



“Elecon Engineering Company Limited Q1 FY19
Earnings Conference Call”

August 08, 2018



**MANAGEMENT: MR. PRAYASVIN PATEL – CMD, ELECON
ENGINEERING.
MR. PRASHANT AMIN – EXECUTIVE DIRECTOR,
ELECON ENGINEERING.
MR. KAMLESH SHAH – CFO, ELECON ENGINEERING**

Moderator: Ladies and gentlemen good day and welcome to the Elecon Engineering Company Limited Q1 FY19 Earning Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing ‘*’ then ‘0’ on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Binay Sarda from Christensen IR. Thank you and over to you sir.

Binay Sarda: Thanks. Good evening to all the participants on the call and thanks for joining this Q1 FY19 Earnings Call for Elecon Engineering. Please note that we have mailed down the press release to everyone and you can also see the result on our website as well as it has been updated in the stock exchanges. In case if you have not received the same you can write to us and we will be happy to send this thing over to you.

Before we proceed to the call, let me remind you that the discussion may contain forward-looking statements that may involve known or unknown risks uncertainties and other factors. It must be viewed in conjunction with our business risk that could cause the future result performance or achievement to differ significantly from what is expressed or implies by such forward-looking statements.

To take us through the results of this quarter and answer your questions we have with us the management of Elecon Engineering presented by Mr. Prayasvin Patel – CMD, Mr. Prashant Amin – Executive Director and Mr. Kamlesh Shah – CFO. Mr. Patel will give a brief overview of the quarter past and the full year and then we will open the floor to Q&A session.

With that said, I will now hand over the call to Mr. Prayasvin Patel. Over to you sir.

Prayasvin Patel: Thank you. Good evening all. Ladies and gentlemen a very warm welcome to our Q1 FY 2019 Conference Call. Discussing the results at the stand-alone level. We have had a relatively healthy quarter from a margin stand point with gear business reporting a good performance. During the quarter the total operating income net of GST grew by 39.7% year-on-year to 234 crores from 167.9 crores. The EBITDA on absolute basis stood at 30.9 crores as compared to negative 14.5 crores during the corresponding period of the previous year. This translates into an EBITDA margin of 13.2% in Q1 FY 19. We closed this quarter with a net profit of 3.4 crores as compared to a loss of 38.7 crores during the corresponding period of the previous year. Coming to the consolidated financials of the Q1 FY19. The operating revenues net of GST were 303.5 crores while we recorded an EBITDA of 37.4 crores up by 541% over Q1 FY18. EBITDA margins also has improved to 12.3% in Q1 FY19 as against negative 3.5% in Q1 FY18. The consolidated profit after taxes stood at Rs.7.5 crores for Q1 FY19 as compared to a loss of 36.2 crores in the corresponding period of the previous year.

Overall, we have had a relatively healthy performance in the quarter largely driven by improved product mix and traction in the gear business as a whole. We continue to see

improvement in the demand scenario lead by revival in the economic activity and we saw significant ramp up in the ordering booking with orders worth 149.8 crores booked in the gear business and closed order worth Rs.113.5 crores in the material handling business. This translates to an order booking of 779.4 crores for the gear business and 533.3 crores for the MHE business for execution in the remaining part of the year.

Our overseas business Benzlers-Radicon registered a revenue of 71 crores with an EBITDA of Rs.6.04 crores. Overall, we are seeing increased activity in the engineering sector and the demand outlook looks positive. Moreover, we are now seeing the effect of change carried out in our strategy and reorganization done during the last financial year in terms of improved performance. We are confident that the performance will continue to improve in the future looking at the revival in the demand scenario and on back of a strong execution and favorable product mix.

Thank you all we will be happy to address your specific queries about business going forward. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. We have the first question from the line of Ritika Garg from Equitas Investment. Please go ahead.

Ritika Garg: Sir I wanted to know how is the US business doing.

Prayasvin Patel: U.S. business is on a slight improvement the reason is we have made corrections because there were losses earlier so we have made corrections and those corrections are being implemented right now. We are seeing the effect of it however the complete effect would be seeing during the end of the financial year.

