



“Elecon Engineering Company Limited 1QFY14 Earnings Conference Call”

August 19, 2013



MANAGEMENT: **MR. P. B. PATEL – CHAIRMAN & MANAGING DIRECTOR**
MR. H. C. SHAH – CHIEF FINANCIAL OFFICER

MODERATOR: **MR. BHARGAV BUDDHADEV – ANALYST, AMBIT
CAPITAL**

Moderator: Ladies and gentlemen, good day and welcome to the 1QFY14 Earnings Conference Call of Elecon Engineering Limited hosted by Ambit Capital. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" followed by '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Bhargav Buddhadev of Ambit Capital. Thank you. And over to you, sir.

Bhargav Buddhadev: Good evening, everybody. I would like to thank Mr. P.B. Patel, CMD of Elecon Engineering and Mr. H.C. Shah, CFO of Elecon Engineering for giving Ambit an opportunity to host this conference call to discuss the 1QFY14 results. I would now request Mr. P.B. Patel to give us a brief introduction on the quarterly results, and post that we will open the call for Q&A. Over to you, sir.

P.B. Patel: Good evening everyone and welcome to the conference call on the first quarter FY14 results of Elecon Engineering Company Limited. I have with me H.C. Shah, the CFO. You must be aware that the entire business restructuring is over and now Elecon Engineering Company, a listed entity, will have complete focus in dealing with the power transmission gear business. We have come out with the financial performance of Elecon Engineering Company which was duly considered and taken on record by the Board of Directors at its meeting held on 14 August 2013. You must have observed that though total revenue has been lower to Rs105 crores in the first quarter of the current year as against the total revenue of Rs125 crores in the corresponding quarter of the previous year, we have been able to improve earnings before interest, taxes, depreciation and amortisation (EBITDA) margin from 17% in 1QFY13 to 21% in 1QFY14, that is from 21.55 crores in 1QFY13 to 22.80 crores in 1QFY14. However, profit before tax has been lower from 7% in 1QFY13 to 5% in 1QFY14 mainly because of high depreciation charges arising due to the business restructuring exercise.

New order booking in FY14 up to 31 July 2013 stands at Rs226 crores as compared to Rs181 crores up to 31 July 2012 in FY13 and pending order as on 31 July 2013 stands at Rs253 crores as compared to Rs297 crores as of 31 July 2012. However, we are very optimistic in respect of the strong growth in export order intake and revenue and this will compensate for the domestic market remaining sluggish with delayed order finalisation.

The Indian economy continues to face challenges, which has a consequential impact on industrial growth including the engineering industry. Though our performance is not up to expectations, based on our transformational initiatives in operation and focus on cost control and continuous improvement across our businesses, we are confident to end the current FY14 with a comfortable position in terms of turnover and sustaining margins amidst the prevailing industrial scenario. With this I would like to open the call for questions. Thank you.

- Moderator:** Thank you very much sir. Participants, we will now begin with the question-and-answer session. We have the first question from the line of Niraj Somaiya from Span Capital. Please go ahead.
- Niraj Somaiya:** My first question was this gear business does not include exports, right? It does not include the international gear business which should be another probably 70-80 crores for you? Have I understood right? This is only the domestic gear business?
- P.B. Patel:** Yes.
- Niraj Somaiya:** Your gear business locally is about Rs100 crores plus international must be another Rs60-70 crores. Would that be right?
- H.C. Shah:** Yes, it will around Rs72 crores.
- Niraj Somaiya:** My point was that this Rs350-crore business to take it to Rs1,000 crores in the next 3-5 years. Do you think you are on track with the management in terms of building the business and making it as big as the domestic business? Are you guys on track and what are the steps you have taken to build the international? Any progress there?
- P.B. Patel:** Basically as far as we are concerned, right now we are operating it almost close to 50% as long as the factory utilisation is concerned. So, as such to grow, we have ample opportunities as long as manufacturing is concerned. As long as market development is concerned, especially in exports, we have seen a surge of almost 15-20% in the last 1-1.5 years, and we believe that over a period of time with the expansion plans that we have for Radicon, especially as long as the marketing network is concerned, we believe that we should be able to reach 25-30% very shortly.
- Niraj Somaiya:** In terms of growth?
- P.B. Patel:** Yes, in terms of growth.
- Niraj Somaiya:** So you could achieve this probably in 3-5 years? Your target somewhere to achieve that 1,000-crore mark; would that be possible?
- P.B. Patel:** Yes, for sure.
- Niraj Somaiya:** And the same way in domestic when the demand picks up, your utilisation is 50%. So you could easily do revenue of Rs200 crores a quarter, if I got it right?
- P.B. Patel:** Yes.
- Niraj Somaiya:** Secondly, coming to the MHE business which is now in the subsidiary, how are things there? Have debtors improved in anyway? And could I also know one more bookkeeping question? In the parent company, how much is the debt now in the Elecon as a standalone?

