September 23, 2019

Kellton Tech Solutions Limited: Ratings downgraded to [ICRA]BBB+(Negative)/[ICRA]A2

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Working Capital Facilities	24.00	20.00	[ICRA]BBB+ (Negative); Downgraded from [ICRA]A-(Negative)
Short-Term Non-fund-based Facilities	20.00	20.00	[ICRA]A2; Downgraded from [ICRA]A2+
Long-Term/Short-Term Non-fund-based Facilities	0.00	28.21	[ICRA]BBB+ (Negative)/[ICRA]A2 Downgraded from [ICRA]A-(Negative)/[ICRA]A2+
Unallocated Limits	106.00	81.79	[ICRA]BBB+ (Negative)/[ICRA]A2; Downgraded from [ICRA]A-(Negative)/[ICRA]A2+
Total	**150.00**	**150.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action takes into consideration the continued high working capital requirements of Kellton Tech Solutions Limited (KTSL), driven by elongated payment cycles from customers and accrued revenue, which have, in-turn, resulted in high utilisation of working capital facilities in the last two years. Thus, timely sanction of enhancement of working capital facilities remains a key rating sensitivity, given the expected increase in scale of operations. While revising the rating, ICRA has taken note of the significant reduction (~57%) in KTSL's market capitalisation in the last six-month period, which is likely to moderate the company's financial flexibility.

The ratings, however, continue to reflect KTSL's established position in the digital transformation segment and its ability to cater to client's requirements across various sectors. The ratings further continue to positively factor in the relatively healthy order book position of the company of ~ Rs. 600 crore (as of August 2019 end), which provides visibility for revenue receipts going forward. In addition, the ratings take into consideration the company's strong management team of technocrats, which has aided to establish itself in key markets such as the USA and secure repeat orders from customers.

Nevertheless, the ratings remain constrained by the high geographical concentration risk (~80% of KTSL's revenue is derived from the USA market) and the high industry competition. The ratings further take into consideration the company's moderately elevated debt levels due to the part-debt funded acquisitions and the high working capital requirements. However, ICRA notes that the debt-protection metrics remain comfortable. Furthermore, the company's operations remain susceptible to foreign exchange fluctuation risk and risks such as employee attrition, which are typical to IT industry.

Key rating drivers and their description

Credit strengths

Established presence in Digital Transformation Segment – The operational scale of KTSL has witnessed a healthy increase over the past five-year period, aided by strong order in-flow, especially from the digital transformation segment and the strategic acquisitions that expanded its sectoral and client coverage. The company now has an established presence in the digital transformation segment, equipped with the ability to cater to client requirements across various sectors such as Information Services & Technology, Professional/Business Services, Education, Education and Utilities, Banking and Financial Services etc.

Healthy order book provides revenue visibility in near-to-medium term- As of August 2019, KTSL had an unexecuted order book of Rs. 600 crore (including Rs. 41 crore order from Food Corporation of India), which is expected to drive reasonable revenue growth for the company going forward.

Experience of promoters in IT Industry – The established presence of KTSL's promoters has helped the company to identify lucrative opportunities for acquisitions, while also expanding its client base.

Credit challenges

Relatively high working capital intensity owing to receivables and accrued revenue – The working capital intensity of KTSL remains relatively high, owing to the elongated payment cycles (especially from large customers) and the accrued revenue. In FY2019, the working capital intensity was also impacted by sale receivables of Bokanyi and Supremesoft Global (net assets included under other current assets). The aforementioned factors have impacted the company's overall cash flows and consequently, the working capital utilisation levels, given the limited sanctioned working capital lines. The utilisation of sanctioned working capital facilities remains full especially at the standalone level.

High geographical concentration risk with dependence on USA market – The company derives about 80% of its revenue from the USA market, which is characterised by high competitive intensity as well as risks pertaining to restrictions on workforce deployment as well as level of permissible outsourcing.

Debt levels to remain contingent on acquisition plans: Given that the company is likely to grow its business through acquisitions (in line with past trends), part debt-funded acquisitions are likely to keep its debt levels moderately elevated.

