"Elgi Equipments Limited Q1 FY 2016 Results Conference Call"

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Faizal: Ladies and gentlemen, good day and welcome to the Elgi Equipments Limited Q1 FY2016 Results Conference call hosted by Asian Market Securities Limited. 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 "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kamlesh Kotak. Thank you, and over to you Sir!

Kamlesh Kotak: Thanks Lizann. Good afternoon everyone. On behalf of Asian Markets I welcome you all to the Q1 FY2016 earnings conference call of Elgi Equipment Limited. We have pleasant an inviting with Mr. Jairam Varadaraj, Managing Director of the Company. I request Mr. Jairam to provide us an overview of the quarter results and then we shall begin the Q&A session. Over to you, Sir!

Jairam Varadaraj: Thank you Kamlesh. Good afternoon ladies and gentlemen. It is a pleasure for me to be with you this afternoon. As per our normal structure of presentation, I will focus on the consolidated results as we look at the current year's Q1 compared to the previous year's Q1. There has been a marginal increased in sales to the extent of 28 million, contribution after material cost is higher by 29 million. This 29 million has been contributed 12 million due to increase in sales and 17 million due to the decrease in material cost. Now considering that the contribution is higher by 29 million the EBITDA should have been 260 million which is the addition of last year's EBITDA to the 29. The actual EBITDA is 310 which is kind of indicative that we have done better than significantly better than the previous year to the extent of 49 million. Now, how have we been able to do this 49 million primarily there has been a reduction in variable cost other than material cost significantly not only in India, but in the rest of the world. There has been a reduction in fixed costs in the US and in India, which has been quite significant and part of the fixed cost reduction is also the discontinuation of our legal expenses that we incurred last year. So this is basically overall the financial performance. I would say that the performance has been better than Q1 of last year. The overall assessment is the cost structures are by and large in place. There are some costs that are represented in a distorted manner primarily people cost and that is because we have not been able to grow the topline that this current compliment of people can achieve, so there is an inherent distortion there, but the other costs have been in good control both in India and in the rest of the subsidiary. The current sales that I told you marginal increase of 28 million is after almost 2% that we lost because of the appreciation of the rupees with respect to the Euro, so we have not lost in volume, we have lost in value because of the exchanges, so in effect I would say the overall volume based increase has been to the extent of 3% and 3.5%. Again, not something that I would write home about but it is something that we need to be working on. The second highlight is in the first quarter of last year, we had significant income in a very special product in our french subsidiary, that business is almost zero in this quarter. So to that extent our normal core business has grown to the extent of almost last year it was closed to 90 million in the first quarter, in this quarter it is hardly in any value, so effectively you should take another 3%, so we are talking about 6% effective growth in the performance of the company in the first quarter. India sales has been higher than last year marginally again to the extent of about 4.5%. I would not say that the growth of sales has happened in any specific sector, it has been across all except the large project based sales that has been quite under pressure for us. In terms of the composition of sales it almost continues to remain 50:50, 50% of our revenue is coming from India and 50% of our revenue is outside the country. This has been stagnating at this level for the last almost two-and-a-half, three years, this is an area that we would like to see a greatest sales coming from outside not by reducing India sales of course, but by growing our rest of the world business faster than we are growing the India business. In terms of the overall assessment the Indian market again like I said in the last quarter conference there seems to be a lot of conversation, lot of optimism, but we still do not see any action on the ground especially from companies that had built a lot of capacity over the last three to four years. The good thing is quite a bit of that capacity is getting utilized. The bad news for us is it is not been fully utilized to the extent the next round of capital investment is going to happen, so whereas small and medium size companies that did not do this large capacity increase over the last five, six years are making some marginal increases in the capacity and to that extent we have been getting orders, so again we have to wait and see when the past capacities will get fully utilized to the extent people feel confident to start building new capacities, significant movement in that direction is not happening in the market yet. So in the meantime we are looking, we are pushing hard on opportunities outside the country, we are pushing hard on opportunities inside in terms of looking at specific segment either geographically or industry wise or customer segment wise where we believe that our position is relatively weaker, we are trying to push hard there, so these are all kind of incremental improvement that we are trying to do, so this is basic synopsis of the performance and the present market condition, I will be happy to take specific questions as we go along, thank you so much.

Moderator: Thank you**.** Ladies and gentlemen we will now begin the question and answer session. Anyone wishing to ask a question may press "*" and "1" on the touchtone telephone. If you wish to remove yourself from the question queue, you may press "*" and "2". Participants are requested to use handset while asking a question. Ladies and gentlemen we will wait for a moment while the question queue assembles. The first question is from the line of Raviu Swaminathan from Spark capital. Please go ahead.

Raviu Swaminathan: Thanks for taking my question. Could you explain more about the new products, how traction has been in your all oil free screw compressor and your centrifugal compressor and are we seeing some good traction in those products?

Jairam Varadaraj: I would not say that they are significantly better. We are continuing to sell good quantities of oil free screw that is manufactured by the company and we are beginning to see traction for these products outside the country also, but they are not significant quantities, but these are significant because these are all creation of references in different parts of the world, which will lay the foundation for us for future growth. Centrifugal, two of our machines are already running, the performance has been very good, so we are continuing to develop the full range out.

Raviu Swaminathan: Okay, how big are the markets for these in India and abroad and among your competitors, who will be the strongest in this?