- P.B. Patel:** Elecon as a standalone?
- Niraj Somaiya:** Both if I could get.
- H.C. Shah:** The borrowing will be for Elecon Rs300 crores and Rs274 crores for the MHE business.
- Niraj Somaiya:** So about Rs550 crores to Rs600 crores will be the total debt, right?
- H.C. Shah:** This including the long term and short term.
- Niraj Somaiya:** In terms of the MHE business, how is it progressing? Could you just throw some light and generally how is the scenario? Did you already have orders? So how are you executing? Is it improving and the debtors any concerns on that if you could just throw some light on that?
- P.B. Patel:** The scenario is more or less the same as what it was before this quarter began. The situation is such, especially for Elecon, that we have reasonably good orders on hand. The only question is that we have customers who are not lifting the goods and basically not paying for the goods which have also been lifted. So there is an acute cash crunch which goes on, and we are hoping that our focus, we would like to change more towards the government plans, who are reasonably well banked and ensure that we do more turnover from them rather than the private customers.
- Niraj Somaiya:** Do you see any bad debts or anything like that or any provision would you need to make or do you think then money would come back? Could you just throw some light on that?
- P.B. Patel:** Right now we do not see that happening, but we would have to wait and watch. If you have projects which are ongoing normally, what happens is, in case the customer is not able to pay us, the final customer who is establishing the power plant is normally quite often even directly contacting us to get the goods. So we have reasonable confidence that it would not turn into bad debts.
- Niraj Somaiya:** Only thing it would take time; that is it?
- P.B. Patel:** Time is an issue.
- Niraj Somaiya:** One last question on, you already built a very significant US\$300 million size company. Where do you think your vision is to take this company in the next may be 7 years from now when India redevelops or the next growth phase happens? And would you have a fixed dividend policy and how would you be investor-friendly, if you could answer? Just throw a very broad picture light on the business and how in terms of dividend or stock falling to so much level buyback or how will you deal with the investors and first if you could answer on the business and then on the investors?
- P.B. Patel:** We believe that if the economy turns around in India...

- Niraj Somaiya:** It will at some point.
- P.B. Patel:** It will at some point, we believe that growing and growing to the tune of anywhere between 3,000 and 5,000 crores should not be an issue. The reason is, as I told you, in both the divisions we are operating at round about 50% capacity and to scale up in EPC projects is not difficult at all because you do not need any additional infrastructure even to do 5,000 crores on its own. Now the only reason right now that we are not trying to pick up more orders especially when the margins are under constraint is because we do not want to sacrifice the bottomline at the cost of growing the topline, and that has always been our philosophy that we do not grow the topline at the expense of the bottomline. We are keen that when the things improve that we pay a handsome dividend and we create a situation where we would sustain the interest of our investors. It is very difficult to conceptualise as of now as to where it would take us. And it is also for the board collectively to give that answer. But what I can assure you is that we have a lot of board members who are thinking of the shareholders and especially the minority shareholders.
- Moderator:** We have the next question from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.
- Madan Gopal:** First on MHE, just wanted to know what is the sales and EBIT in this business?
- H.C. Shah:** On EPC, because this is unpublished data, we will send you an email.
- Madan Gopal:** On the gear side, when you referred to exports of Rs72 crores, what were you referring to? This is not part of the reported number? Where is it reported?
- H.C. Shah:** Rs72 crores is an additional turnover achieved from the Benzlers Radicon group. We have not included Rs72 crore turnover in the reported nos of 105 crores.
- Madan Gopal:** It is not exports. It is Benzlers' revenue.
- H.C. Shah:** It is our acquired entity, but they are sold outside India.
- Madan Gopal:** This Rs100 crores would include some portion of exports, right?
- P.B. Patel:** Yes, of course.
- Madan Gopal:** How much is the exports?
- H.C. Shah:** It will be Rs15 crores per quarter.
- Madan Gopal:** How much it has grown, possibly has grown by 50-60%?