Ritika Garg: Okay. So, do we expect it to be profitable by the end of the financial year, I think last year there were \$2.5 million worth of losses at PBT level.

Prayasvin Patel: Yes. What we expect that we would be at least cash neutral by the end of the year.

Ritika Garg: Okay. Do we expect to be PAT positive?

Prayasvin Patel: That means 0-0 level.

Ritika Garg: Okay. But then do we expect to be positive in FY20 onwards.

Prayasvin Patel: Yes, for sure.

Ritika Garg: Okay. And we did some reorganization right where the shares of Benzlers were acquired by Radicon, what was the reason for doing that?

Prayasvin Patel: I am sorry I did not understand that.

- Ritika Garg:** Sir note whereby shares were issued by Radicon to ETIL Mauritius for the business of Benzlers.
- Prayasvin Patel:** See basically we are restructuring the entire foreign operations so that tax wise we become more favorable and that is being done basically by moving the Mauritius or liquidating the Mauritius entity and moving to Radicon UK or let say into UK. And that would start happening shortly.
- Ritika Garg:** Okay. And what would be the effective tax rate for overseas subsidiary.
- Prayasvin Patel:** Kamlesh are you on the line can you answer that please.
- Kamlesh Shah:** Yes. After the effective rate once will be applicable so that would be nearly 27% what we are expecting which is applicable in UK it will be down the line.
- Ritika Garg:** Okay. But this quarter we did not provide for any tax in the overseas subsidiary or minimal tax in the overseas subsidiary what was the reason.
- Kamlesh Shah:** As per the working out also it is not applicable to provide for Radicon at this point of time for the quarter itself that is why we have not provided for.
- Prayasvin Patel:** Also if I can just give a little more clarity, we have certain tax benefits that are getting passed on because of previous losses accumulated in Benzlers that gives us a lower tax rate as we go forward because we are able to carry them forward.
- Ritika Garg:** Okay. But for how long do we expect to have lower tax rate and how much.
- Prayasvin Patel:** It will all depend on how much profit we generate because that is offsetting again past losses. But as Kamlesh said probably at a consolidated level it will be anywhere between 20 to 25 little bit more than the withholding tax rate that applies.
- Ritika Garg:** On a consolidated level it will be 20 to 25% and standalone is 34%.
- Prayasvin Patel:** That is Benzlers-Radicon entity level Kamlesh can answer that.
- Kamlesh Shah:** Yes. That would be we are expecting we would be on the normal tax rate so far as what we are looking to the current scenario we would be on normal tax rate also.
- Ritika Garg:** Okay. But then subsidiaries would be 20 to 25% or the consolidated entity would be 20 to 25%.
- Kamlesh Shah:** Correct.
- Ritika Garg:** So, the subsidiaries would be 20 to 25%?

- Kamlesh Shah:** Yes.
- Ritika Garg:** Okay. And the revenue mix has changed it is moving more towards gears now, it is 65%:35% so do we see a further change in this mix for say FY20 onwards.
- Prayasvin Patel:** Basically, I would tell you that the mix would almost remain the same going forward during the year. Because the material handling business since we have changed our strategy and the top line would tend to reduce slightly however the bottom line would get positively affected.
- Ritika Garg:** Okay. But we did expect a growth of 15% right in revenues in material handling business.
- Prayasvin Patel:** No we were not expecting a growth this year because of the change in the strategy that we have.
- Ritika Garg:** Okay. So, we do not expect growth in revenues.
- Prayasvin Patel:** Growth in top line is not expected, growth in the bottom line is expected.
- Ritika Garg:** Okay. And have our two loss making projects been completed.
- Prayasvin Patel:** No. They have been delayed further because of strikes at our customers end. However, we are expected to finish in the third quarter.
- Ritika Garg:** Okay. So, how much additional cost would this incur?
- Prayasvin Patel:** Actually, it won't incur a substantial cost or there would not be a much increase in cost because there was a status quo because of the strike and the customer has given us extension in time. So, the negligible cost of man power staying out there for a longer duration is the only additional cost that would incur.
- Ritika Garg:** Okay. So, in the MHE business would it be profitable at a PBT level this year?
- Prayasvin Patel:** That is what we are trying hard to do, we are expected that at least as we go further during the year our negative results would be converted into positive we are expected that at least we would reach 0-0 level or become positive by the end of the year it would be difficult to judge that as of now.
- Ritika Garg:** Okay. And the order inflow that we have seen in the MHE level is from which industries.
- Prayasvin Patel:** Basically, orders are coming in from the fertilizer business as well as cement, partially there is also revamping and modernization going on in the coal industry which is at the power plant sector and we are hopeful that we will bag more profitable revamping orders by the end of the year.

