



SQS India BFSI Limited
Q2 FY19 Earnings Conference Call

October 26, 2018



MANAGEMENT: **MR. BALAJI VISWANATHAN – MD & CEO, SQS India BFSI Limited**
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MODERATOR: **MR. DIWAKAR PINGLE, CHRISTENSEN, IR.**



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Moderator: Good day, ladies and gentlemen and a very warm welcome to the SQS India BFSI Limited Q2 FY '19 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode, there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*#' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Diwakar Pingle from Christensen IR, thank you and over to you Sir.

Diwakar Pingle: Thanks a lot Ali. Good afternoon to all the participants on the call. Welcome to the Q2 FY '19 Earnings Call of SQS India BFSI Limited.

To take us through the results today, to answer your questions we have with us the top management of SQS India BFSI Limited represented by Mr. Balaji Viswanathan – Managing Director and CEO and Mr. Desikan Narayanan – Chief Financial Officer. As all of you are aware, it's the first earnings call for both Balaji and Desikan. So, Balaji will start the call with a brief overview of the quarter gone past; we will then take a Q&A session as usual.

I would like to remind you that anything that is said in this call or which gives any outlook of the future which can be construed as a forward-looking statement must be viewed in conjunction with risks and uncertainties that we face. These risks are included and not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual reports which you can find on the website.

With that said, I now handover the call to Balaji. Over to you Balaji.

Balaji Viswanathan: Thanks Diwakar. Good evening everybody, this is Balaji. This is my first call, I was there as a spectator or a listener in the last one but I thought I will probably quickly do an introduction about myself before I go ahead and talk about the performance and also hand it over to Desikan for a quick introduction about him as well.

My name is Balaji. I have been here in the company for a little over 2 months now, 2 and a half months to be precise but I am not new to the industry. I used to be in the outsourcing and offshoring industry particularly in the Technology and Process Services space for the last 9 years. Since 2009, I was with IBM which got acquired by another company called Concentrix. I have managed the BFSI vertical there and prior to that spent close to 15-odd years in the banking industry working with some of the leading banks in India - HSBC, HDFC Bank, YES Bank and for 3 years with MasterCard managing their Operations and Technology as well. So, not new to the industry and I am quite excited to get into this role and looking forward for a very successful and fruitful venture here with SQS, probably this will or may be the next one would probably be the last call at SQS before we move into the new branding after the acquisition with Assystem. Before I get on to talking about the quarter results, I will give a brief update on the



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integration with Assystem as well. The integration is progressing very well. As of now, we are looking at launching of the new company along with the branding by somewhere in the first week of February globally. As you all know, there is some amount of statutory work that we may have to do to change the brandings here in India but we will operate with that new branding starting February onwards and over the next 3-6 months kind of a time frame after that, we will go through all the statutory changes for the name change and other processes as well. So, I am sure that there is a lot of interest around what is the strategy for the future, what we are likely to do and when are we going to see a significant amount of growth, etc. While that is in the progress, it is currently WIP and hopefully before our next call, we will have a firm plan in terms of what we are planning to do and how that is going to pan out. As you all know, Assystem as a company is not so much into the BFSI space but it gives us a phenomenal opportunity to move more into the technology space from where we are currently in the Testing and Quality Assurance area. We have already started doing some amount of work in terms of planning for getting into consulting, getting into some amount of more technology-led automation even in the testing and quality assurance phase based on some of the capabilities that we would get from Assystem but the plan is still work-in-progress and hopefully in the next two quarters it will be firm but next quarter we will probably have some highlights in terms of how that is going to pan out. So, that is quickly on the integration update and about myself.

Talking about this quarter, the quarter has been fairly flat in terms of our business growth while we have seen around 4% growth from last quarter and close to 9% from compared to the same quarter last year, the growth has been almost flat, compared to last year; growth is probably 1/3rd from a business growth and almost 2/3rd of it is, thanks to the Foreign Exchange gain. And from quarter-to-quarter, from last quarter to this quarter our business growth has been fairly flat; around 1% and the remainder of the benefit has come primarily from Forex. We actually had growth in almost all the regions, particularly in the UK region and in Europe as well and we expect that UK and Europe as part of Brexit and some of the other macroeconomic things that are actually happening in that market will have a short-term and medium-term opportunities in growth as well. US has been our worry for the last 4-5 quarters at least and I can assure you that we are working on a very firm plan of what we want to do in the US and what kind of investments that it would take for us to grow significantly there considering that that is the largest market for the industry. Hopefully, in the next 3-4 quarters we would start seeing much better numbers from US and we are working on a very firm plan of what we want to do there. And as part of that is what we are looking at how do we move towards left from where we are doing, which is more in terms of digital enabled services, supported by automation also doing some amount of data management and analytics. We have signed some of these opportunities with strategic customers of us and hopefully on the back of success on those projects, we should be able to grow significantly on those, so that is quickly on where we are.