- H.C. Shah:** Last year it was Rs57 crores for the whole year in the gear division in Elecon, and now in the first quarter itself, it is Rs15 crores. That is why the Chairman has already referred in this note that we are exploring the export intake orders.
- Madan Gopal:** Which are the markets, can you elaborate a bit, on this export strategy because given the current rupee and all, are you seeing any possibility of improving your exports? How is it structured as of now, if you can throw a broader view on this?
- P.B. Patel:** Basically, we have our own offices in the Far East and Middle East and we are relying on our partners or our associate company, Benzlers-Radicon, for Europe and United States. Last year, we had a reasonably good intake from markets which we were not able to explore much earlier. But Benzlers-Radicon, with their help, we were able to bag a few orders in unexplored markets also, and we are reasonably confident that over a period of time with their exploration in further new markets, we would also have a good opportunity.
- Madan Gopal:** So you are basically targeting the African region by any chance?
- P.B. Patel:** Yes, Africa is looked after by our Middle East office, and so it is Africa and Middle East. My Far East is independent.
- Madan Gopal:** So here in MENA region, what is the kind of competition you see? You generally see Chinese or who comes in this market?
- P.B. Patel:** To tell you it is a very difficult answer because generally speaking the Chinese are there with their very, very low prices, and so it depends on the customer preference as to what he would like to go in for. If he wants the cheapest then we do not stand a chance because the Chinese are extremely competitive. But if they want good quality and better prices than the Europeans or the Americans, then we stand a chance.
- H.C. Shah:** Our exports have doubled in this first quarter as compared to the corresponding quarter of previous year.
- Madan Gopal:** What is the kind of margins you make in this export as compared to our Indian domestic margins?
- P.B. Patel:** At an average, I would say that our margins would be much better in exports than in the domestic market and especially Middle East and Africa is more profitable than the rest.
- Madan Gopal:** Then it should be above the 20% range?
- P.B. Patel:** It is difficult to say because it depends on a case-to-case basis, but generally speaking those are the markets where a lot of replacement also goes in, which normally fetch us a better price.
- Madan Gopal:** These are mostly 'standard gears' that goes into this market, right?

- P.B. Patel:** No, these are replacement where you have to replace the original supplies made by other suppliers or manufacturers and therefore the margins are better.
- Madan Gopal:** You are basically replacing some European-supplied gear or is it...?
- P.B. Patel:** Yes, something like that.
- Madan Gopal:** In the MHE business, last time when we met all the companies in this space, we were really worried on the level of pricing that was happening; in some of the projects, the pricing for the EPC was as low as 20% than the previous projects of a similar nature. So how are we going to react to this? Are we going to be product-specific and leave the projects for some time?
- P.B. Patel:** I would say that it is not that we would leave the projects total, but we will not try to pick up any orders where we can see losses right from the beginning. So we would have to wait and watch and take it project-by-project. We would try to sell our products and still achieve a reasonable turnover.
- Madan Gopal:** But the current situation is surely making you feel that projects do not make money, the way the last three projects, one backed by BGR and another by McNally Bharat, the pricing, we hear, was too low?
- P.B. Patel:** Yes, it is true and over a period of time it will go down further, which is the reason why we have gone ahead and backed orders. Today, as we speak, on 31 July 2013, our outstanding orders in MHE sphere was 1275.
- Madan Gopal:** How much of that is project?
- P.B. Patel:** About to the tune of 400 crores.
- Madan Gopal:** 400 crores only project? Product is how much?
- P.B. Patel:** Balance would be products.
- Madan Gopal:** 800 crores of products order we have?
- P.B. Patel:** Yes.
- Madan Gopal:** This products order alone is executable over a period of...?
- P.B. Patel:** Yes, in a period of the next 2-3 years.
- Madan Gopal:** Normally, the product orders get finished in a year's time, right? This 2-3 years of time...
- P.B. Patel:** Products means it would be stacker-reclaimer with a small conveyor system. It depends on what you define as product.

