"Quick Heal Technologies Limited Q2 FY21 Earnings Conference Call"

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MR. NITIN KULKARNI – CHIEF FINANCIAL OFFICER

Moderator: Ladies and gentlemen, good day and welcome to the Quick Heal Technologies Limited Q2 FY21 Earnings Conference Call. We have with us today from the management Mr. Kailash Katkar - Managing Director and CEO, Mr. Sanjay Katkar - Joint Managing Director and 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. Thank you and over to you sir.

Nitin Kulkarni: Thank you Faizal. Hello and good evening everyone. I'm pleased to welcome you all to our earnings call to discuss our Q2 and H1 FY21 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. Over to you Kailash.

Kailash Katkar: Good evening, ladies and gentlemen. Thank you for joining us today to discuss the company's financial results for Q2 and H1 FY21. I would like to take this opportunity to update you about the development and initiatives for the quarter. We have delivered a strong financial performance in Q2 as we came out of the lockdown even though the uncertainty of COVID-19 is still in place. I will let Nitin discuss our financial performance in detail later.

In the previous quarter, we launched our next generation consumer product powered by privacy, protection and performance. We have received highly encouraging response from partners and customers for the same. On the enterprise side, we have been working on next generation products that will enable us to target the large enterprise customers. I'm excited by the progress so far and we expect to release this in the next financial year. To accelerate the development of these products, we have appointed two senior global expert leaders in research and development. First, Mr. Sanjay Agarwal as CPO, Chief Product Officer, Sanjay will be responsible for driving the overall product vision and strategy in the line with our market expectations and Mr. Bibhuti Kar , as VP and Engineering Head for R&D. Bibhuti will lead our development efforts, a team of talented Security Research and Engineering. With these two new additions our R&D leadership has become stronger than ever. Now, I would like to hand over the floor to Sanjay Katkar our Joint Managing Director and CTO to discuss the trend in cyber security market. Over to you Sanjay.

Sanjay Katkar: Thanks, Kailash. Good evening everyone. I would like to discuss a couple of points before I speak about trends in cyber security market. During the quarter, security researchers at Quick Heal Security labs uncovered a new APT targeting India's defense forces. Dubbed as "Operation Sidecopy", threat actors behind this campaign were found misleading the security community by copying tactics and techniques and procedures that pointed at the Sidewinder APT group. However, researcher at Quick Heal security labs discovered strong evidence of operation side copy having potential links with Pakistan backed transparent tribe group. This is a breakthrough discovery making us the first cyber security company to expose the real identity of these threat actors. Upon revelation, we immediately informed the government authorities to have precautionary measures and this discovery once again reinforced our robust threat intelligence and our ability to detect previously unseen and highly sophisticated threats.

On the product development part, to which Kailash referred earlier, we are developing a few new products which will open a much larger total addressable market for us, and more importantly, will help us enter the lucrative large enterprise market. With the addition of industry veterans like Sanjay Agarwal, and Bibhuti, I'm confident that we will be able to deliver the right solution in-line with the market requirements and continue to innovate and deliver the best in class protection against advanced threats.

Now coming to the trends in cyber security market, as we come out of the lockdown, we have noticed demand coming to pre COVID level on the consumer side of our business. Demand for laptops and computer continues to remain strong. Even though government has lifted the lockdown, schools, colleges and many offices are still shut and work from home and online learning are becoming a new norm. You must have heard the news that some large organizations had shut some of their offices and asked employees to work from home permanently. We believe that work from home and remote learning will continue to remain a part of our lifestyle over the next few quarters. Due to absence of robust security measures, this has created a newfound opportunity to target users and steal sensitive data and hold it for ransom. This in turn, has resulted in increased cyber security awareness across the country. Government business has been slow since the last two quarters due to shift in spending focus as the COVID related issues take the priority. On enterprise side, we have seen good recovery, which has been reflected in our enterprise sales for this quarter. I would like to conclude my remarks by stating that demand is gradually coming back to normalcy in the enterprise business, physical meetings is key to cracking deals in the enterprise segment and with lockdown norms now being relaxed our sales team is back on the field to develop strong relations with our customers and partners and penetrate further in the market. On the retail side, we will continue to work with our partner network on exploring various avenues to establish a strong connect with the customers and create a strong pool for the brand in the offline market. Online sales have seen record growth during the lockdown, and we will continue to push our product on e-commerce platforms and our website as well. I would now hand over the floor to our CFO Mr. Nitin Kulkarni to discuss our financial performance with you.