- Ritika Garg:** Okay. So, what is the change in strategy that we have done for the MHE business.
- Prayasvin Patel:** We have stopped taking large projects, but we are concentrating more on profitable product business as well as revamping and modernization projects which are coming up. So, the intention is that they give better margins and the intention is that we grow the bottom line rather than the top line.
- Ritika Garg:** Okay. And what is the outlook for the transmission business.
- Prayasvin Patel:** The order inflow has been reasonably healthy, what was different this year was the fact that we had a good amount of orders which we would execute in the first quarter and that is what has brought in this substantial change and going forward there are orders, reasonably healthy orders on hand and we are expected that if this traction in the economy continues to be the way it is right now. We are hopeful that things will look very-very positive by the end of the year as we have seen the results in the first quarter.
- Ritika Garg:** So, what revenue growth do we expect for FY19.
- Prayasvin Patel:** Well we are expected to do close to 600 crores.
- Ritika Garg:** Okay. And EBITDA margins.
- Prayasvin Patel:** They will be more or less the same level as the first quarter, however, we are trying to further improve upon them. So, that we are able to perform better.
- Moderator:** Thank you. The next question is from Sunil Kothari from Unique Investment. Please go ahead.
- Sunil Kothari:** For the improved performance, basically the strategy which we are changing from MHE project to product division. So, what is your thought process over the period, what we want to do, how we rationalize the cost structure and because transmission division in any case is now moving towards very profitable and positive performance so MHE is our major concern and drag, so how you want to change those cost structure and improve profitability may be year or two.
- Prayasvin Patel:** The cost structure we have already started changing over period of time. There is lot of restructuring that we have done. And apart from that as a strategy we are going into larger in-house manufacturing and reducing the contracting and as well as activities more at site, trying to reduce them so that our cost come under control and we are able to get higher margins. So, that is the strategy going forward and because of that we have tried to restructure the organization with the kind of man power that we require to do so. And we believe that this strategy would start paying results by the end of this year as well as in the next year going forward.

Sunil Kothari: Okay. So, what type of growth in terms of revenue we are expecting the MHE may be current year or may be next year.

Prayasvin Patel: As we said looking at very conservatively we are presuming that if we are able to sustain even the top line that is the revenue rather than growth, if we are able to maintain the top line we would be able to substantially improve the bottom line. This strategy has been not as long as material handling division is concerned not to grow the revenues but to grow the EBITDA and that is what we are trying hard to do. And if the economy supports us the revenues or the turnover will automatically increase.

Sunil Kothari: Correct.

Prayasvin Patel: As we are operating at almost 50% of our capacity there is ample capacity available to take more orders and execute them provided the inflow of orders come in with the improvement in the economy.

Sunil Kothari: Right. And sir any thought process on any restructuring of debt or maybe reducing debt by, I think we are planning NCD with convertible warrants so any detail about those.

Prayasvin Patel: Well it is still in the transition phase, so it is very difficult for me to comment on it right now, but our intention is that going forward we reduce our debt and also reduce our interest cost. So, that is the strategy going forward over a period of time. I am not too sure how much we will be able to reduce our interest cost considering that the market is going the other way but the costs are increasing. However, the intention is definitely to reduce debt in the long run so that is what we will strive to do over a period of the next year or two.

Sunil Kothari: Given your long experience in the industry is the current traction in transmission can it gain momentum, are we seeing early signs of some revival on the ground?

Prayasvin Patel: We are seeing revival for sure. However, considering the banking scenario I am not too sure whether this will continue and for how long it will continue if the financial sector is able to support the economy and its growth then for sure ETI poised to turnaround.

