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Q3 FY2020 Investor's Conference Call February 7th, 2020

SPEAKERS: Mr. François-Charles, Chairman and CEO;
Mr. Ganesh Murthy, Chief Financial Officer;
Mr. Sanjay Bhambri, President and COO.

Operator:

Good morning ladies and gentlemen, I'm Avinash, the moderator of this call. Thank you for standing by and welcome to Onmobile Q3 FY 2020 Investors Conference Call. For the duration of presentation, all participants' lines will be in listen only mode. There'll be an introduction to the results followed by a Q&A session. Joining us today on the call, Mr. FC the Chairman and CEO; Mr. Sanjay Bhambri and Mr. Ganesh Murthy from the management team.

Before we begin, I would like to mention that some of the statements made into this call, maybe forward-looking in nature and may involve risk and uncertainties. For the list of consideration, please refer to the earnings presentation. Onmobile Global undertakes no obligation to publicly revise any forward-looking statement to reflect future likely events or circumstances. Please be advised this conference is being recorded today. I would like to now hand the call to Mr. FC. Thank you and over to you sir.

François Charles Sirois:

Thank you very much. Thank you everyone for joining this morning. Overall, a good quarter, stable revenues and we have a lot of new deals that started yielding some revenues. So, on that side, I just want to mention that we have seven of our top ten customers that actually had a growth quarter over quarter. So, there is improvement in operating profit as you can see also, and a very good cash position. It was a good quarter for cash collection and cashflow, ending position at USD 35 million. So, that's a good on the highlights.

On the lowlights, I want to share with everyone a couple of points which are quite important for analyzing our margin. First of all, you know on the LatAm side, we have been experiencing some decline in revenues in the last quarters. And just to share with everyone, the loss on this quarter is around INR 29 million. So, it's getting worse and worse. We are at negotiation right now with some key customers to address exactly that point and bring it back. We kept it because we had some expectations to actually start delivering new services and grow revenues in LatAm. LatAm used to be a very important region for us. Now it's very low in the revenues; but, obviously, we cannot afford to maintain a position where we lose a pretty much USD 400,000 per quarter. It has a key impact on our profitability, on the core profitability. So, that's why I mentioned it.

The second thing I want us to think about is our gaming investments. We are investing a lot in R&D on gaming to bring the old platform and the Appland platform to the next level. We have very good plans which we will be releasing in the coming quarters. But today from both a distribution point of view where we activate new clubs, we did activate eight new clubs this quarter. But obviously, as I explained last time, there is a cost to deploy new clubs versus the actual

starting revenues which take a couple of quarters. So, when you look actually the distribution costs and the R&D costs combined on the gaming, which I really said is a key investment for us, we are talking about this quarter of INR 34 million of loss which is pretty much USD 500,000. So, when you combine both the LatAm loss and the gaming investment to our INR 111 Mn of EBITDA, you know, our core business EBITDA should be around INR 174 Mn which is almost USD 2.4-USD 2.5 million per quarter. So, on a normalized annualized basis, we are talking about USD 9.8 million.

So, when you look at the actual EBITDA margin of 7.4%, on the core business, it should read actually 12.9%. So, that's an important point that I want to share. And next quarter we will be tracking both the gaming investment and the LatAm situation so that investors understand a bit more the profitability of our core business versus investment or issues in some region.

Lastly, I just want to say that we have been working on the business transformation. We changed in this quarter the way we operate. That is a big change touching everyone. We are changing the way we see our customer facing units, making sure that the customer facing units are lighter, more agile with the customer, and on the core operation that we have less processes and more accountability. So, we will see the impact of this in the coming quarters also in our results. So, after this I am going to ask Ganesh to go through the financials.

Ganesh Murthy:

Thank you FC. Moving on to the financials, in the current quarter, our revenues were stable on a quarterly basis with the revenue of INR 149 crores as against INR 148 crores in the last quarter. Our key product lines, i.e. Videos and Contests witnessed growth of 4.5% and 19.4% quarter on quarter. This quarter, we had the full impact of the newly introduced Indian accounting standards. So, we had to amortize our contract acquisition costs against revenue unlike previous quarter which had only a two months' impact of the same. So, this contract acquisition cost has impacted our gross margin. But if you look at it on a like-to-like basis, our gross margin remains constant at 53.5% quarter on quarter.

On the cost front, our manpower cost is down by 5.3% quarter on quarter despite the fact that we gave salary increases across the board effective December 2019. We are on track in our process automation and rationalization, which has enabled us to keep this manpower cost under control. Our exit headcount for this quarter stood at 702 people as against 734 people last quarter. Our EBITDA was marginally higher with a 3.3% growth. That is INR 10.7 crores

were in Q2 versus INR 11.1 crores in Q3. Our PBT at INR 9.8 crores has grown by 38.3%. Our profit after tax registered a multifold increase from INR 1 crore to INR 6.5 crores. And our ETR, effective tax rate, is lower and touched 33.7% in Q3 on account of decrease in deferred tax assets.