Nitin Kulkarni: Thank you Sanjay and again good evening to everyone. Let me take you through the financial highlights for the second quarter as well as half year ended September 30th, 2020. As Kailash mentioned earlier, we were able to deliver good growth in the second quarter, which has always been seasonally one of the stronger quarters for us. However, on the half yearly basis also, we are happy that we were able to marginally do better than last year despite so many uncertainties around the pandemic. Let me elaborate more on financial performance. I will speak about some of the developments for the quarter and then H1.

In Q2 consolidated revenue from operations for the quarter Stood at Rs.844 million up 15% as compared to Rs.735 million in Q1 of FY21 and down 14% as compared to INR 986 million in the same quarter last year. If you recall, Q2 was our strongest quarter during financial year 2020. While the current quarter still has some impact due to COVID-19 crisis that we all are going through. However, we believe given the constraints the teams have performed well. 81% of our revenue came from retail segment and 19% from enterprise and government. Enterprise has seen a 5% Y-o-Y growth in both licenses and revenue as the teams and processes we put in place a few quarters ago are slowly beginning to bear rewards. I will talk about this in more detail shortly.

EBITDA for the quarter was up 22% quarter-on-quarter at INR 391 million and down 18% Y-o-Y while PAT stood at INR 288 million up 15.5% quarter-on-quarter and down by 22% Y-o-Y. PAT margin was at 34.16% almost flat compared to previous quarter.

For H1 FY21 consolidated revenue was at INR 1,579 million was marginally higher compared to INR 1,562 million for the same period last year. For the first half of this year 83% revenue came from retail and balance 17% came from enterprise and government. Enterprise sales for the first half of this year was impacted due to the lockdown in Q1 and also a number of government enterprises reallocated some of their budgets to pandemic related expenditure. In Q2, we have seen this trend change with a good pickup in demand in Q2. For H1 of 2021 R&D cost has gone up by 8.6% Y-o-Y. And this is mainly on account of increase in headcount, which will help us to accelerate product innovation and expansion of next generation enterprise security solutions. Both sales marketing and general and administrative expenses costs are down due to lower sales promotion and traveling expenses along with the lower overhead cost. We had physical dealer meets for our retail vertical in last year of H1, which were not possible during the current H1 due to pandemic situation. We also reversed some part of doubtful debt provisions, which we did in Q4 of last year. If you recall, we made these provisions as a matter of abundant precaution, despite the fact that we have had business dealings with these distributors for decades.

EBITDA for the first half was at INR 712 million versus INR 606 million in last year. Due to lower operating cost, we were able to deliver a strong 17.6% Y-o-Y growth in EBITDA. We were able to quickly implement remote working systems and also reassess some of the operating overheads. Our EBITDA margin for H1 were at 45.1% versus 38.8% in last year. In the previous quarter, we had informed you that as preventive measure due to volatility in the market, we had shifted our investments into fixed deposit, and this has led to lower other income for the second quarter. But as the markets have subsequently stabilized, we have reinvested our funds back to mutual funds and tax-free bonds. The overall returns on investments have gone down compared to last year. While we do not actively seek to profit from treasury operations, the move to fixed deposit was with a view to protect the capital and avoid any kind of volatility.

PAT was up 11% at INR 538 million versus INR 486 million last year. PAT margins for H1 of current year were at 34.1% as against 31.1% in last year. Licenses sold in retail segment during

H1 FY21 were up 17.8% compared to H1 of last year. While the revenue from the retail segment is up only 7.4% Y-o-Y basis. This has resulted in lower ARPU for the first half of this year.. As explained in all earlier calls while we report ARPU as a simplified measure of our performance, our business is very dynamic and the nature of bundling the products changes and hence the simple ARPU matrix does not fully capture the moment in the business. On enterprise side, licenses sold during H1 FY21 were down 15.3% Y-o-Y, while revenue for H1 FY21 was down 10.5%. We have seen a great recovery on the enterprise side during second quarter of this year, but the demand is yet to come back to pre COVID levels. Another major reason for muted performance as Sanjay mentioned earlier is the lower traction in the government segment. But even with the lower number of licenses sold in H1 FY21,We have seen ARPU for the enterprise side going up by 5.8%, which is good sign of progress for us as our enterprise business teams are getting better traction from their customers and are able to sell a range of products more effectively.