Sunil Kothari: Out of various industries that we service because our footprint is very large, where do you think the problems are and where do you think the growth opportunities are for us.

Prayasvin Patel: The problem lies more in the power sector. And unfortunately, we are considering the material handling business as well as gear business we are quite dependent on the power sector. That is yet to show traction but on the other hand there are signs that the industries like cement, which is showing positiveness, fertilizer is showing positiveness as well as infrastructure is also showing a good growth. So, there are areas which are showing growth and the overall scenario is such that people are now seeing or have changed their attitude towards a positiveness which would overall help the economy.

- Sunil Kothari:** Any sign, any big growth in any of our overseas market?
- Prayasvin Patel:** The US economy is doing quite well, as well as Europe has also it is surprising that, that is also doing equally well right now. So, especially these two are the major driving engines of the global economy and if they continue to do well over a period of time I think the entire world will get into a situation where the outlook would be very-very positive.
- Sunil Kothari:** Any broad indication for next year?
- Prayasvin Patel:** I believe that we are in the phase of revival and even as Elecon as a company we probably have seen that our worst days would be getting. As the outlook that I have and we are working towards it with a lot of positiveness and we hope that if there is a little support from the economy that is all we need.
- Moderator:** Thank you. The next question is from Pavan Parakh from Renaissance Investments. Please go ahead.
- Pavan Parakh:** Sir you basically spoke about this material handling business so any other we also talk about this reorganization that we did in FY18, so was it all related to material handling business or some other activities in the gear which also if you would like to highlight.
- Prayasvin Patel:** No, we have done reorganization in both. However, in material handling it was both drastic because there was an entire strategy change. So, that was the reason why we are expected to do much better and though it is right now still incurring losses, but the losses have started reducing and going forward we have a very positive outlook.
- Pavan Parakh:** Alright. So, there has been like a substantial improvement in gears business both in the standalone consolidated. And you referred a part of it as because of the product mix so can you explain a bit more what do you mean by product mix?
- Prayasvin Patel:** Apart from product mix what I would say is, this was the first time that at the end of the year we had enough orders for the first quarter. Up till now what used to happen is that we would try hard to finish off all or most of the orders by the end of the year and we would have very few orders pending for the first quarter to be executed. This time the backlog was robust enough for us to continue the momentum that we normally have in March for the first quarter. And we see the same thing happening in the second quarter that there is a reasonable traction that would give us the necessary momentum. So, if this continues we will be able to do substantially well by the end of the year.
- Pavan Parakh:** Right. So, sir you mentioned some 600 crores of number in terms of revenue for FY19 so that is, what is that number that is because FY18 our consolidated revenue is about 1200 crores so what is that 600 crores of revenue referring to?
- Prayasvin Patel:** That is the gear business the total invoicing that we expect is around 600 crores.

- Pavan Parakh:** Okay. That is for standalone gear business?
- Prayasvin Patel:** Yes, I believe that is for standalone gear business.
- Pavan Parakh:** Okay. And sir if you could highlight power as a percentage of your revenue so what is our dependence on power sector especially power generation side which is both power generation and coal mining.
- Prayasvin Patel:** Kamlesh maybe Chirag can provide you our power business thing I would say I would had to guess because it has changed substantially in the last two years. Maybe we can get that number and share with you later.
- Pavan Parakh:** Yes sir. Given that we are seeing that there are green shoots of revival across gears industry except for power which is the key challenge for us what are the dependence or exposure to power sector in terms of FY18 revenue or maybe the current order book in hand if you could help that?
- Prayasvin Patel:** Yes, normally our dependence on the power sector if you look at the gear business it remains approximate 30% level that is 30% of our orders normally come from the power sector. This year it has been much lower, however, there are orders that we have bagged from the power sector as a strategy what we have done is, we have taken up more or less all the orders which were available in the power sector this year. So, our market share in the power sector has increased as compared to what it used to be earlier. But, there are also healthy orders from other sectors like sugar as well as from cement and we see that going forward cement and sugar would give us healthy inflow.
- Pavan Parakh:** Okay. And material handling business, power exposure?
- Prayasvin Patel:** Material handling basically the dependence on the power sector is almost to the tune of (+50%) in the material handling business and as I told you we have changed the strategy rather than pursuing project orders we have concentrated more on products and we are also looking at revamping and modernization of plants and that we have been able to do it successfully for the various old customers of ours which is also generating tremendous goodwill apart from giving us healthy margins.
- Pavan Parakh:** Okay. So, this R&M that we are doing, these are for coal base power plants.
- Prayasvin Patel:** Yes.
- Pavan Parakh:** Can you name a few.
- Prayasvin Patel:** Basically revamping and modernization. As such we are doing in Maharashtra, we are doing it even for utility company in Gujarat, so it depends there are also proposals at various other states also.