High competitive intensity: KTSL faces competition from the larger Indian IT services companies and other small and mid-sized companies in the respective markets. However, the company's focus on mid-size customers (<$5bn orders) limits competition from larger players, particularly in the international markets.

Liquidity position: Adequate

At a consolidated level, KTSL's liquidity is adequate, with healthy cash flow from operations of nearly Rs. 50-55 crore, long-term debt repayment obligations of Rs. 21.7 crore, and earnout payable of Rs. 12-15 crore for FY2020. The capex incurred for FY2020 has been in the form of acquisition of Tivix Inc, at a consideration of $2mn, mainly funded from the sale proceeds of Supremesoft Global. While there is a cushion available with respect to working capital requirements at a consolidated level, at a standalone level, the utilisation of working capital facilities is high. Hence, timely enhancement of the same remains critical.

Rating sensitivities

Positive triggers – ICRA could revise the outlook on KTSL's rating to stable provided there is [a] timely enhancement of working capital facilities and/or [b] reduction in working capital requirements on a sustained basis.

Negative triggers – Negative pressure on KTSL's rating could arise in case of a] any significant build-up in the receivable position and b] any further delay in enhancement of working capital facilities in which case its liquidity position at a standalone level is likely to be stretched. Also, any large sized and debt-funded acquisition would remain a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Information Technology (IT) Services Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the consolidated financial statements of the rated entity.

About the company

Incorporated in 1993, KTSL is a global information technology company which provides IT services in the web, mobile, security, ERP and cloud space. The company offers customised Digital Transformation solutions, which include three major business units namely Digital Transformation, Digital Connected Enterprise and Enterprise Solutions. It currently has around 1500 employees across India, the US, Europe and Asia Pacific regions.

At a consolidated level, in FY2019 the company reported a net profit of Rs. 76.94 crore on an operating income of Rs. 814.44 crore compared to a net profit of Rs. 68.40 crore on an operating income of Rs. 783.48 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	783.48	814.11
PAT (Rs. crore)	68.40	76.94
OPBDIT/OI (%)	15.34%	14.75%
RoCE (%)	34.43%	27.98%
Total Outside Liabilities/Tangible Net Worth (times)	1.23	0.82
Total Debt/OPBDIT (times)	0.96	1.04
Interest Coverage (times)	7.27	6.24
DSCR	2.01	2.67

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Rating (FY2020)					Rating History for the Past 3 Years	
		Type	Amount Rated	Amount Outstanding	Current Rating	Earlier Rating	FY2019	FY2017
					23-Sep-19	9-Apr-19	28-Sep-18	03-Mar-17
1	Fund-based facilities	Long Term	20.00	-	[ICRA]BBB+ (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	[ICRA]A- (Stable)
2	Non-fund-based facilities	Short Term	20.00	-	[ICRA]A2	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
3	Non-fund-based facilities	Long Term/Short Term	28.21		[ICRA]BBB+ (Negative)/[ICRA]A2			
4	Unallocated Limits	Long Term/Short Term	81.79	-	[ICRA]BBB+(Negative)/ [ICRA]A2	[ICRA]A- (Negative) /[ICRA]A2+	[ICRA]A- (Negative) /[ICRA]A2+	[ICRA]A- (Stable) /[ICRA]A2+

Amount in Rs. Crore

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	-	20.00	[ICRA]BBB+(Negative)
NA	Letter of Credit	NA	NA	-	5.00	[ICRA]A2
NA	Bank Guarantee	NA	NA	-	15.00	[ICRA]A2
NA	SBLC*	NA	NA	-	28.21	[ICRA]BBB+(Negative)/[ICRA]A2
NA	Unallocated Limits	NA	NA	-	81.79	[ICRA]BBB+(Negative)/[ICRA]A2

*includes roll-over clause post one year

Source: Kellton Tech Solutions Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name*	Ownership	Consolidation Approach
A Kellton Dbydx Software Private Limited	100.00%	Full Consolidation
B Kellton Tech Inc	100.00%	Full Consolidation
C Kellton Tech Solutions Inc	100.00%	Full Consolidation
D Kellton Tech Limited (Ireland)	100.00%	Full Consolidation

The entities mentioned below are wholly owned subsidiaries of KTSL

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About ICRA Limited:

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