



Subex Limited

Investors Conference Call Transcript

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Management

Surjeet Singh, CEO and Managing Director, Subex Ltd.

Surjeet Singh

Good day all and thank you for joining our Investor Call. I will just open the financials and we will take it up from there. Broadly speaking on the year, revenues were overall about \$53M or \$53.5M, up about 10%. Our EBITDA, on a margin currently basis which is what I look at to measure where we would be ending up operationally, was about 23% at \$12.3M, up almost 14%. Over the years we have tried to move the business from a pure technology license model to a more solution oriented managed services business and therefore, due to our change in focus, our license business has declined by almost 30 - 33.5%. Our managed services business which used to be less than 5% just about four years ago is almost 1/3rd of the business today. Our mix of managerial business has been such that we have been able to get almost 50% of our new business in managed services. We have worked tirelessly over the last two to three years to stay operationally efficient and nimble and try to focus on profitability. I always stated that that this business could be in the 20-25% profitability range operationally which is where we have brought this to, again with a 23% sort of margin business. We did evaluate some part of the legacy Syndesis intellectual property that was bought many years ago which led to many Balance Sheet problems. While we did take a check as of last year, we were trying to piece the puzzle of some of our assurance business related intellectual property and we did that reassessment work once again based on where we were and where the IP was and what we were able to use and not use and therefore we have done a onetime write-back of about \$15-16M which is again a non-cash charge. From the Balance Sheet perspective, which was something the key focus on the strength of operations, was to make real headway to this company and I am proud to say that almost \$120M of debt including high cost rupee based, overloaded working capital debt, besides the unsecured debt and FCCB, everything has been completely restructured - either equitized or repaid barring a tranche of \$3M of FCCB which will be done in July and also unsecured which has been done now as we speak, end of April. So something which was seemingly difficult and unachievable when we started in 2012-13 is now fully claimed and the company's balance sheet is fully liquid and unlevered and is almost zero-debt. Whatever working capital debt that we have is well supported by debtors.

I think we are now in a point where from a so called large product play, promoter-driven firm with system governance challenges, has been now converted to fully profitable, transparent, and Board governed. It is probably one of the unique cases of being a widely-held promoter-led public company, I think we talked about how we think about taking this company forward and that's where we wanted to do two or three things. From a strategy perspective, my view is that we have a legacy assurance fraud management business which has its well-entrenched customer base and anything that we do strategically needs to leverage that - that is one bucket. We know that the world around us is changing and so is our customer's business especially in telecom operators domain where business models are rapidly evolving. The current revenue streams are deflating at a much higher pace.. their businesses are evolving to basically partner ecosystems, more digital ecommerce type platforms, etc. I think we can't stay distinct there and as I have stated earlier, ultimately Subex needs to embrace this and become a larger digital transformation company working with its customers to partner with through this journey of transformation at a corporate level.

All in all, I think strategically where we want to take this firm is to enable it to become a digital transformation partner of the operators and towards other similar related business services areas like utilities services. But for the moment we are talking only on telecom operators' domain. In order to do that, we are mindful that our current business will also undergo a change; from a technology business to a managed services business; and where the customer consumption is held to a manner which will start becoming variablised more and more. And where I see this going is that our "as-is" business will start evolving itself into more of a SAS business, or more like a software service business or a platform service business. Hence, it is important for us to house our "as-is" operations into a division which will focus and invent itself once again from a managed services operation to a potentially leveraged SAS business and as we do that, and as we leverage this current base and convert ourselves to a digital transformation company, I think it is important that we invest very heavily into analytics, digital automation, asset assurance, internet of things, security areas and so on. Both

these aspects, while they have to co-exist, will also be managed with different mind sets. They have to be invested with different matrices, they have to be measured against different performances, therefore we have gone ahead and taken an in-principle approval from the Board to house these two businesses into two divisions and therefore given them an LLP structure. What that does is it will enable us to manage them strategically. I think it also needs to be supported by an underlining structure and therefore we can invest around people and processes which may be distinct, although inter-dependent, but will be distinct from that. So, that is another approval which we have taken and now we would be marching on towards that.

