CMP: Rs.210.00

KELLTON TECH SOLUTIONS

Thesis –

We live in a world where we transact billions in Capital market, banking system just with a click. From ordering food to buying grocery to booking a cab everything is done online. There has been a blowout of the number of applications made in past 3 years with the entry of smart phones.
India has already become a big start up hub with large number of jobs being created.
Over the last 250-300 years there have 4 revolutions that have changed the way man live

1) 1760-1820 – Use of Machines change Industry and Output
2) 1830-1876 – Growth of Railways and Steam Engines changes logistics
3) 1900-1930 - Use of electricity instead of kerosene got appliances except light
4) 1960-2000- Growth of Computers
5) 2010- ? - Growth of Internet of things?

We have definitely entered a massive growth phase in internet of things, Social, Cloud, Analytics and Mobile. This is a story not for the next 1-2 years but for the next decade. We believe in the next 5 years smart cars, smart appliances, smart watch and smart glass will be the new normal.

So why Kellton ? – There has been a massive surge in business from start-ups in the last few years and they have become critical. As Bill Gates say if your business is not on the Internet, you won't be in business for long. There has been a change in the way people do business; Market places have made businesses extremely efficient and transparent.

Kellton got its name from the founders university i.e. Kell – for Kellogg (USA) and ton from Wharton (USA). The new management took over in 2009 and has increased employee count from 2 in 2009 to 1000+ in 2015. They have done this with help of organic as well as inorganic growth. They have a strong client case of marquee client like Flipkart, Alibaba,Snapdeal,

STOCK DATA

Market Cap(Rs. cr)	950
Debt	83
Cash	17
Enterprise Value	1016
Promoters Holding	62.68%
52 week high/low	243.90/162.7
Shares outstanding	4.6

KEY FINANCIALS (Rs. in cr)

Y/E JUNE	2012	2013	2014	2015
Revenue	40	49	133	240
Operating exp	35	42	120	206
EBITDA	5	7	13	34
Depreciation	1	1	2	3
Interest Expense	0	1	3	6
PBT	4	5	8	25
Taxes	0	0	1	4
PAT	3	4	7	21

VALUATION : Kellton is currently trading at fair value.**We decrease weight in kellton from 9% to 5% because of weakness in short term chart patterns.** Kellton is a high risk bet not for people looking for portfolio stability. We believe in the management and adding more weight if kellton manages to close above 240 would be a great idea.

Makemytrip etc. We normally don't like companies that are growing with a lot of inorganic growth but with kellton we think that it was the right decision. Why? Once you get a client he wants you to build an application for him, then he wants analytics to understand buyer behaviour and then may be an ERP setup. So acquisition in midcap software actually creates value as you become all in one shop. You will want the same person to setup analytics software for you as the one who developed the software for you as it easier for both parties and makes more sense. In an interview Niranjan chintam (management) says that he acquires companies for customers which we believe is amazing as now he already has the capability to be a one shop solution company.

The Company has set out an guidance of 2000 crores revenue in the next 3 years, we definitely have no clue if that will be achieved or no, as it's foolish to forecast. What we understand is that the opportunity is massive and promoters are amazing. In the later part of the report we have given scenario's which may play going forward. We are buying a fast growing company in SMAC space at fair valuations.

Below are the Numbers for the last 12 quarters where the company has grown sales from 12 Cr. to 116.51 Cr.

	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Sales	11.95	12.63	25.22	26.42	40.23	41.81	42.41	45.43	46.31	103.76	110.22	116.51

Traits of this growth company that we like:

Smart and Efficient Management:

Kellton Tech was formed in 2009-2010 after Krishna Reddy chintam and Niranjan Reddy Chintam took over a two employee company VMF softech. They have transformed this 2 employee company to above 1000+ Employee Company today. The promoters have nurtured and sold three companies prior to Kellton, thus they possess the ability to grow and run business efficiently. In last 5-6 years they have created value the disruptive SMAC space for their clients and shareholders. **70% of Kellton's clients are start ups or small enterprise Business which have growing demands for information technology.**

Below is the list of few Clients that kellton Serves in India & Abroad.

AEGON LIFE	**JP MORGAN**	**DUPONT**	**JOHNSON&JOHNSON**
GE HEALTHCARE	**NOVARTIS**	**KAPLAN**	**DISCOVERY CHANNEL**
SNAPDEAL	**JABONG**	**PAYTM**	**MAKEMYTRIP**
STARBUCKS	**NIKE**	**CLUB MAHINDRA**	**INDIGO**

Kellton has issued warrants to promoters in 2009 (est. 6-7 per share), 2015 (90 per share) and promoters have created value for themselves. Management has the understanding and ability to take correct acquisitions decisions which help them to grow their top line and bottom line at CAGR 82% in last 3 years.