Our focus on collections in this quarter, as FC mentioned, has paid off very well, and this is reflected in our cash balance improving from INR 234 crores at the end of Q2 to INR 253 crores at the end of Q3. And this is despite dividend payment to our shareholders of INR 16 crores during the quarter. Our higher collections from the customers has also resulted in improvement of DSO from 155 days in Q2 to 140 days in Q3, and thereby also contributing to our favourable cash position.

In summary, I would like to say that this quarter has been a quarter of consolidation with focus on collections, cash, cash flow and on closing several deals. And the impact of this will be felt in subsequent quarters. We continue to remain focused on our strategy of leveraging tones and expanding on Games and exploring opportunities beyond operator wallet. Now with this, I would like to hand it over back to the moderator and open the line for questions.

Operator:

Sure sir. Thank you. Ladies and gentlemen, if you'd like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. A voice prompt on your phone line will indicate when your line is open. Please state your name before posing your question. Once again, please press star one to ask a question. We will pause for just a moment to allow everyone to give an opportunity to signal for questions. Once again, ladies and gentlemen, if you'd like to ask a question, please signal by pressing star one on your telephone keypad. We will now take our first question, I request the participant to please state your name before posing your question.

Arman Morya:

Hi, this is Arman Morya from Alfaacurate. Sir, my question is largely towards the revenue growth. If I see consistently from last five, six quarters, we had been de-growing. Now the credit to the management is that from last two quarters, basically your profitability had started improving. So, how we should look going forward from the revenue growth outlook and the profitability perspective?

And I'm also looking to ask that all the restructuring which we wanted to do at the employee level, are those done? And how the business looks like, because there has been a consistent change in the

business model over a period of time. So, if you can help us understand these three things

François-Charles Sirois:

I want to start tracking every quarter our core business profitability versus our key investments or key losses in LatAm. You know, you see this quarter is stable on revenues, last quarter grew. This quarter should have grown with seven of our top ten customer growing but, in some regions like LatAm, they have been impacting the results down on different situations. So, in my view, you know, a 12.9% EBITDA margin on the core business should be increased, towards at least the 15% mark. That's what I personally aim at. And that's why I want to track it separately because the more and more you'll see huge opportunity on gaming. I really see a big opportunity in the Indian market. We will have to invest in marketing, we will have to build our brand, and also deploy it globally. So, it's very important that we start tracking this project separately because it's like a big soup, right? If we put everything in the soup, you won't be able to know what's in, what's out and what's happening. So, it's very important that we track the core business separately from these special projects like gaming where I see a big future, but that comes with some key investments.

And specific situation like LatAm is the same thing. I mean, for me, I don't want the drag of LatAm every quarter and add losses. This is the first quarter, we actually highlight the issue. We've been having the issue for a couple of quarters now. It's getting the losses at its peak right now. And I expect that we solve the situation in the coming quarter.

Now, in terms of business transformation, we did a lot of changes during the year. Now this new way of operating, we just announced it at the end of the Q3. We are presently implementing the new processes. In many cases, we are cutting down a lot of processes and we are making way for more accountability on some departments. You should start seeing the impact coming, I'd say, in one or two quarters.

Sanjay Bhambri, you want to add anything on this?

Sanjay Bhambri:

No, I think FC had covered it. Beyond that, I think one was on the stability of the revenues. I think we will continue to be stable on our revenues. And as we have more newer verticals specifically coming from non-operators, from India's stand point, if we have to look at it, I just have to go over the next few quarters, that will add strength on the revenues.

Arman Morya:

Okay. So, right now when you say that strategy for financial year 2020, would be we grow video, expand Games, leverage Tones, and digitalize Contest? So, is this part of like, you know, how big these all revenues are today and I mean how we should see this scaling going forward?

François-Charles Sirois:

Now, let me tell you that those are the objective for the year. The year 2020 is almost over, there is only one quarter left. Now I'm really aiming at the 2020-2021. So, we will have a new set of objectives. Again, I'm repeating myself but I really see a big market in Gaming and Contest. And those two lines should definitely grow during the year. So, that's a main focus that we have, which will come with investments. So, that's why I really want to separate and be able to explain to investors exactly what's the core business and what the new projects are.

And on the core business, there are other projects that are really adding also. Like for tones, I really believe in being able to actually monetize advertisements on tones especially with all the changes that happen in India. So, as you can see, the tones business in India has been very difficult in the last two years. Now it has really stabilized and should start growing with new incentives like advertisement on tones in the coming quarters.