Now coming to balance sheet items, due to better working capital management. The overall net working capital days have been down to 93 days versus 104 days in September 2019. Our receivable days, which is a major component of networking capital remains slightly elevated at 141 days, but we have taken number of steps to deal with it. As you might know, several small and medium sized enterprises are currently impacted with lower liquidity as the nearly four months of lockdown has severely impacted their businesses. However, the positive for us remains that we have long relationship with these customers and do not see the need to make any additional provision at this stage. Our current cash and cash equivalent stand at around INR 4,479 million, including investment in mutual funds, tax free bonds and fixed deposits. I would like to highlight this again that we are cautiously looking for opportunity to better utilize the cash on our balance sheet. On the M&A side, we again remain very cautious and calibrated in our investments and we will be looking at smaller and mid-size investments. We have made two small investments in last six months to one year and they are progressing well.

To sum up, we are seeing a recovery in the demand environment, especially on the enterprise side and that has been visible in our second quarter numbers as well, we continue to believe the demand environment will remain strong as the economy slowly starts coming out of lockdown and the cyber security becomes even more evident. Overall the first half has been good, and we are well set for the next leg of growth. With this we'll open the floor for questions. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Kranthi Bathini from WealthMills Securities. Please go ahead.

Kranthi Bathini: Just want to know, as we are talking about the pent-up demand in the Q2, how the business environment is looking forward at least for the next Q3, Q4. Can we expect clear visibility of demand?

Sanjay Katkar: So, you rightly said we are seeing the recovery in sales but the thing is it has not come back to to the pre COVID levels. But we do hope by the end of Q3 we should be closer or maybe almost close to the pre COVID-19 level. So that is what our observation is. And the demand on the enterprise front where SMB is our more focused target and then even the government segment. SMB has started opening up and we have started seeing some demand coming from there as well. But on the government front we are seeing the priority for spending on cyber security is still lower and they are taking long time for concluding the cyber security related orders. But we feel that quarter three will still be low for the government segment, but some demand would come back for SMB segment.

Kranthi Bathini: With respect to Quick Heal brand is concerned of course, you are number one retail brand, but enterprise somewhere you could not cope up with the market expectations. So, what is your plan with respect to enterprise model, are you going to increase the team size and what is your view on this?

Sanjay Katkar: So, the products for very large enterprises are in a different category and the products we have been dealing are for small medium and midsize organizations. But at the same time, we are investing heavily into scaling up our products for very large enterprises. We are investing into increasing our product basket by investing into new products which we have just announced on the call and we will be coming out with couple of these new products by next financial year, which will target purely very large enterprises and this will add up major market segment to our revenue. So that’s the plan actually and that where our current investments are going on.

Kranthi Bathini: In Q2 compared to Q1, what is your marketing expenses, have you increased, or you kept it stable?

Nitin Kulkarni: No. So, if I talk about H1 overall, if you compare it with last year H1 marketing expenses have gone down. Primarily because we had few dealer meets for our retail verticals in the last year of H1 and because of the current situation we were not able to do physical dealer meets. . Also, traveling is restricted. So there is definitely some dip in the sales and marketing expenses.

Kranthi Bathini: And any kind of ad expenses you are incurring, you are increasing the brand visibility through ads?

Nitin Kulkarni: Yes, so we are doing a lot of advertisement and we are incurring expenditure on advertisement. So, with the current situation it is not up to full scale which will definitely pick up from now since things have started coming back to normalcy. So, we expect these expenses should pick up from Q3 onwards.

Kranthi Bathini: Okay, commendable effort, we have done our study with the dealers, about the Quick Heal brand and we visited a couple of shops also they have given us beautiful feedback. In fact in our offices also and we are encouraging people to have Quick Heal products, the feedback is very good.

Moderator: Thank you. The next question is from the line of Ankit Kumar from AB Capital Advisors. Please go ahead.

Ankit Kumar: So, first question is on what percentage of revenue is contributed through outside India for H1?

Nitin Kulkarni: , H1 is currently the number is very small, it should be about 2%.

Ankit Kumar: So, we do have multiple subsidiaries outside India. So, what are these for, like our technology partner?

Nitin Kulkarni: So basically these are all front-end sales subsidiaries who are doing marketing for our products and selling these products into these geographies.

Ankit Kumar: So, these are selling it India itself or in the respective country that they are presenting?

Nitin Kulkarni: So, definitely India is a different team so, the subsidiaries are present in four geographies where they are selling the products.

Ankit Kumar: Okay. And so as we know that cyber security is a very attractive market in many parts of the world and in India as well. So, what are the plans of increasing our expansion beyond India, because as you said that we have just 2% contribution currently. So, any plans of expanding outside India or in India increasing regional distribution?

Nitin Kulkarni: Yes, there are definitely plans for increasing our reach in the overseas geography. Since we have presence in these geographies by way of subsidiaries so, definitely. In retail we are holding highest market share in India and there are plans for these overseas geographies. And as Sanjay mentioned, since we are working on these products, which will cater to mid and large sized enterprises, which are expected to roll out into the next year. So definitely with this we will be able to tap these overseas geographies very well. And there is definitely a plan for increasing the presence in these overseas geographies.

