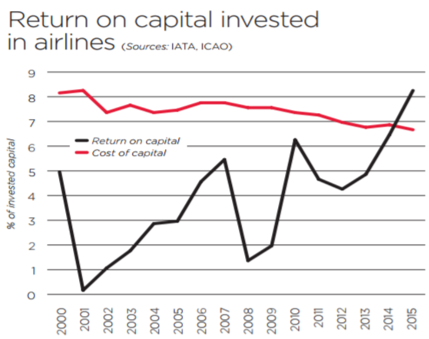
StockScan: Accelya Kale Solutions Ltd.

Vishal Khandelwal | 29th September 2017 | www.safalniveshak.com

Over the past forty years, air travel has expanded ten-fold and air cargo fourteen-fold, compared to a three to four-fold rise in world GDP. Yet over this period, airlines have only been able to generate sufficient revenues and profit to pay their suppliers and service their debt. There has been nothing left to pay investors for providing equity capital to the airline industry.



Over the years, one of the key initiatives the airline industry has taken towards improving profitability has been to outsource most non-core processes like aircraft maintenance, repair and overhaul providers, catering, ground handling, and technology. In fact, such has been the scale or outsourcing that investors have earned 'excess profits' i.e., a higher return than they would have got by investing elsewhere, in these outsourced processes.

The highest returns in the air transport supply chain are earned in the distribution sectors. Computer Reservation System (CRS) services provided by the Global Distribution Services, which is a network operated by a company that enables automated transactions between travel service providers, mainly airlines, hotels and car rental companies, and travel agencies, earn an average return on capital of 20%, double their 10-11% cost of capital.

It is no surprise that CRS has seen some high-niche, tech-oriented businesses that have built solid competitive advantages over the years. The industry is consolidated among three big players – Amadeus, Sabre, and Travelport – which also provide various technology solutions to the airlines industry. Then there are third party players like NIIT Technologies and Accelya Kale, the company I've analysed in this report.

Accelya Kale Solutions Ltd (AKSL) is a leading solutions provider to the airline and travel industry. It was earlier called Kale Consultants, but changed its name to the current one post its acquisition by Spain based Accelya Holdings in 2010. During early 2017, Warburg Pincus, a global private equity firm acquired Accelya Holding Luxembourg S.A. from Chequers Capital and through this, a controlling interest in the Accelya group of companies. Notably, Warburg is also the majority shareholder of Mercator, which is a global provider of product-enabled solutions to the travel and transportation industry. Accelya and Mercator will now operate under a single brand i.e., Accelya. The combined group has revenues of $200+ million and over 400 customers, including 250 airline customers.

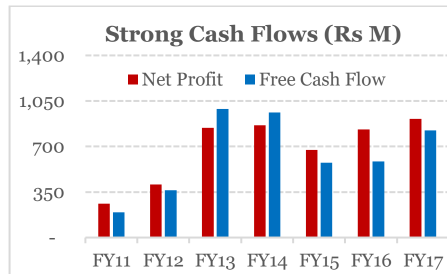
Coming back to AKSL, its expertise spans the following areas of an airline's technology requirements – Revenue Accounting, Audit & Revenue Recovery, Credit Card Management, Miscellaneous Billing, Finance & Accounting Processes, and Decision Support & Analytics. The company is especially strong in the Revenue Accounting space where it serves around 13 airline companies and holds a 6.5% market share.

AKSL's revenue accounting product is called Revera. It works on a pay-per-use model, which enables airlines to have a low capex and variable costs. At the same time, this model ensures the company annuity revenue streams resulting in revenue visibility. With most airlines plagued with huge fixed costs, it is imperative for them to take decisions with regards to their capital and operating expenditure, and a high level of agility to overcome these obstacles. This is where the opportunity lies for AKSL, which is a known brand in the "third party" airline revenue accounting space, through its Revera platform. AKSL also has a cost management solution called FinesseCost.

As far as financial performance is concerned, AKSL has done well on both the sales and net profit growth over the years, with these having grown at average annual rates of 13% and 20% respectively over the past eight years. Growth over the past five years has been decent too, at 11% and 17% respectively.

With the airline industry witnessing rising passenger volumes, carriers would have to continue to improve their technological systems, including revenue accounting. This could create a good growth opportunity for AKSL. Not just growth, being in the software products industry that has a high operating leverage enable AKSL's profits to grow at a faster rate than revenue after initial product development costs are recovered. AKSL's is a high ROE business. The same has averaged around 45% over the past ten years, and 68% over the past five.

Given that the business continues to generate more cash than it consumes, AKSL is retaining a small part of its incremental profits while giving away a large portion to shareholders as dividends (dividend yield stands at 3.6%). The return on what has been reinvested has been great. The business is not asset heavy, and thus does not require heavy/constant capital investment. Depreciation has approximated capital expenditures over the past decade. The combination of the company's high margins (net margin has averaged 25% over past five years) and low requirements for capital investment results in significant annual cash flow.



AKSL's competitive advantage lies in the fact that a software solution that is integrated across and deep into the systems of a company creates switching costs in the long run. In addition, if the vendor is doing a good job and is staying up to date on technological advancements, carriers would have little incentive to change to another vendor and risk disruptions that could be very costly to the business and to their own customers.

As for key risks, the big one is technology obsolescence. While the existence of very few players that service the space that AKSL does talks about the competency the company possesses, it still needs to remain on top of advancements, especially in the airline revenue accounting space. Another key risk is that of losing a big customer. While the industry trends are suggesting otherwise, it may happen that a big airline and AKSL's customer decides to bring the system in-house and hence not renew the contract with the company.

The stock currently trades at around Rs 1,430, which is 23 times its trailing twelve-months earnings (earnings yield of 4.3%). Please do proper homework and ensure sufficient margin of safety before making any investment decision.

Statutory Warning: *This is NOT an investment advice to buy or sell shares. Make your own decision. I do not own the stock, but my analysis may be biased, and wrong. I, Vishal Khandelwal, am a registered Research Analyst as per SEBI (Research Analyst) Regulations, 2014 (Registration No. INH000000578).*