Opportunity size:

The size of the overall SMAC industry globally will be close to $1 trillion by 2020. From the Indian software exporters' point of view, it will be $15 billion within the next three years, and over $ 225 Billion by 2020.SMAC (Social, Mobile, Analytics, Cloud) and IOT Services are hot in recent times due to immense opportunity.

These services have redefined the ease of doing business and making money in the IT space. There is ample opportunity as more companies are shifting on cloud and analytics is helping them to explore new ways of improving their way of doing business (In an interview the management said that shifting small enterprises to cloud is an important revenue source). Mobile app market is doing really well as more and more internet users shift to mobile for their daily life needs.

What is SMAC and how it helps?

SMAC creates an ecosystem that allows a business to improve its operations and get closer to the customer with minimal overhead and maximum reach. The proliferation of structured and unstructured data that is being created by mobile devices, sensors, social media, loyalty card programs and website browsing is creating new business models built upon customer-generated data. All the four technologies mentioned above, together creates synergies and hence competitive advantage.

Social & Mobile: It has provided businesses with new ways to reach and interact with customers, while mobile technologies have changed the way people communicate, shop and work.

Analytics: It allows businesses to understand how, when and where people consume certain goods and services.

Cloud Computing: It provides a new way to access technology and the data a business needs to quickly respond to changing markets and solve business problems.

The integrations of all these technologies can do wonders to a company taking it from nowhere to everywhere. For example in case of Flipkart, they can get the data of how many people visit their mobile app and what do they search for. This data which is stored in cloud can be used for analytics purpose. The various statistics drawn from such analytics can help Flipkart to get increased customer satisfaction and traffic to its website.

Management Guidance

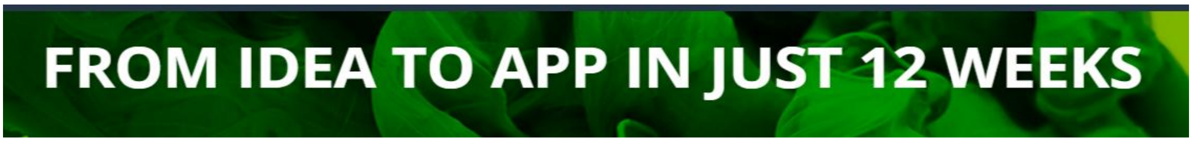
Kellton Tech targets Rs. 2000 crore annual revenue in the next three years. The company aims to double the revenue coming from ERP and EAI segment.

The company plans to reach 600 crores of revenue by June 2016. We believe that 600 crore is a difficult task and kellton will manage to do approximately 440-470crs.

About Kellton's Business

Kellton is in the business of:

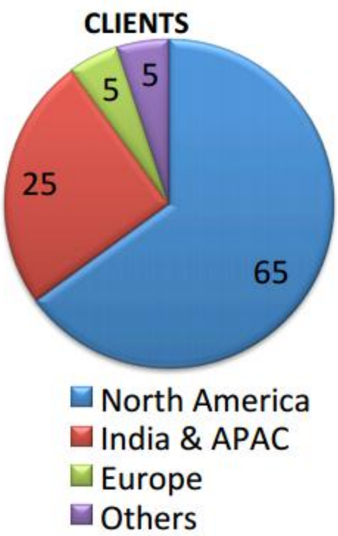
1) Making Mobile application for start ups and a few fortune 500 companies.

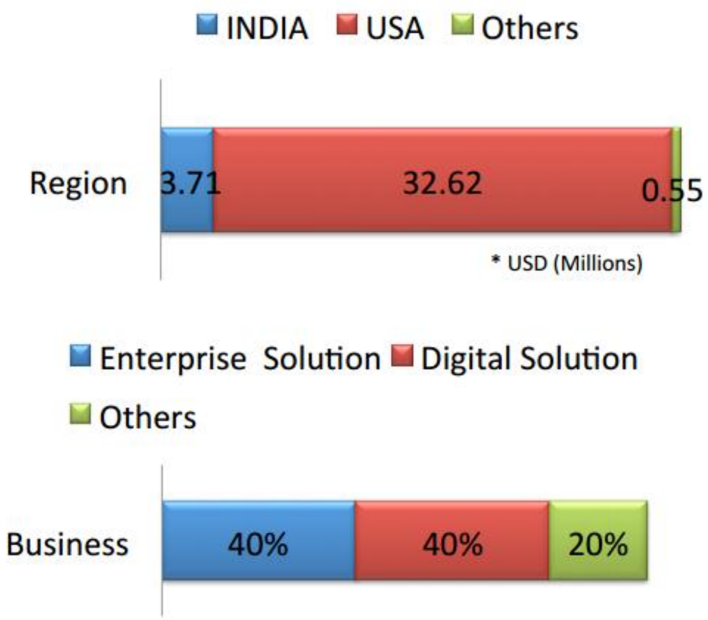


2) Shifting the company to an cloud based platforms

3) Providing Internet of things solutions.