For the current quarter, you could see that in the deck as well so we have done Rs.758 million in terms of revenue and Rs.763 million in terms of total income, which is including the export



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benefits as well. We improved on EBITDA and Profit After Tax and that is apparently because we were able to manage our costs much better than what it used to be and that gives us both an opportunity for the future as well as looking at what kind of investments we need to make to grow the business. Consolidated for first half of this year, we are at Rs.1,489 million in terms of business and the EBITDA currently stands at around Rs.300 million while Profit after Tax is at around 14.6% in terms of margin. We have a healthy cash position and we are at close to around Rs.76 odd crore in terms of cash that we have in the bank, so that is quickly about the financial summary. Before we get down to question and answers, I will hand it over to Desikan to quickly introduce himself, he is our new CFO.

Desikan Narayanan:

Good evening everyone. This is Desikan, basically a Chartered Accountant with around 20 years of professional experience, out of which 12 years in heading finance function, taking care of end-to-end finance function from a controllership to a business finance and also worked as a core member of dealership team in high growth companies. I joined SQS around 2.5 years ago, taking care of the business finance and my previous experience was majorly into IT and ITES companies like Perot Systems and Mascon and had an initial stint in a manufacturing company; Indo Matsushita Appliances. So, that is my introduction, we can start the Q&A session now.

Moderator:

Sure, thank you very much. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Lalit Dua from Rajasthan Global Securities. Please go ahead.

Lalit Dua:

I think we hold Rs.74 crore of cash at the moment in the balance sheet, so what is the treasury returns the company is making upon this cash?

Desikan Narayanan:

We do have created term deposit that gets around 6% to 6.5% returns.

Lalit Dua:

But why the company or the board of directors do not deliberate that instead of earning 6% to 7%.

Moderator:

Sir it seems his line has dropped, we will move on to the next question until he joins back. The next question is from the line of Saket Saraogi, an Individual Investor. Please go ahead.

Saket Saraogi:

Firstly, I would like to know like this quarter we have seen some growth in the revenues but as I see if we convert into currency, this is I do not think there is a much better growth in the revenues but the profitability has seen to be growing too much, what was the thing that transpired this kind of growth in profits?

Balaji Viswanathan:

I will probably try and figure in; Desikan please feel free to add. So, the revenue growth has been marginal, the profitability growth primarily is led by the Forex gain and the Forex change, if you were to look at H1, the business growth was 1/3rd and the forex contributed to 2/3rd of the



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growth. So, this was primarily led by forex and we certainly had some reduction in our overheads and in our costs as well. You know it is not something which is very different from what it was but probably we were able to tightly manage some of the costs.

Saket Saraogi:

Sir, this cost has been managed or it is like general, there is some kind of reduction or just there was a deliberate attempt from the management side to reduce the costs?

Balaji Viswanathan:

Yes, there are two parts to the cost reduction; one cost reduction element was, we had a significant number of consultants or third party resources who were actually there as part of the team which we have constantly been reducing and having more our own resources. Our own employees which actually helped us in building our competence and also in managing the cost as well. And the other element is some of the SG&A expenses which have reduced in the last two quarters primarily due to some of the reduction in travel but those are minor, it is not a very significant number but the significant number is primarily because we were able to reduce the third party resources or contractors and having more of our own resources working on projects.

Saket Saraogi:

So, currently like all the IT companies, other companies are showing quite a good growth but our company is not being able to show the growth from quite some time now, so how do you think that we will be able to grow at least with kind of the growth your Industry is showing?

