8K Miles and the minority shareholder

17 September 2018

I had a semi-awakening while standing on the footsteps of Chennai Central Station many years ago. An auto driver quoted ₹ 200 for an important address I had to go to. He circled the station and dropped me just a few meters ahead, to my destination. Surprised, but also a man of my word I handed ₹ 200 what should have been ₹ 5, and ventured to ask him about pricing. He said, “Sir, suckers like you come very rarely these days. And we have to make the most of limited opportunities.”

For long I felt a lonely sucker until I began investing. The stock market attracted so many of us that I at once felt like home. Our community even has a name - minority shareholders. We are privileged to be wooed by everyone – promoters, management, brokers, fund houses and the media. It’s true that many of us move out after experience, but India has a demographic dividend that keeps on giving. However the flip side of a large supply is that companies take it too easy and make ‘suckering’ nakedly obvious.

And I want to send a message to them to do a better job.

Take 8K Miles Software Services Ltd (NSE:8KMILES), a ‘technology company born on Cloud’. In April 2018 their CFO was reportedly awarded for being ‘quiet’, ‘working behind the scenes’ to make sure that 8K Miles is ‘safe and sound’. Their auditor Deloitte however writes that this award winning CFO’s financial statements cannot be relied upon and may undergo big changes. But that’s not my point. My point is that the same Deloitte also helped pick up this CFO for awards, *‘after sifting through 1000s of companies’*! Moreover the CFO’s real behind- the- scenes work was to sell his shares. Soon after the Board announced a ₹ 7/share dividend on May 10 2017 he started selling. After dumping nearly half his stake the dividend was revised down to ₹ 1 / share!

So why was the CFO selling shares of an award winning company? According to the CEO, “*….Ramani (*the CFO*) has….eh there are…there are…see basically eh I own 55% of the company shareholding and I have not sold one single share from the inception. Ramani as part of his eh charitable eh and a eh trust what he was selling and he has made an announcement in the analyst analyst meet also….*”. We are led to believe that the CFO had a charitable commitment for about ₹ 60 crores. But the CEO also knew, as he was speaking, that the CFO provided an unsecured loan to 8KMiles soon after selling his stake. That’s what they have signed on, in the Annual Report.

As such, the structure of 8KMiles is like a complex asana. A California based NRI takes control of an India listed trading company, converts it into a software company, which in turn starts US entities located in the same California. Almost all the action in the Balance Sheet / P&L happens there, including buying of various US businesses in exchange for cash / stake dilution. The Indian entity mostly only provides funding for the US entities whose accounts in turn have never been shared. Often the interests of Indian shareholders in the US entity are diluted even as they are not properly informed (as pointed out by the Secretarial Auditor). Till date no one knows who the remaining 37% owners are. We are kept entertained in the annual report with buzzwords like Cloud, Artificial Intelligence, Deep Learning, Machine Learning, Block chains, Platforms and so on. Plodding through the financial statements (that the auditor admits may change bigly) is not so entertaining. For its work Deloitte charged shareholders around ₹ 22 lakhs. For that sum even suckers expect something in return. Like, to check if a copy paste job is done properly, or that management does not say one thing in one place and the exact opposite in another. But, no.

1. Deloitte does not think Sandeep Tandon who holds 6.01% of the company as per exchange filings, holds more than 5% of the firm. His name is missing from names of shareholders holding more than 5% share in the notes to accounts.

2. Management says 8KMiles advanced a sum of ₹ 708.25 lakhs made to a related party on page 177, but the same amount, is not a material transaction with a related party on page 179. How can something be true and not true at the same time?

3. Can a financial liability also be a contingent liability at the same time? On page 165 & 177 '*Contingent* Consideration for Acquisition' of around ₹ 21 crores is shown as a crystallized liability. In other words something is simultaneously *surely owed to* and, *may not be owed to*.

Minority shareholders are always ready to be gullible but management has to put in more efforts to conceal the obvious. Look at this.

1. The CFO sells close to 80% of his shares partly to provide unsecured debt to the company which then provides debt to its US subsidiary, which then funds US companies owned/managed by the NRI promoter. Those companies are yet to pay full interest.
2. The CEO says there are about 500 people employed outside India. Most of these 500 are said in the US. The financial statements say it also develops and 'capitalizes' software products from these entities. So where do they work? The company's website lists offices but these are office suites and not development centers that can house hundreds of people. The rent paid by these entities put together is in Rupee terms just 50% more than what it pays in India, while employing 250% more employees. I don't know how that's possible. Unless they have bunk desks (like bunk beds) – one on top of the other.
3. A company that has more than tripled revenues over three years and develops/buys so much of software (~ 60% of tangible/intangible assets), has less computers & accessories than it did then!
4. The company says it books revenues even *on expired contracts that are 'under renewal'*.

The list is much longer but you get the drift. It goes like this -

Management presents financial statements that the auditors, whose namesake shortlists the CFO for awards for making sure the company is 'safe and sound', and such CFO who has sold most of his shares of this 'safe and sound' company, ostensibly for charitable commitments, but actually to provide unsecured loans, which in turn is ultimately used to fund the US promoter's interests, such auditors who say such financial statements may change bigly, charge ₹ 22 lakhs but cannot spot a copy paste error, can hold something to be yes and no at the same time, such financial statements who subsidiary accounts where most money is made is not shared but whose shareholding keeps changing.

Shareholders are now asked to approve these financial statements.

The denouement is on 29 September 2018 when the AGM will be held, at 8:59 am. Why 8:59 am? Why not 9:00 am? That's because Rahu Kalam starts at 9 am and management knows that protecting sentiments of minority shareholders is more important than protecting our shareholder value.

Sources:

1. Financial Express report on awards - https://www.financialexpress.com/india-news/and-the-award-goes-to/1120563/
2. Annual Reports sourced from https://8kmiles.com/investors/annual-report/ last sourced at 15:00 hrs on 16 Sept 2018
3. Analyst conference call on 15 Feb 2018 sourced from https://www.researchbytes.com/8k-Miles-Software-Services-Limited-P0005.htm
4. Company locations sourced from https://8kmiles.com/contact-us/ last sourced at 15:00 hrs on 16 Sept 2018

Kimi (or Krishnaraj) is an investor based out of Bangalore