Revenue Break-ups: Basis of clients, Business and Geography





Kellton acquired Prosoft for $14 million in 2015

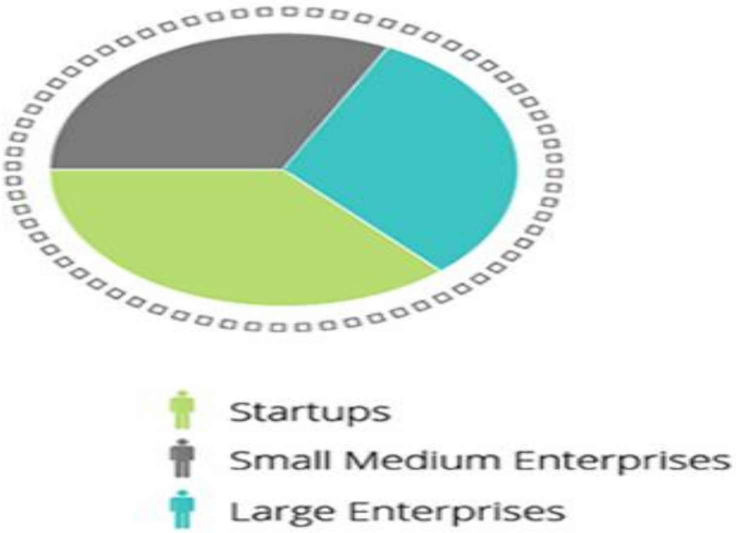
Through this acquisition, ProSoft Group, which consists of four companies — Prosoft Technology Group Inc, Intellipeople Inc, Cyber-World Solutions Inc and Prosoft Business Solutions LLC — will add $40 million to the top line and $3 million to the bottom line of Kellton. The acquisition will bring 375 employees of ProSoft, including 120 working out of its global delivery centre in Hyderabad, to our fold, taking the combined global headcount to over 1,000.

ProSoft would strengthen the capabilities of Kellton to go to a much larger customer base, especially in the ecommerce space. ProSoft Group, besides reinforcing Kellton's expertise in WSMAC (web, social, mobile, analytics and cloud), Internet of Things and other cutting –edge technologies while amplifying its capabilities in ERP-EAI (enterprise resource planning and enterprise application integration) arena, the acquired company would also give Kellton annuity revenues through maintenance contracts that ProSoft has with its clients.

The company has maintenance contracts with 12 of our 75 active customers, with annuity revenues of $500,000 to $1 million. Kellton Tech was actively looking at acquiring two more companies, with revenues of between $9 million and $10 million, in the US and Europe, which would bring in customers or give the depth in the area of business that Kellton Tech is in.

Strong Clientele

85% of the revenue of the company comes from repeat business due to ability to deliver optimum results. They have served more than 500 clients ranging from start-ups and early stage enterprises to Fortune 500 companies.



Company's major revenue comes from small enterprises and start-ups (30% and 40% respectively). i.e. only 30% comes from large mature companies and 70% from emerging companies which have high need to information technology. The opportunity for kellton is huge for the next 5 years.

Risk –

1) Acqusitions risk – Kellton will be doing many acqusitions to achieve its 2000 cr. Sales target in next 3 years. Acquisitions are risky and may fail.
2) Currency Risk – A large percentage of Kellton's Money comes in dollar, hence weakness in dollar is a risk
3) No Cash Flows – The company doesn't have operating cash flow. We understand that fast growing companies have cashflows skewed to the latter part but no cash flow is the biggest risk we see.

Valuation Theory

Now Kellton is a difficult company to value specially because there isn't any operating cash flow which is the biggest risk according to us. If the management cannot create operating cash flows in the next 1-2 years then we believe the game will be over.

For FY 2016 we believe the company will do a profit of 40 Cr. i.e. the company is currently trading at a FY 2016 PE ratio of 22.

