investment on product development is more towards enterprise segment.

David Potter: Hiring, that the gentleman spoke about before, is that going to be focused on the enterprise segment or is that across the board?

Kailash Katkar: Actually, it is across the board but more people under enterprise sector.

David Potter: Okay your talented group one is going to be focused on enterprise segment is that what you are saying?

Nitin Kulkarni: Yes.

David Potter: Just in terms of dividend policy, is that likely to change given the recent budget announcements on DDT and end investor bearing the burden of dividend tax, is that going to change in any scope?

Nitin Kulkarni: David, depending on the requirements of the organic and inorganic opportunities and cash requirements, the Board of Directors will take appropriate call.

David Potter: What I meant to ask is if the dividend tax on end consumer is going to go beyond the 10% which it was before the budget. Does that change the stance from both from promoter perspective as well and a board perspective to effectively switch from cash to within perhaps buy back the bonus shares that is what I trying to understand?

Kailash Katkar: David I got your question very clearly. We are in consultation with our advisors and statutory advisors as well as tax consultants and we have not come to any conclusion for that, but if at all anything, we might declare something. As of now we have not come to any conclusion.

David Potter: Okay and you expect to maintain your dividend?

Kailash Katkar: Yes, as per policy we will continue doing that.

David Potter: Thank you.

Moderator: Thank you. The next question is from the line of Sonia Bindra an Individual Investor. Please go ahead.

Sonia Bindra: I just wanted to know that why the licenses sold volumes are down. The reasons behind it?

Nitin Kulkarni: Basically, if you look at the number of licenses sold, we have it over the range of our products and the market conditions, the competition landscape and partner ecosystem influences this. Overall, slowdown in the economy and overall distribution network disturbance has impacted the licenses sold.

Sonia Bindra: Okay and what would be the future guidance on the same?

Nitin Kulkarni: No, it will be very difficult for us to really comment on the future guidance.

Sonia Bindra: Sir, if you could help with what would be our sustainable EBITDA margin going forward?

Nitin Kulkarni: EBITDA margin for nine months is around 38%. We will definitely hold on to this margin when we close the current financial year. This is what I can talk for the year. I think next year it all depends on what kind of investments we make but I can talk only for this year, so this year we should be able to hold on to the EBITDA margin what we have for nine months.

Sonia Bindra: Thank you.

Moderator: Thank you. The next question is from the line of Parimal Matani from Prudential Investments. Please go ahead.

Parimal Matani: Sir I just wanted to know in terms of distribution, is it that the vendors are not ready or what is it the issue, if you can highlight that and second thing is in terms of debtors' days, what is the way ahead and what have been the sales for one and half month?

Nitin Kulkarni: So challenge is in distribution network is mainly to do with the liquidity problem in the market that is the main challenge and on the debtor days I have also commented in my initial commentary that since we follow stock and sell model for retail, we expect debtor days to remain in this range whatever we have today as of December which is about 143 days, so we expect debtor days to remain in this range.

Parimal Matani: Okay and in terms of how have been the sales since January? You did not see any pickup in terms change in terms environment what was it?

Nitin Kulkarni: I can say that we are on track beyond that I cannot comment anything, Parimal.

Parimal Matani: Sir is there any write off in terms of receivables for us?

Nitin Kulkarni: No. We have not made any write offs in the quarter, so all these debtors we have even these 143 days, all these debtors are collectable.

Parimal Matani: Thank you.

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 joining the call. I hope we have been able to address all your queries. For any further information you can kindly get in touch with EY, our IR advisors. Thank you very much

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

(This document has been edited for readability purpose)

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