We also wanted to make this company more employee-driven and employee-managed and therefore I am pleased to say that both Mr. Vinod, who has been in the company for almost 20 years, and Mr. Ashwin, who has led the technology transformation of this firm, have been invited to join the whole-time Directorship of the Board. Also, Mr. Anil Singhvi was unanimously elected as our Chairman. Mr. Singhvi has been a Key Independent Director, Lead Director of the company and has provided overall Board leadership in our journey from 2011 till now in restructuring the company's overall shape from both finance and strategic perspective and also improving compliances and transparency within the company. Since we did not have any Chairman ever since the founder left, it was important for us to have that position filled, and as we think about the coming years; it is important that we, in the management team, think about the business in an operating cycle of about 2-3 years rather than a quarter or two or even an annual cycle simply because, this is how businesses are shaping and how we work with our customers and how we want to invest. I think there will be some areas which will have longer decision time period and so while it is not lost on us that we will be measured quarterly and/or annually, we are trying to focus on Subex 3.0 on a 3 year operating cycle basis. We believe that we have an opportunity to double the company in that period and we believe that leveraging its current base both of customers and portfolio, and now with our financial freedom, our affordability to invest behind what we have already done incrementally past year or so and the fact we have cleaned up from the Balance Sheet perspective, I think we have tremendous opportunity in front of us. Having said that it's also not lost on me that the market environment is challenging as you know, the direct industry is facing headwinds both from business model changes and also a kind of structure refreshing stand when it comes to consumption of Technology and IT services. But it is clear that until we re-invent and re-innovate ourselves, I think we will face challenges which are going to be much larger. On this note, with those initial remarks, I would love to open it up for Q&A and if you have any kind of background noise, kindly mute yourself so that others don't get disturbed around it. We can go ahead asking questions.

Shareholder

Just wanted to understand your forex hedging strategy which earlier used to have FCCBs on the balance sheet, and would partially hedge your exposure. But now considering most of the FCCB liabilities are off the Balance Sheet, how do you look at current rupee appreciation impact on profitability?

Surjeet Singh

We have purposefully kept ourselves open. I haven't taken any Rupee view and we haven't had any hedging done per se. At a balance sheet perspective, now everything is over anyway barring the \$3M FCCB which we have to repay now in July. If 5 weeks are left, we can take a position and cover today and secure ourselves. I do see obviously as you all know, a little bit secular sensing strength of Rupee. Our overall Rupee cost are about 20 odd million dollars from our total cost base so to that extent you can calculate per Rupee sensibility on our profitability. I think in the business that we are in, although there is a gain, in the next year we might do some hedging. Till now we had kept ourselves open and adopted up zero-hedging policy but we can also take that view. There are no Balance Sheet type items responsible on the Rupee side which is on a trading level of \$20m on our current cost and we will do with that.

Sangmesh from QVT

Thanks for doing this call. I just have two questions. Firstly, could you give us an update on how the order book is looking and the future growth outlook? Secondly, you have been talking about a lot of investments be it in the digital space, the analytic space or future businesses. Would you quantify some of these investments for us?

Surjeet Singh

On the order book, we recognized about 2 million odd dollars where our business was broadly in the same range. To that extent unlike last three years where we have consistently increased the order book in 2013 to an opening order book of \$140M, We ended up with similar order book now. And our order book could change dramatically because it's a function of winning some multi-year contracts. We were hoping to close it aggressively but in two or three deals, the customers ended up choosing to contract for a year rather than three years. That could change the coming orders to that extent, but it will still end up in the positive territory – that's the answer on order book. I think it is a good question on investment and an important one because there will be a gestation period. We have it in principle and that's the reason why I talked about the zero operating cycle. I think in my view that this company will require an incremental investment on the order of about \$7M-\$10M over the next three years. We have created plans to invest between \$4M-\$6M this year and we will measure the same. We have milestones defined to measure to that extent further investments and I think overall about \$8M to \$10M dollars with a gestation period of 9 to 12 months.

Neeraj

I have one question on the write-off which we have done over the last couple of years. I see that this is related to negative accounting profit and it's impacted your results as well. Given this plight, I just have two questions. Firstly, what do you expect about the future write-off about the goodwill, do you see that these write-offs will hit your P&L next year as well? Secondly, since it is impacting your results, will it impact your fund-raising ability for the investments which we just spoke about?