Balaji Viswanathan:

Yes, absolutely. You know that is our focus and that is what we are working on in terms of what is going to be our medium-term and long-term strategy, for any of the companies if you were to look at it, you know the growth primarily is led by the presence in the US and US contributes to a significant amount of growth for many of our competitors and past our peer group company which is where our performance has not been all that great so far and we are working to improve in the US and one of the elements is around what kind of investments we need to make, how do we actually build on a good sales and delivery in mechanism for the US which has been a challenge for the last 6, 7 quarters for us but hopefully in the next couple of quarters, we should be able to get back to it. Before the next quarter's call, we will at least have a medium-term strategy for the US and that is what the growth will come from, it will primarily be led by what will come from US and UK. Like what I mentioned when I started off, there is a lot of medium-term to short-term opportunities in the UK and Europe with some of the Brexit and other changes that are actually happening in the market. Between these two, we should be able to get to a double digit growth sooner, rather than later. I do not have an exact number but we should probably be able to get back to a two digit growth.

Saket Saraogi:

So, one question I had, from quite some time the company paying some dividends, interim dividend but this time around I think there is no dividend now, so what is there exactly a change in dividend policy or is it something that the company has not given?



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Balaji Viswanathan: We do not have a dividend policy foster even earlier, so it was only a practice, so there was no dividend policy earlier as well. What we are looking at is you know, with all the changing dynamics and the kind of evolving technologies that is actually happening, we are looking at what kind of investment options or with best use of cash for us as a company and we will certainly have that done in the next 3 months or so and finalize on what should be the effective use of the money. So, that is where we stand, so there is not really any other reason for that.

Saket Saraogi: What I am asking is will there be any dividend that we are giving for quite some time now almost 3-4 years, so would there be any tweak in the dividends payment structure, change what is planning?

Balaji Viswanathan: As I mentioned earlier, there is not really any decision taken or there is no policy as such we are looking at what is the effective use of cash which will add value to both; the company's growth and for the stakeholders as well. There is not really any other reason behind that.

Moderator: Thank you. The next question is from the line Lalit Dua from Rajasthan Global Securities. Please go ahead.

Lalit Dua: So, I was talking that we are holding approximately Rs.75 crore of cash and the cash is being deployed as we told in some kind of Fixed Deposits which yield around 6-7% pre-tax returns which is approximately 4% post tax returns, so my question is very simple only on the line of how the surplus cash could be deployed, why the management does not do any deliberation in terms of distributing this cash back to the shareholders whereby the promoters do not participate which would result in the optimal structure of the balance sheet, it will also result in the distribution of the surplus cash back to the shareholders. It will also result in increase in capital employed, increase in net worth and it will also help the promoters to increase their stake indirectly. If you would see there has been a lot of buybacks even from the IT companies like TCS, Wipro, Infosys, Mphasis, Sasken Technology, the buyback at these prices, the prices are so low that it would be not only EPS accretive, it will also give liquidity to the shareholders who want to exit and would also result in wealth creation for those shareholders who would like to remain with the company.

Balaji Viswanathan: Yes, like what I had mentioned, I was just talking about the dividend policy and where we want to invest the cash, you are absolutely right; by keeping it in a fixed deposit certainly it is not an effective utilization of cash for sure. That is the same thing which we would be deliberating during the course of this next couple of months and before the next board meeting in terms of how we want to utilize the cash and what we want to do with that and where we want to invest this for the effective utilization for driving growth and also driving stakeholder value. Your point is well taken; you certainly will have an answer hopefully before the next board meeting.



Lalit Dua:

No, I have more questions but only on the line of dividend distribution, only on the lines of how the treasury can be effectively managed. You see the dividend distribution tax is too expensive, it is not the best way of returning the cash back to the shareholders, at least I am not a big fan of dividends in India, then you have a huge expense in the form of DDT which is a dividend distribution tax, also the dividend is taxed at the end of the shareholders if the dividend exceeds a certain point. So, my suggestion to you, my suggestion to the board, and my suggestion to the Chief Financial Officer is that you should calculate a breakeven point whereby the buyback is EPS accretive. There are so many companies as I told you, for the sake of reputations, smaller, bigger which are doing buybacks and also you see last time when I was on the concall I have asked what was the rationale of this open offer price. So, two rationales were given to me – (a) this open offer price was determined by the minimum statutory price which was a 60-days weighted average receding when your acquisition was done and (b) it was also based upon the fact that it was almost on the similar EV/EBITDA lines on which the German acquisition was done. Now you see, the performance of our company has increased and the market price has further decreased from the open offer price, so now the stock becomes hugely attractive. Let us look at our company's financials. We are having a Rs.20 earning; it is per share for the last 6 months, so it translates to Rs.40 average earnings per share. If I deduct the Rs.75 cash per share from the market price of Rs.420, the stock is trading at a PE multiple of 7.5x to 8x. You tell me any single company in India which has got an MNC brand, which has got reputed promoters and is a true genuine company, is not a fictitious fraud company and is trading at abysmal low PE ratio 7.5x to 7.8x. Last time when we discussed, you told that this open offer price of Rs.480, 490 is a fair price but now the stock has even come below that fair price and the financials are improving, so I think the best thing that the company should do, wake up tomorrow morning and start buying back their own shares, utilize this cash judiciously, distribute the cash back to the shareholders.