Ganesh Murthy:

I would like to add on the last item on your question on profitability. As you can see, if you look at the last eight quarters, our EBITDA was in double digits, okay? On a like-to-like basis, after amortization of the contract acquisition cost. And the last two quarters we have crossed the triple digit mark. So, last quarter it was INR 107 million EBITDA. This quarter it is INR 111 million. I know it's not a fantastic growth, but at least we have crossed the INR 100 million mark per quarter in terms of EBITDA. So, EBITDA – profitability is improving over the last two, three quarters.

Arman Morya:

Okay. So, sir, like, you know, I am a long-term investor into your company, right – but what I'm trying to understand from outlook perspective, I mean, what is our outlook for financial year '21 in terms of the profitability and in terms of the revenue mark and in terms of the growth?

François-Charles Sirois:

As you know, we are not supposed to give a forecast. But all I can say is that I'm back on the 12.9% on the core business EBITDA margin that for me has to increase. And that's why I'm tracking the gaming revenue aside, and profitability for core business aside. We are doing quite big investments in gaming, and that for me will bring growth on core to core business, which is stable. So, I'm really expecting a decent growth throughout 2021.

- Arman Morya:** I'm not asking for a guidance. What I'm trying to understand here is that if I see your last five years from INR 800 crores of a top line, we are now going to close something around INR 500 crores kind of a top line in financial year 2020. So, basically every year we had de-grown almost by INR 100 crores. So, idea here is like, you know, how do we see – is it like, you know, the pain is behind and from here on at least we should see 20% growth going forward or still we are going to see a de-growth in the revenue?
- François-Charles Sirois:** Well, if you look at the last year, I think we stabilized the revenues, and that shows clearly. You are totally right that last year was a tough year, year to year, but compare last year to this year, it's a very stable. So, I'm expecting, of course, that we grow from here. I think, you know, the telecom industry in India was terrible. And if you put aside India, we actually grew in Asia, we grew in Middle East Africa, and we grew in Europe. It's been very difficult in LatAm and very difficult in India. And that's why, you see the actual revenue going down. I don't see a major disturbance in our core markets today and I see new products being launched and being deployed that will bring traction. So, that's why I'm quite positive on the next year.
- Arman Morya:** So, all your new products are now profitable or still they are making losses?
- François-Charles Sirois:** No. Again, that's why I'm tracking Games separately. This quarter we're losing INR 34 million on Gaming investment. And that's for two things. All the deployments of new clubs, we're now up to 40 live clubs. And the R&D investment, we're putting a lot of money on the platform to bring it to the next level. So, as soon as we have something to announce to the market that we can show the new platform upgrades, I will share with all of you on this so you can assess the potential of this.
- Arman Morya:** Okay. But then still we are going to make losses in the gaming and other businesses?
- François-Charles Sirois:** Only the coming quarters. My view is that, you know, this will start bringing real revenues and we should be in a breakeven situation at the end of the year on that front.
- Arman Morya:** So, another four quarters of losses, you are saying that in the new services?
- François-Charles Sirois:** That's why I want to isolate the core business which clearly is service to operators and to OEMs and to digital wallets, and that's really a service. On the other front, I really see an opportunity to get into

direct consumer with our own product and brand, and that's why we need to track it separately. And as you know, most of these, once you decide to enter – and the first market will be India for sure. So, once we have really a product I feel good about and we launch it, then we will have to track it separately because most of these business models, we have to invest a lot in marketing and deployment before we start having real profitability. Now the ramp up on number of subscribers and revenues can be quite aggressive too. So, it's going to go in line, right? But they are two very different business models, and that's why I want to start tracking them completely separately.

Arman Morya: Okay, fair enough.

François-Charles Sirois: Thank you.

Arman Morya: Thank you.

Ganesh Murthy: Operator we move to our next question.

Operator: Sure sir. Ladies and gentlemen, if you'd like to ask a question, please signal by pressing star one on your telephone keypad. We will now take our next question from Chinmaya Garg from Dron Capital.

Chinmaya Garg: Hello. Hi. I want to understand that we have been talking about lot of B2C products. So, like, for example, we had earlier spoken about a new RBT product which had advertisement angle to it. How is that product doing?

François-Charles Sirois: Two things. And I just want to understand, when you talk about the new advertising RBT product, it's not been launched yet. We are doing some tests and, that's something that's coming up in the new quarters. When we talked about going D2C with tones that was three years back. That plan did not work. As we remember there was the plan to actually migrate the base from operators back to us. But with everything that happened in the Indian market in the last two, three years, unfortunately, that plan didn't work. So, we never actually really invested. We did the test as you remember in the US with Sprint which was non-conclusive and we stopped that.