Ankit Kumar: Okay, and how has the growth been in digital channel in lockdown and what kind of changes have we done in our strategies to capitalize on the opportunities during the lockdown and the work from home?

Nitin Kulkarni: So, if you look at strategy, yes we have work from home and we also have adopted to the new style of work. On enterprise side, we are talking to customers on regular basis and with increase in awareness for security, definitely we are seeing a lot of traction coming into enterprise side. And on retail side, with increase in sale of PCs and laptops, we see big potential on the retail side as well.

Ankit Kumar: Okay sir. And has there been any price change since the pre COVID during the lockdown and since the lockdown has been eased so have there be any price variation during these times?

Nitin Kulkarni: So, pricing is under pressure and it is applicable for all the industries and we are no exception to this. In the entire partner ecosystem dealers, customer, there is definitely a price pressure and we are dealing with it. That is what I can talk at this stage but yes, there is a pricing pressure.

Moderator: The next question is from the line of Kanika Sinha from CPS Capital. Please go ahead.

Kanika Sinha: Would you please share the online sales figure for Q2 and what is the proportion of online sales and overall sales. Additionally, I would like to ask what is your overall online strategy?

Nitin Kulkarni: Yes, so on the online sale number for the quarter, this includes sale on our website plus what we are selling to e-commerce platform. So Q2 number is about INR 20 crore of online sales. There was a lockdown in first quarter and physical dispatches were not possible. So most of the sales came through online channel and we are definitely seeing increase in online sales. And online sale for H1 of last year compared to H1 of this year, there is an increase of about 25% - 26% in overall online sales. So, we have we clear cut strategy for this and there is increase in online sales.

Moderator: Thank you. The next question is from the line of Parimal Mithani From Credential Investments. Please go ahead.

Parimal Mithani: Sir, I have two questions for you. One is, you have seen a reduction in other expense from INR 20 odd crore to INR 14 crores in this quarter. Can you explain what is the reduction for? The second question is, that in channel checks we found that the inclination of the company to promote more sales to distribution channel compared to the online channel and there's a price differential in terms of the customer renewal done, who have renewed three year pack with the company. So there is a substantial price difference between the online and through distribution channel, why is that if you can explain and the third question is, on a service tax demand, what is the status because you have been getting this notice again and again from the government?

Nitin Kulkarni: So, reduction in other expenses basically if you see last year, we did a share buyback. So, there was a buyback cost of INR 2 crore which was incurred in H1 of last year. And during the first half of this year we have also reversed some doubtful debt provision, which we made in Q4 of last year and we also mentioned in the Q4 call that this provision was made based on abundant precaution, more on a conservative basis. So, we have been able to collect that money from these customers. So, these are the main reasons for reduction in expenses. And on your last question on the service tax, so, we have already won that case in ITAT and tribunal has clearly given order in our favor. And there is no further movement on this, but the order which was given to us was clearly given based on the merits of the case. And based on that, we are quite confident that we will be able to set aside the demand for the subsequent years.

Parimal Mithani: Okay, and the third one is the channel check which I have seen in terms of pricing difference between online and offline. If you can highlight that, what's the difference, why is there such a big difference in terms of renewal. At least for the customer who renewed Quick Heal packages after three years since he is in three years customer, why the difference?

Kailash Katkar: What is the difference, because I don't know.

Parimal Mithani: No, sir if I am renewing, this is through some of the check that we have done on this. So, as a customer I have taken your service pack for 3 years for 10 user or 25 users, there is a price difference when its online renewal compared to through channel partners.

Kailash Katkar: Usually what happens is that channel partners pass on their margins to the customer.

Parimal Mithani: So, we don't suffer any in terms of margin erosion because of this, through channel partner sir. Is it safe to assume that?

Nitin Kulkarni: No, we don't suffer any margin erosion Parimal.

Parimal Mithani: Because there's a significant difference. Because the one I purchased the difference was almost close to 10- 20% in terms of renewal.

Kailash Katkar: Of course. See, that is what I'm trying to tell you the margins which partner is supposed to keep it with him, he passes on to the customer. So, this happens with every IT products, if you check with any IT product.

Moderator: Thank you. The next question is a follow up question from the line of Ankit Kumar from AB Capital Advisors. Please go ahead.

Ankit Kumar: Did we have any change in prices during the last quarter or during the lockdown. So any percentage that we can quantify, how much is percentage change?