- Madan Gopal:** In the Products segment where do you make most of the margins? Is it the pure product orders that you get from companies like Techpro or someone or is it the complete EPC for the product that you get installing the entire stacker-reclaimer that sort of orders that you get directly from the developers?
- P.B. Patel:** Let me give you an answer in a roundabout fashion. We do not make money in overall large projects because the market scenario is such that people are willing to quote ridiculously low prices, and so that is a very, very competitive market. So as long as products and small projects are concerned, the margins are high.
- Madan Gopal:** So this complete EPC of BOP projects is not making money, but installation of equipments and our own equipments and then pure equipments orders are making better margins?
- P.B. Patel:** Yes.
- Madan Gopal:** Recently, we met TRF, and they seem to be also started focusing on the products completely? Are you seeing an increased competition from them or the market is there enough for both of you to take enough of the share?
- P.B. Patel:** The market is, I would say, reasonably OK. Whether it is TRF or XYZ, there would definitely be competition but I believe there the situation is not as bad as projects.
- Madan Gopal:** In pure products orders, like the way you are taking it from Techpro and other EPC players, TRF also backs it from other EPC players. Who are the other guys in this product business? You both are there. Is there any other major player in this space?
- P.B. Patel:** There is L&T also in certain products and there are other companies. Also, Techpro is also there in certain products, and so it varies as to what the product is and what type of equipment is desired.
- Moderator:** We have the next question from the line of Bhalchandra Shinde from Batlivala & Karani Securities. Please go ahead.
- Bhalchandra Shinde:** Regarding the export business, I would like to know about the depreciating rupee; is it creating a good competitive advantage for us in the gear business? Do we see more inclination towards the Indian products than any other country products?
- P.B. Patel:** To tell you honestly it is not creating a competitive advantage, but I would say that it definitely is improving our margins, at least as of now because the rupee has suddenly lost value and a lot of these contracts or orders that we are executing right now have been all finalised earlier where we are getting the benefit of the depreciated rupee because we are earning foreign exchange. Over a period of time, one has to wait and watch and see whether you want to pass on all the value depreciation that has happened to the euro and dollar to the customer or to the retain part of it. So it will depend on the market scenario because normally it depends on whom you are competing with. If you are competing with the Europeans, I do not see a

necessity of passing that to the customers. If you are competing with the Chinese and the likes and where the situation is very competitive, then one needs to do that.

- Bhalchandra Shinde:** Is there any specific sectors where we see competition from Chinese or is it across all sectors?
- P.B. Patel:** Though it is across all sectors, but it depends on the customer preference. There are a lot of customers who refuse to buy Chinese products. Who say that we do not want to even look at a Chinese offer.
- Bhalchandra Shinde:** If we consider with the order book which we have mentioned, how much will be the average execution cycle for the gear division and average execution cycle for MHE business?
- P.B. Patel:** Gear can vary from one month to about 8 months, depending upon what product it is. And in EPC products, it could vary from 4 months to almost 18 months.
- Bhalchandra Shinde:** Is it 5 or 6 months for gear business and EPC business around 12 months?
- P.B. Patel:** The reason why I gave you the range is this is our supply time, but the question remains is what product it is. So depending upon which product it is, the delivery times varies.
- Bhalchandra Shinde:** Out of the order book which you said MHE business for 1,275 crores, how much we expect to get it executed in FY14?
- P.B. Patel:** I would say this would constitute almost 80-85% should get executed this year.
- Bhalchandra Shinde:** Just to clear out my doubt, post restructuring on a consolidated basis, we will have 60% of the MHE business reflecting in our revenues?
- P.B. Patel:** Yes.
- Moderator:** We have the next question from the line of Sudhakar Prabhu from Span Capital. Please go ahead.
- Sudhakar Prabhu:** I had actually a couple of questions. First of all on the international gear business, you mentioned that the revenue for the quarter was 72 crores. Has the business broken even in this quarter and also on the bottomline?
- P.B. Patel:** The 72 crores is the turnover of our Radicon, which has not been consolidated into the report because the consolidation takes place annually once a year
- Sudhakar Prabhu:** But I just wanted to understand whether the business has broken even?
- P.B. Patel:** To tell you honestly, we have not received further details as of now, but what we could do is we can email you the details.