- Pavan Parakh:** Okay. And what is the debt and cash levels as of now.
- Prayasvin Patel:** Kamlesh can you take the question please.
- Kamlesh Shah:** The current debt level at my standalone basis is at 490 crores.
- Pavan Parakh:** And consolidated?
- Kamlesh Shah:** Consolidated it is 590 crores.
- Pavan Parakh:** Okay. And this is gross debt or net debt sir?
- Kamlesh Shah:** Gross debt.
- Moderator:** Thank you. The next question is from Vishal Mittal from Optimum Securities. Please go ahead.
- Vishal Mittal:** Just wanted to understand the cost numbers of both our division. So, just say we make a sale of Rs.100 in both the divisions. How would the general cost structures be for them as an input cost, employee balance expenses, broadly to just get a sense of profitability in both the divisions.
- Prayasvin Patel:** According to me this is a sensitive question so I would not reveal that information.
- Vishal Mittal:** Broad range also. Fair enough, would it be possible to just, it is okay that is absolutely fine sir.
- Prayasvin Patel:** If there is any specific information if I can help you because while I cannot answer that I would not like to dissatisfy you so if there is any other way that I can help you.
- Vishal Mittal:** Sir basically what we wanted to understand is how the profitability in both the division differs and how can it be ramped up that is the only thing so if there is any light you can shed on that?
- Prayasvin Patel:** For sure I can answer that. Our fixed costs are high because of our very high capital investment and therefore what is happening is the more turnover you do especially in the gear division the profitability increases substantially. In material handling also there are two aspects of it, the in-house manufacturing has got high margins and they are healthy margins. Therefore, what we are trying to do in material handlings is to do more in-house manufacturing which means we take contracts where there is higher in-house manufacturing and less activity at sight or we see to it that the bought-outs are also at the bare minimum level. So, that is what we are trying to do in material handling. However, there also you need a minimum invoicing to be done to maintain the margins. So, if we are operating below breakeven point then there are losses.
- Vishal Mittal:** So, broadly we are just at that level.

- Prayasvin Patel:** Did that satisfy you.
- Vishal Mittal:** Yes.
- Moderator:** Thank you. Next we have a follow-up question from Ritika Garg from Equitas Investment. Please go ahead.
- Ritika Garg:** Sir how much will the subsidiaries contribute to revenues and profitability in FY19 and '20?
- Prayasvin Patel:** These proportions would be more or less the same.
- Ritika Garg:** So, 25%.
- Prayasvin Patel:** However, we are expected that the margins would improve especially because the margins today that the foreign subsidiaries are achieving are being in the consolidation. US right now is showing negativity and therefore it is being eaten up. Going forward, as we become neutral and positive out there, that will tend to further improve.
- Ritika Garg:** So, what EBITDA can we expect for the UK subsidiary.
- Prayasvin Patel:** We would be able to bring up the EBITDA from the present level by at least another 3% to 5%.
- Ritika Garg:** So, at the current level it will be 9.5% to 10% in UK.
- Prayasvin Patel:** Unfortunately, I do not have those figures with me as I am in the US Kamlesh can you confirm that the EBITDA percentage right now?
- Kamlesh Shah:** Currently at UK EBITDA margins nearly 8% to 9%.
- Ritika Garg:** Okay. And have we started executing the marine order?
- Prayasvin Patel:** Yes, we have started execution, however, the invoicing will take place by the end of the year.
- Ritika Garg:** Okay. So, it will not contribute to my FY19 revenues or will it?
- Prayasvin Patel:** Yes, it will contribute to the FY19 revenues for sure but that will be in the last quarter.
- Ritika Garg:** Okay. And how much would it contribute like, it is your 500 crores right spread over....
- Prayasvin Patel:** We are expected to do one ship set which would be about if I am not mistaken 70 crores to 80 crores approximately.
- Ritika Garg:** Okay. And do we have any CAPEX plans for FY19.