Surjeet Singh

I don't think so. It is a non-cash charge. Firstly, I think our balance sheet is fully delivered, unlevered. I don't see any capital raising issues. Secondly, I actually believe in making the business related incremental investments through operating cash flows and incremental accruals rather than raising debts and making operating investments. I think I would rather raise debt to do acquisitions rather than organic investments. I don't see that as an issue. I don't believe that there will be further write-back of goodwill. But it would be a realistic view of what we were thinking and where we were. I feel that Subex's Balance Sheet is good, Operations were done at very high price and when I decide on this company's Balance Sheet, I don't even worry that they are carrying values. We have been justified based on ongoing business instead of operations but in value of intangibles, if you look at Balance Sheet, it means about all that. I won't worry too much about those issues to be honest.

D P Rajesh, Banyan Capital

I wanted to understand about the formation of these two entities that you spoke of. You talked about executives attracting BG investors - in that, should we assume that the investments that you talked about will be coming from outside post using the operating profits of Subex?

Surjeet Singh

No, when I talked about creating two entities, it was not for raising capital for investments. It is that internally when you run operations, that strategy has to be far more effective so we are basically creating that. The true sense is that whenever you are going to your newer customers who may or may not have bought its business from you, or the adjacent customers, for example- media player or partner ecosystem of telcos, you don't necessarily have to worry about revenue assurance or fraud management. You can sell them your digital products and that's the reason why we are creating that for operating services. As I said earlier the specified outline would be from our existing cash that we have and also from the operating cash flow that we will generate. We are not creating these entities and/or divisions to raise money separately around that.

Neeraj

When you report financials, would you be separating in and out these two segments as well?

Surjeet Singh

No, we will be reporting financials at a Subex Limited consolidated level. We are just creating these as an internal division and therefore they are not separate segment reporting. As I said earlier, that our existing business of Revenue Assurance and Fraud Management has moved from being technology license to managed services. I want to over a time, take it to a SAP model which will have a different type of leverage and the same type of customer base and/or adjacent customer base to move into digital transformation type services which may have a different dynamic level as it relates to the revenue model or cost model. In anticipation and to measure them we did them internally. But from an external reporting perspective, these are not different segments.

Shareholder

Will there be three pieces to the business - one is the Fraud related revenue line and then these two new entities? Is that the right way to think about it?

Surjeet Singh

No, Revenue Assurance and Fraud Management is our core legacy business what we are calling as Revenue Assurance or Subex Assurance LLP. And then we are saying that there is a digital transformation services business which includes analytics, asset assurance, IoT securities, etc. We are housing that or attempting to house it as Subex digital. Just to repeat myself, The Revenue Assurance and Fraud Management business was license technology-based businesses and we morphed it to managed services. We would love to move it to more of an SAP model. The digital transformation business will be more consultative to begin with. It will be a more services-led model to begin with. We will have to create IP assets and therefore it could be IP led services, as an example. We may sell some components to that, we may create very different fiber revenue models, etc. That's the reason why it is such. But ultimately it will serve an overall umbrella of telcos and make them successful in their return on capital employed initiatives, in their customer matrix initiatives, and so on. Our customers whatever they buy from us, the X, it will get serviced through X1 and Y1. And what we need to do to X1 and Y1 could be different in different life cycles. That's why we are creating these and we plan to manage them internally well.

Rubin, Kotak AMC

Just wanted to know the nature of these investments that you will be making. Will it be for hiring new talent or will these be towards new IT infrastructure? What will these investments be like?

Surjeet Singh

These are largely investments in three broad categories. First we have to re-architecture our current technological platform. We moved a lot of our client server technology earlier to more analytical model. They have to make it cloud based, and some investments for the underlined "as-is" infrastructure that we have. Then obviously, as you rightly said, we have to make investment in hiring new people, more consolidated business people, different sales type people of different mindsets and then finally we have to do make three customer POCs and potentially three projects in the beginning to innovate with our customers and with that business. It's a combination of all. I roughly estimate 1/3rd will be in infrastructure, re-creation and balance related to people and geography, registration, and so on.

Srivasthan

Couple of questions. One is at broad level, you did mention that your Revenue and Fraud Assurance is your historical practices. What proportion of revenues would these two businesses standup? What will be the new service offerings? And also, wanted to know how would the fractions of Asset assurance and analytic pieces be? We had couple of new customers joining on the asset assurance piece, have we been able to take it global? Want to get your thoughts on that?