Desikan Narayanan:

Yes, your point is well taken, that is one thing which Balaji was telling that we are considering all options for us to look at how we can efficiently use the cash what we have and again we want that to use it more for increasing, the business value and also for the value of the stakeholder. That is exactly what we are looking at and thanks for all the suggestions what you have given to us.

Lalit Dua:

No, I have one last question and then we will logout. You see when the open offer was made, the price was artificially deflated because unfortunately we were branded as a shell company and that was the time when the global acquisition took place. So, first of all, we were not a shell company but the market at that time in the historical past average was discounting that we were a shell company, I am sure you were aware of this. So, why the German shareholders, they got a very good deal, they got a 57% premium to the 14th December, 2017 prices, they got 53% premium to the 6 months weighted average price, they got 31.5% premium to the lifetime highest price. As compared to this, the minority shareholders they got a 0% premium to the 60 days weighted average price which as I told you was itself deflated because of the fact that we were



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branded as a shell company, we got a 63% discount to the lifetime highest price that SQS had done earlier and even your parent, it is not that buyback is a new term to them, so your parent also have bought recently 6 million shares at 37.5 Euro, so why your parent is not deploying the surplus cash back to the shareholders in form of buybacks, I do not know why in terms of SQS India neither they did a good deal in terms of the open offer, neither they are buying back their own shares. Do they genuinely want to do consider or what it is?

Balaji Viswanathan:

So, your point is well taken, like what I mentioned and what Desikan mentioned as well. The consideration is certainly there in terms of what options are available and we will certainly have a policy, or if not a policy we will certainly have the plan of what we want to do and be rest assured that that is going to be something which will be beneficial for...

Lalit Dua:

You must pass on this idea to the promoters. Look at your PE ratio of the promoters, where do they trade and look at the PE ratio of where SQS India trades minus the cash, 7.5 to 8 times the earnings multiple of a growing company, if we have a Rs.40 earnings per share minus the cash we are trading at 8 times, tell me any single FEMA company in India, tell me any single multinational company in India which is trading at a single digit PE multiple. I understand the stock market price is not in your hand but I think it is a result of extremely poor corporate governance on the part of the promoters that they first of all handed a very raw deal to the Indian minority shareholders and there has been no buybacks. So, I think this cash should be immediately returned back to the minority shareholders in the form of a buyback where the promoters do not participate and it is a very good price for you to increase their stake also, As you increase your stake in the German company, that is the SQS AG through which you have got this company indirectly. I think that was a costly acquisition as compared to the Indian stock market price at this moment of time. You must go, deliberate, do your homework very carefully in terms of what is the cash available to you and what is the market price, at what price the, in fact it is EPS accretive.

Balaji Viswanathan:

Yes absolutely, point taken.

Moderator:

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

Balaji Viswanathan:

Thanks Ali. Thanks once again for joining the call, certainly appreciate the questions being asked and we certainly have some of the action points that is what we mentioned, we will come back on what we want to do in US and also before the next board meeting and the next call we will have the integration and the branding update as well. Thank you for all your confidence and support and looking forward for your continued support. Thanks so much.



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Diwakar Pingle:

I think that is about Balaji and Desikan. I think the feedback has been taken and as Balaji did mention, we will take this to the parent and you will definitely see some action before the next board meeting. Thank you.

Moderator:

Thank you very much. Ladies and gentlemen, on behalf of SQS India BFSI Limited, that concludes this conference call for today. Thank you for joining us, you may now disconnect your lines.