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Sales	**45.43**	**46.31**	**103.76**	**110.22**	**116.51**
Expenses	39.11	38.1	91	94.21	100.04
Operating Profit	**6.32**	**8.21**	**12.76**	**16.01**	**16.47**
OPM	13.91%	17.73%	12.30%	14.53%	14.14%
Other Income	1.05	0.09	0.6	0.07	0.13
Depreciation	0.37	0.75	0.86	0.76	0.75
Interest	1.32	1.57	1.91	2.66	3.26
Profit before tax	**5.68**	**5.98**	**10.58**	**12.66**	**12.59**
Tax	0.83	0.47	2	3.09	2.46
Net Profit	**4.85**	**5.5**	**8.59**	**9.57**	**10.12**
NPM	10.68%	11.88%	8.28%	8.68%	8.69%

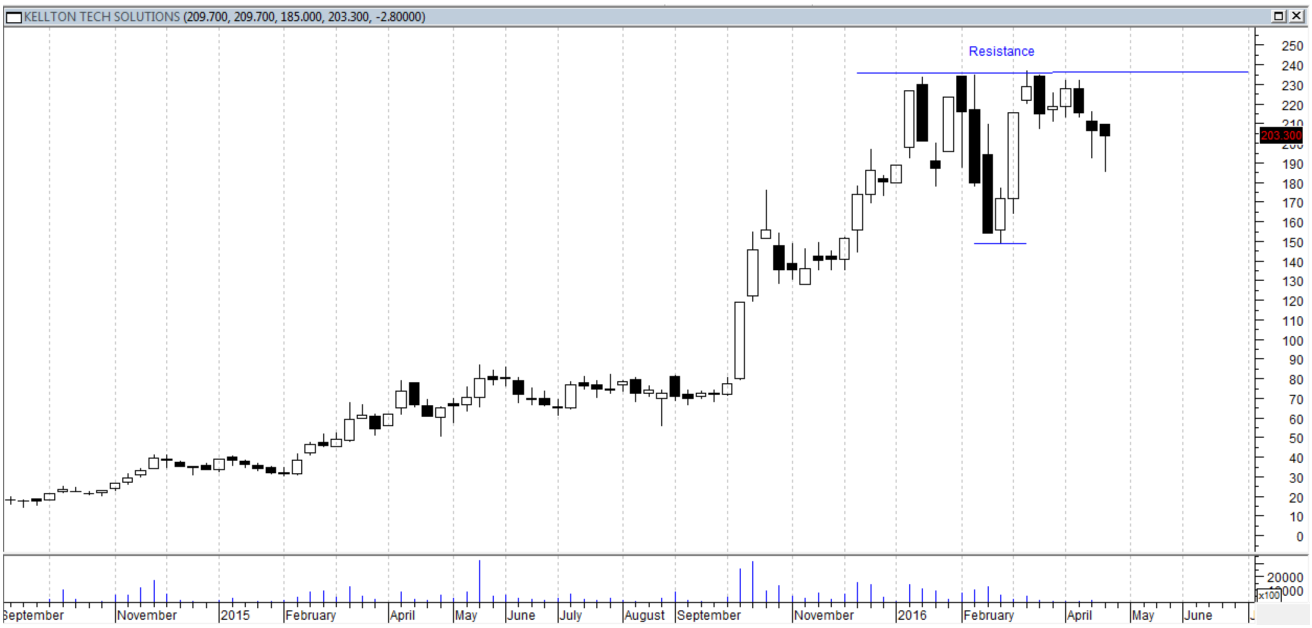
Kellton is in a sector which can grow 5x-10x in the next 3-4 years. The management has stated that they will achieve the growth via organic and inorganic growth. Kellton is expected to come with its QIP soon to raise about 100 to 120 crore. This is a Risky Bet and shouldn't be taken for people for looking at capital protection.

	Best Case	Scenario 1	Scenario 2	Scenario 3
Revenue in 2018 (cr.)	**2000**	**1000**	**1200**	**1600**
Net Profit Margin	12%	10%	10%	10%
Profit	240	100	120	160
Valuation @ 15 PE	3600	1500	1800	2400
Discounted at 15%	2367	986	1184	1578
Equity Dilution 20%	1894	789	947	1262
Today's Fair Price	421	175	210	281

Here is the valuation of the company according to the guidance given by the management. After factoring in the growth forecast given by them (management) and the expected dilution in the equity due to the QIP, the company's valuation stands at 421 per share. It is usually observed that management guidance is never achieved in high growth companies and hence it would be very wrong to consider this level as the benchmark for valuation purpose and forecasting growth is useless as major growth for this company in the past and going forward is going to come from inorganic growth. Historically a growth stock trade way higher than its fair value due to the large opportunity size, Kellton (being a growth stock) too can trade at higher valuations. Growth Stocks get a scarcity premium because in a world with negative interest rates, 80% CAGR growth achieved by kellton in last 3 years is a dream.

So in the table given above we have showed different possibilities, the best case is according to the management guidance and even if the company does revenue lower than, we can assume that it is currently trading at fair value and since this is a growth stock we can expect the stock to trade above its fair value.

Technical View – Kellton is in a long term bull market but has been facing resistance at 210-215 levels in short term. Kellton has been a massive underperformer in the rally in april. We believe that Kellton will rally only once it crosses level of 240. For opportunity cost traders it will be good to add some positions now increase bet size as kellton closes above 240 for 2 days.



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