Surjeet Singh

Almost 75% of our business is in traditional Revenue Assurance and Fraud Management type area and about 15 odd percent is in partner settlement and partner management and about 10% is in Asset assurance. Although not full asset assurance, as you would like to see, but part of asset assurance in terms of network, discovery, etc. That is our “as-is” business. As we speak we are doing at least 5-6 groups of free project, so to speak, in analytics and full asset assurance life cycle management. One of them will start to become revenue generating business in this coming quarter. My expectation, and this is not forward looking, is that in the coming year, 2018, about 10-12% will be from our “as-is” transformation business and our desire to this will be from 10-12% to 24%. That’s where we want to make these. We started about 18 months ago, and we were in a kind of tight spot to make investment because of our balance sheet issues at that time. So our thesis was strong to be able to do two POCs at that time. My belief is the time has come that we have to invest aggressively and actually just test our belief in the market rather than stay conservative. We will stay financially prudent but we have to become aggressive in the market and create some kind of a financial status as well.

Srivasthan

Very nice to see Ashwin and Vinod on Board. Wanted to understand from an employee incentive program, most of the old ESOPs will not be relevant. Was there any fresh plan of giving meaningful ESOPs to these senior management?

Surjeet Singh

Yes, we knew that the stock related compensation is present. Given that there is expanded capital base of the company, we have already done two things. One, we have already created a good kind of retention and variable component for the senior management team including Vinod and Ashwin. We have also done something more just for the Senior Management. We have actually created a team of 45-50 Subexians and we are calling them an ‘Operating Leadership Team’. They are working on various initiatives from both a customer touch point and internal perspective. We have sort of created differentiated cash bonus and tight structure for them which is for a period of three years which is directed more towards retention on one side and also differentiated performance. We are going to move towards an equity based compensation structure over the next coming quarter or so and we wanted to kind of cleanup the balance sheet and make sure that we have operating grant right up and therefore be able to project out as to how we can create shareholder wealth first and that can also be shared with employees. I think our directional thinking is that we want to have a meaningful equity distributed to our employees as we move and make this fully sort of employee managed company.

Shareholder

How is the business shaping up? Are you looking at raising of capital?

Surjeet Singh

We don’t have any eminent means. We look for M&A. We might raise some capital, raise debt but operationally we don’t have to raise capital. We have cash in hand and make those investments in operating aspects.

Shareholder

What does the order book like?

Surjeet Singh

We started with an order book of close to 135 to 140 Million Dollars. That is where we are at.

Shareholder

What is the order book last year?

Surjeet Singh

Started with 135 and closing is same. Some of the customers and some of the new business which we won could have been at 3 to 4-year contract basis and can become that way. We ended up with the same order book as we started the year and I think that can change in the coming quarters.

Shareholder

Are we looking at dividend payment to shareholders?

Surjeet Singh

That is our desire and attempt and we will endeavor.

Shareholder

I think that it will boost the shareholders and since the result is better this year.

Surjeet Singh

Right.

Jitin

I have seen over years that to clear debt, equity base has gone up quite a much. Do you think that it will create the balance sheet at a high equity base that makes Subex Share price go up? The promoter holding as of now is very less.

Surjeet Singh

We don't manage the share prices. Share price is function of overall performance. Our focus is to operate the company well and make it profitable.

Mangesh Kulkarni, Almond

I just wanted to know from your business, do you have any pipeline in IoT and product pipeline in digital platform business?

Surjeet Singh

Yes, we have. As I said earlier 4-5 POCs and one of them will convert to commercial order in the coming quarter. This will take gestation of 9-12 months and our endeavor is to do it earlier. But that is why we are making investments right now but from whatever POCs we have done, whatever market testing we have done, I think we are on the right track and that's why we want to invest in them.

Shareholder

You have also mentioned doubling from year in the next three years. The Current growth rate is around 15%, so business growth rate will not be able to do that. We are looking at much higher growth rate in one or two years, is that's what it should be?