Nitin Kulkarni: So, there are various factors to it, so it all depends on what kind of product we are selling. It also depends on the competition price, it also depends on what kind of cross selling and up selling opportunities we have. So it is very difficult to generalize and answer this question but as I said earlier, definitely there is a pressure on pricing and this is applicable to the entire industry and we are no exception to this. But really to quantify what kind of price pressure is there, it is difficult.

Sanjay Katkar: I would like to add to that. When we are present in the market with a range of products, there is a product for every price segment in Quick Heal basket. So, when there is a price pressure, the low-cost products move faster as compared to the fully loaded or higher cost products. So, that automatically reflects into the ARPU in the financial figures that we share. So, it's seasonal, as you rightly pointed in COVID season, we have seen that low-price products are moving much faster than high priced products.

Ankit Kumar: Okay. And other question is on working capital. The Working capital position has significantly improved so how sustainable it is?

Nitin Kulkarni: So, there is a liquidity pressure with the dealers and recoveries are slow. But with our sustained and focused efforts on collection, we have been able to reduce the working capital which predominantly driven by debtor days in our case. So, it was 170 odd days as of June 2020, which we have been able to bring it down to 141. But this pressure will remain and we see debtor days to remain in this range at least for next two quarters, we are making all our efforts to bring it down, but the overall situation in the market and the liquidity pressure, we expect debtors days to remain in this range.

Kailash Katkar: There is a big challenge in the market when it comes to cash flow and we have to deal with this situation because of the COVID-19 situation. Even if you look on a retail point of view or even from a SMB point of view, there are cash flow challenges to every small organization and every person who is using our product at home also. So, they are based on the cash crunch challenges, customer decides to buy sometimes lower end product and some time it totally depends upon his requirement and need, based on that he goes for the premium product or the low-cost product.

Ankit Kumar: Okay, sir. Sir just one last question, can you throw some light on the new Enterprise products that Quick Heal is going to launch soon, in terms of scalability and opportunity?

Nitin Kulkarni: See, as Sanjay mentioned earlier that we are working on products. These are all new and innovative products which we will cater to mid and large enterprises and we are on track as far as the overall progress is concerned beyond that it would be very difficult to share anything additional on this call.

Kailash Katkar: See actually what Sanjay mentioned about his new products which I cannot disclose here. But what you mentioned about scalability, yes, we are working on two parallel tracks. The current products scalability, we are working on that and that is a continuous work. So, that will start giving a good result in coming years. And we are working on new products which Sanjay mentioned which we cannot disclose here. But even those products may start getting released by Q2 to Q3 of next year actually.

Moderator: Thank you. The next question is from the line of Dwarka Prasad, Individual Investor. Please go ahead.

Dwarka Prasad: Sir my question is, you have more than INR 4,000 million of cash in your books, is there any further plan to buy back the shares to better utilize the case available in your books?

Nitin Kulkarni: So, we did a buyback about a year back and we would like to use this cash for organic and inorganic opportunities. And during these current uncertain times, we also would like to preserve some cash. So, all those calls for buy back, higher dividend will be taken by Board based on the company performance and the future plans.

Moderator: Thank you. The next question is from the line of Kanika Sinha from CPS Capital. Please go ahead.

Kanika Sinha: Sir globally we have seen McAfee IPO recently, so has Quick Heal considered any foreign listing?

Nitin Kulkarni: No, at this stage we are not thinking of foreign listing. We would like to consolidate on our performance here in India, ensure that this we take the business to the next level. So at this stage, there are no plans of foreign listing.

Kanika Sinha: Sir another question that I had was that, we have good cash balance and since cyber security is moving are there any M&A plans that we have?

Nitin Kulkarni: Yes, so there are M&A plans and we are definitely looking at target companies. In fact, we did two small acquisitions in last six months to one year. And yes, we are we are looking at inorganic opportunities. There are M&A plans, and we are working on targets.

Kailash Katkar: We have a separate team for M&A.

Moderator: Thank you. The next question is a follow up question from the line of Parimal Mithani from Credential Investments. Please go ahead.

Parimal Mithani: Sir, I just wanted the update on the two acquisitions that we have done in last 12 months how are we placed, can you just update on that?

Nitin Kulkarni: These acquisitions, so these are all startup companies and they have started generating revenue and the progress has been good in-line with our expectation, but then it will take some time to figure out what kind of revenue growth we get from these companies, but they are on track as far as the progress is concerned.

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

Nitin Kulkarni: Thank you, everyone for joining the call. I hope we have been able to address all your queries. If you need any further clarification, you can kindly get in touch with E&Y our IR advisors. Thank you very much.

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

The transcript has been edited for reading purpose.

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