Prayasvin Patel: The CAPEX overall is at a negligible level and it will continue to be at a negligible level for at least next one or two years. However, if you want the exact figures we can let you know.

Ritika Garg: No that is fine.

Prayasvin Patel: But there is nothing significant in value, they are not very significant in values.

Ritika Garg: And how much will the subsidiaries contribute to my PAT level consolidated in FY19?

Prayasvin Patel: Kamlesh can you take that question please?

Kamlesh Shah: This all depends upon the economic scenario at this point and if I say in terms of my quarter one that is already known to you, as far as it is contributed nearly 4 crores to me in this quarter one itself so if going forward the trend continues the same scenario will be there at the end of the year that is what we expect.

Ritika Garg: Okay. So, like a quarterly run rate of 4 crores?

Kamlesh Shah: Correct. We expect to continue the same business scenario to continue that is what we are hopeful and the same thing is being planned and it is coming in that line also presently.

Ritika Garg: Okay. And how much exports do we expect in FY19? I believe it was 60 crores in FY18.

Kamlesh Shah: Yes, this year we are expecting between 80 to 100 crores or so.

Moderator: Thank you. The next question is from Arvind Joshi from Bataleur Advisors. Please go ahead.

Arvind Joshi: I generally wanted to get a feel for the kind of additional outlook for our defense business we made a good start by bagging up few orders in the last few years, how do you see the business going ahead especially in the light of our good background and good relations with the navy and also good track record and government's urge to indigenized more and more of defense products. How do you see the outlook in the defense business now, incremental business?

Prayasvin Patel: The prospects seem to be quite good and healthy, the reason is there is a good demand especially since the Indian Navy as well as coast guard are planning to construct a lot of ships and therefore the demand is going to be reasonably healthy over a period of time. In the next two to three years I would say that there is a strong possibility that we will get at least 200 crores to 300 crores worth of orders from that segment.

Arvind Joshi: Okay. And sir one more thing, now with the problems in the coal business and the uptick in cement business also leading to scarcity of coal, the increasing amount of domestic coal is being used Coal India is also telling customers that they are going to ramp up the production ordering for additional rakes and all that. So, will Indian coal lead to more of washing, pulverizing and all that and leading to better business outlook for us now? Normally, we were

not expecting the power sector to provide too much of business for us but now in light of the domestic coal coming into play do, you see some additional tailwinds building up for us?

Prayasvin Patel: As of now we are not seeing anything, and though there have been statements I would look upon them very cautiously. Because when the actual implementations start, I would give weightage to it.

Arvind Joshi: Okay, fine. And sir finally we have been talking of restructuring our MHE business and focusing only on better margin products so by at least by the middle of next year would we go back to our old margins of (+18%) to (+20%) in the product business or you feel it could happen earlier?

Prayasvin Patel: I would presume that by next year onwards you should be able to see that.

Moderator: Thank you. We will take that as the last question. I would now like to hand the conference back to the management for any closing comments.

Prayasvin Patel: As you all know that we have done well in the first quarter, seeing that the traction is building in the Indian economy, we are expected to do well by the end of the year. However, this is just a stepping stone, I believe that if the economy seems to be reviving and if it continues to perform well, since the telecom is operating at almost 50% of the capacity the potential to ramp up and to grow is substantial and I can assure you from the management that we will leave no stone unturned to make sure that we grab the opportunity and show better results going forward. So, I hope that worst days are over, and we are looking at the situation very-very positively and hope that the economy supports us in what we try to endeavor to do. So, with this I thank you all for taking all the interest in the results of Elecon Engineering. And hopefully, we will be able to meet up with your expectations. Thank you.

Moderator: Thank you very much. On behalf of Elecon Engineering that concludes this conference. Thank you for joining us. Ladies and gentlemen you may now disconnect your lines.