Surjeet Singh

Yes, that's what we said earlier. When We make investment, we want to make sure that we are thinking on 3-year operating cycle bases and that's on goal and that's the reason. My view is that as a company, if we can't grow faster, you might become smaller sooner. Therefore, it is important for us to grow faster and in the areas which create a multiplier effect of the growth rate. That's the areas which we have identified and going to invest in.

Shareholder

On the Separation of two businesses again - we are completely not looking at any investment and if any investor comes and says that they are interested in one part of the business, are you not going to look at this proposal?

Surjeet Singh

We will measure every proposal on its merit. And the question I was answering to was that whether we are creating these two divisions for raising capital, and go out to raise this capital. We don't need capital for these divisions for organic plan but if there are inorganic opportunities that present themselves and are strategic and if we need to raise capital, we will raise capital and it will not be limited by these divisions. It will be raised by the parent company, if necessary. If we need to structure it differently, we can think about that. That's not a problem.

Kumar

In one of your interviews three years back in July 2014, you were hinting Subex to be a \$100M company in three years. So, we are almost three years now and you are half way through it, so, what went wrong and what would you think in next couple of years?

Surjeet Singh

I would like to take all the questions in one shot and reply

Kamal

I just wanted to know what is the revenue guidance in the coming quarter, now that the balance sheet is also clean. What are the possible areas you are working on in the future years? And the second question is, there are rumors happening in the market that there can be an M&A possible? Do you have any comment on that?

Surjeet Singh

Any other last question?

Amit Mishra

I just want to know that in the software business we have around 30-35 clients from top 50 clients across the world. Is this business secured for us or there are any competitors? What I want to ask is, is there a Monopoly for Subex in this aspect? And the second question is we have a very big equity base, is there any plan in future, may be couple of years or three, to reduce the big equity base by doing some reverse split and acquisition by promoters? Any guidance if you can provide for the coming years and congratulations for the good set of numbers.

Surjeet Singh

I'd to respond to the July 14 reference, I don't recall the exact verbiage, but maybe in a year after taking over, I think I may have said that this could become a \$100M business and I truly believed in that and we needed to make those investments at that point in time. At that point of time I also thought that the Balance Sheet restructuring could be faster than where it ended up being, as you all know. We ended up taking almost about 14-15 months in the regulatory approvals for our restructuring to covert the FCCB base to equity and therefore we just couldn't execute on our investment thesis and today as we sit here in mid of 2017 almost, I would have liked to see the digital transformation services business to have taken the forefront shape. Anyway, regardless, I think my thesis around strategic, its better off this company has not changed since then. And our endeavor as explained in this call will continue to remain so. We don't provide any revenue guidance as a policy and so, I will refrain from providing quarterly and annual guidance per se but I have indicated as to where, collectively as a team, we want to take this company both from investment perspective and therefore how we are thinking about in terms of operating timeframe and operating cycle. We are mindful that we are a public company and therefore we have to report quarterly but I have to say that we don't plan quarterly or think quarterly because we cannot afford to do like that in a business like this.

M&A Rumors always can happen. I am not afraid about those nor am I alien to those. Previously also we have managed those. But once again, I think my view is that you know M&A as a business is that you don't have to project or predict. Our objective is to expand shareholder value and you know if it happens, at the end of the day, shareholders will decide about that. We from the management perspective are here to run the company efficiently.

Our software business of 35%, no business is normally these days, but we are fairly well entrenched and that is the reason why we adopted the managed services strategy three years ago and almost cannibalized our license business in order to stay engaged with our customers and stay relevant in their domain, and to that extent. I think we are well entrenched and well protected. We can only measure by customer losses if any and I am pleased to say that we don't have any customer losses in the last three years. Yes, our equity base is high, there was no option but to equitize our large debt, there wouldn't have been any possibility but to equitize it, given the size of debt we had. And as we grow the company's business forward and as we stand the business, if there are opportunities to reduce that base and reward the shareholders. If there are different ways to do that, the board will absolutely consider that and whatever is appropriate, we will definitely do that. We want to make sure that we make adequate investments in the business on time. Once the business is protected and is growing well, the rest is easy to take care.

With that I want to thank everybody for your time and we would like to do have this call more regularly. And thanks for listening to us.

If you have any questions, please do email and we will entertain the request and if there are any clarifications required, we are happy to entertain them and we are here to answer those questions. Thank you once again.

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