- Sudhakar Prabhu:** One more request for you, since Elecon still owns 60% in the Materials Handling business and controlling stake, it would be better for the investors if you can come out with the consolidated results. It will give a better picture of how the company is shaping up.
- P.B. Patel:** I think that is a good idea. I will discuss this with the board and then take the appropriate steps.
- Sudhakar Prabhu:** In the India gear standalone business what kind of growth do you see this year including the export business, because in the last call we were talking about 10-15% growth in the gear business? Do you think that number is still achievable or you think that number is still far away?
- P.B. Patel:** The first quarter to our surprise has been reasonably good. We are seeing reasonably good demand coming up especially we saw that starting from May, June, July and if this gets sustained over a period of time, things look to be much better than what it was last year. How much exactly it would be is anybody's guess. But as of now there are strong signs that the demand has hit up to some extent.
- Sudhakar Prabhu:** I had two questions for Mr. Shah. One is that you mentioned that total debt is around 574 crores, does this include the acquisition debt of Radicon?
- H.C. Shah:** No.
- Sudhakar Prabhu:** That would be additional around 100 crores?
- H.C. Shah:** 120 to 125 crores.
- Sudhakar Prabhu:** By the end of this year, do you see the debt number coming down?
- H.C. Shah:** Absolutely. As of 31 July, it was 676 crores and we also have a repayment in Benzlers-Radicon about 25 crores in the current year as well as repayment of term loan in Elecon which will be around 43 crores.
- Sudhakar Prabhu:** So the debt level should come down by around 60-70 crores by the end of this year?
- H.C. Shah:** Certainly, it should come down. We are not planning any additional borrowing as of now.
- Sudhakar Prabhu:** Lastly, this 5 crores of other income, what is this regarding, the standalone business?
- H.C. Shah:** Rent income from EPC, because after restructuring whatever the assets are in Elecon, we used to get a rent income from the other companies.
- Sudhakar Prabhu:** Is this like a more of a recurring type of income for you because even last year...?
- H.C. Shah:** On the basis of the property utilisation of land and building and other things, that we will pay the rent per month, maybe from 4-5 crores or 3.5 crores to around.

- Moderator:** We have the next follow-up question from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.
- Madan Gopal:** This is with reference to the statement that you made regarding Chinese competition in export market, where you said we need to pass on the rupee if we are competing with them. So is the price difference between you and Chinese around less than 10% or something like that so that by passing down the rupee you will be able to benefit?
- P.B. Patel:** Normally, the price difference is almost to the tune of 15-20%, but they always value the Indian product to be better than the Chinese and therefore they are willing to give you a premium over the Chinese. So based on that if you are 5-10% more expensive than the Chinese then they still give you weightage for that.
- Madan Gopal:** So despite this recent 5% correction in rupee that should be moving you closer basically?
- P.B. Patel:** For sure.
- Moderator:** As there are no further questions from the participants, I would now like to hand the floor back to Mr. Bhargav Buddhadev for closing comments. Thank you and over to you, sir.
- Bhargav Buddhadev:** I take this opportunity to thank the management of Elecon Engineering. Mr. H.C. Shah and Mr. P.B. Patel, would you want to add any closing remarks?
- P.B. Patel:** We are very thankful for you showing a lot of interest in Elecon and as I had mentioned earlier we are expected to do better in the next three quarters. The only thing that we hope for is that the economy will support us further, and if that happens, I am sure we will post even much better results than what is expected. Thank you.
- Moderator:** Thank you, sir. Ladies and gentlemen on behalf of Ambit Capital that concludes this conference call. Thank you for joining us. You may now disconnect your lines.