So, you know, really, tones for me is a service that we're doing. We have a lot of traction on the on the digital app with tones. We're now past above 1 million active users on the app for tone subscribers. But those again are branded with the operator brand and it's not our own brand although it's all our service behind. So, that's why I see this as really a service provided to operators, than our core products.

So, so far in the market, a true product that I feel is worth investing real marketing dollars and going for a real growth, so far we've not done it. We've talked about it in the past years but I didn't feel we had quite the product to do so. Now my feeling is that we're on the right track with Gaming and Contest, and that's something that we're working on to launch in the coming quarters.

Chinmaya Garg: All right. And in Gaming and this Contest product, how many subscribers do we currently have? Or where do you see it going?

François-Charles Sirois: We didn't launch it yet.

Chinmaya Garg: What do you say the potential of this product is? How big can it become in let's say 24 months or something post launch.

François-Charles Sirois: For now, I want to restrict myself from answering on this, but I just want you to realize that the Gaming market is the biggest market in mobile entertainment. It's huge.

Chinmaya Garg: Yeah.

François-Charles Sirois: So, if we do things right, we have a huge potential. So, data strategy was not to go D2C with Gaming and Contest, it was to stick as a service B2B. And that's why we're deploying 40 clubs now with operators. We have signed recently with Phone Pe, we signed with OEM providers like Samsung. So, we are deploying this as a service. Now I'm looking at the new features that we're adding on it, and that's where we're spending a lot of money on R&D to upgrade the platform and say do we have the product to go D2C and really make a huge difference. And I feel we're really on track to be able to launch this. So, as soon as we launch it, of course, we'll advise all investors about this new product launch.

Chinmaya Garg: All right. And these clubs that you're talking about, I think 40 clubs, you mentioned, how many subscribers does it take for the club to become profitable for you?

François-Charles Sirois: Again, because it's a service, in some cases, we have a minimum guarantees paid by, the actual service providers in between them. Some cases we're direct with the operators; in other cases, we're dealing with other partners who in turn are dealing with the operators. The cost is not very high to be able to turn profitable and it's more who pays for the deployment. And in some cases, we pay for a full deployment where we expect the operators to really invest behind the product. In some other cases, we are not paying much and we're getting a minimum guarantee. In some other cases, actually we are bundled in tablets with a very big customer doing

tablets for kids, and we're getting EURO 2 per tablet. We just shipped out 115,000 tablets.

So, again, you know, those are different models, but, again, they're really on the service side, they're not on the D2C side.

Chinmaya Garg: All right. And you had mentioned the deal in South Africa. Could you give us a little more detail what is that?

François-Charles Sirois: Sanjay, can we talk about it or not?

Sanjay Bhambri: I think I'll give a little 1000-foot level detail. Fundamentally what we are doing is at the moment is we are taking the monetization of a ring-back tone services with our digital assets. And that should be going live by the next quarter, and we will be announcing in little more detail about that once we have permission from the operator.

Chinmaya Garg: All right. We'll wait for that in that case. And Ganesh, this tax rate that we have achieved in this quarter, can we assume that this is the tax rate that will broadly remain? 35% odd?

Ganesh Murthy: Yes, I mean on a regular business, yes. But if there are some previous tax cases, I mean, there are a lot of tax cases with the department where we have gone and appealed or the tax department has gone and appealed; impact of that is not factored in. On a regular basis, yes. We are looking at around 35-40% effective tax rate.

Chinmaya Garg: All right. Okay. So, since – it seems like we are well on our path to profitability and we have so much cash, any thoughts on buyback now?

François-Charles Sirois: I'm looking at the stock price. Honestly, again, I don't want to give any thoughts, but at 28.5 or I don't know how much it is – today there – you know, INR 30. We have a cash position of INR 253 crores. So, it doesn't make a lot of value for the business. So, I don't know how we account as an investor. But return on investment as we discussed is very high on this level. So, yeah, it's a feasibility – Right now. Just so you understand, the year finishes in one-month-and-a-half. We're currently doing the projections for the whole business case and operating plan for next year which will be presented to the Board in March. So, we start the year 1st April. So, as soon as we've done that, that's certainly something that we'll consider.

Chinmaya Garg: All right. Thank you so much.

François-Charles Sirois: Thank you.

- Operator:** Thank you. Ladies and gentlemen, if you'd like to ask a question, please signal by pressing star one on your telephone keypad. Once again, ladies and gentlemen, if you'd like to ask a question, you may press star one on the telephone keypad. It appears there are no further questions at this time. I would like to turn the conference back to the speaker. Thank you.
- François-Charles Sirois:** Well, thank you everyone. Thanks for joining. Again, you know, we're in a good position both on the core business and investment in gaming and new projects, so a lot to come in the next quarter. So, I look forward to the next call and I wish you a great day. Thank you.
- Operator:** Thank you so much. This concludes today's conference call. Thank you for your participation. You may now disconnect.