Jairam Varadaraj: Oil free screw the strongest manufactures, strong player in the market is Atlas Copco. In centrifugal compressor, I would say the strongest is Ingersoll Rand. Atlas also has a strong range of products. The market size, I would not like to talk about the market sizes in India because it is just giving away too much of information. In terms of the world market, the estimate is that the oil free screw could be anywhere between 2 to 3 billion dollars and the centrifugal could be about 1.5 to 2 billion, these are estimates.

Raviu Swaminathan: Any flavor on exports from India, how that has grown during the quarter, vis-a-vis domestic sales?

Jairam Varadaraj: Like I said the ratio of sales has pretty much remained the same, I would say the difference India market is probably 2% higher than the rest of the world in this quarter compared to last year.

Raviu Swaminathan: The year-on-year margin expansion that has happen at a subs level that is among our acquired entities, which has seen a faster turn around Patton or your pellets and are they profitable at an EBITDA level and at a PAT level?

Jairam Varadaraj: The US patents have always been profitable. US operations rather than patents are significantly reduced it's loses as EBITDA level. China has reduced it's loses at EBITDA level. Brazil has improved its profitability. Belair has been a challenge because we lost one segment of sales like I was explaining to earlier that it is not there, but growth in revenue has been there. Generally at a consolidated level, the losses in subsidiaries have significantly come down.

Raviu Swaminathan: **A**nd what would be the steady state margin that you would be targeting at a subs level hoping that we could achieve say in a reasonable time period in a year or two?

Jairam Varadaraj: I do not see any reason why the subsidiary should be, the profitability of the subsidiary should be any lower than the parent organization, but these are all subsidiaries with overhead that are capable of even doubling the sales, so our losses are not at the variable cost level, our loses are because we are carrying fixed cost that are designed for much higher levels of sales and most of the subsidiaries where the market opportunities are huge growing at a reasonably comfortable pace, so that is why I believe that if we continue to maintain that pace of growth in sales we should be able to post much better results in terms margin from the subsidiaries.

Raviu Swaminathan: Because why I am asking is, in India if there is a recovery in the market, we would see 20, 25% north of 20%, 25% growth year on year, but the subsidiaries also do they have so much amount of scope for growth for you?

Jairam Varadaraj: Some of the key subsidiaries are growing even at a higher percentage than that.

Moderator: Thank you. The next question is from the line of Amol Rao from Phillip Capital. Please go ahead.

Amol Rao: Good afternoon sir, you did mention in a very encouraging development that things are looking up slightly for us, any particular commentary on which sectors enduser segments are kind of showing promise?

Jairam Varadaraj: In India, I would not say that there is any one industry vertical that is doing very well like I explained the large project type of businesses are still struggling and in the non-project type of businesses large customers who have build capacities in the past have not come back to the capacity increase or capital investment cycle yet because they need to use up their existing capacity. Small to medium size companies that did not go through a major increase incapacities **or** doing incremental capacity increase, so which is where the growth is coming from.

Amol Rao: Would it be correct then to info that this kind of demand as you said which is coming in from the SME or MSME segment would be of slightly lower ticket size and what we are usually accustomed for a large client sir?

Jairam Varadaraj: We are not doing the project business revenue it is struggling; therefore the average if I have to divide the sales by the average number of machine sold it is probably lower this quarter than last year.

Amol Rao: Alright, **o**ne final question from my side sir, we have been hearing a lot about stuffs happening in the railway segment, about orders being placed for new locomotives and stuff like that and we are pretty strong there, so I was wondering if railway compressor as a business was seeing at least an increase in the enquiries that we are receiving sir?

Jairam Varadaraj: It is not just increase in enquiries we have registered a growth in a business, not significant, but definitely a growth considering that in 2014-15 it was flat.

Amol Rao: Okay and we are hopeful that in this business this is the start of traction?

Jairam Varadaraj: We are hopeful, there was a separate budgetary provision that the government had made, but unfortunately very little of that has been spent.

Moderator: Thank you sir. The next question is from the line of Shashank Tulsian from HDFC Mutual Fund. Please go ahead.

Shashank Tulsian: My question regarding the subsidies only, for the full year in your annual report, there has been four subsidiaries where we are kind of worried which is basically the Chinese subsidiary both the subsidiaries the Brazil subsidiary where the losses have actually expanded in spite of not a significant growth at least in a Chinese subsidiary, Brazil although we have seen some growth, but the loses have expanded much more there, so could you explain that, why the negative trend in these two subsidiaries?

Jairam Varadaraj: I had explained this in the last conference call, in China we are having some fundamental issues because our products that we are selling in China from a design for interview inherently have a higher cost then what the Chinese market is willing to pay for an Indian brand and an unknown brand that too. So we have decided that we need to go back to the drawing board as far as China is concerned, come up with new product line, which is more consistent with Chinese expectations of an Indian manufacturer, so that in the meantime what we are trying to do is cut back on expenses in the Chinese operation, reduce the loses and in this quarter we are already beginning to see the result of that. As far as brazil is concerned as a business it is extremely profitable, last year we had on the 30th of March the Real, which is the Brazilian currency depreciated quite significantly with respect to the dollar and because there is no direct rupee to Real's exchange rate it is a triparty kind of an exchange rate, there was a huge devaluation, forex loss that we have to report. In this quarter that has actually reversed itself and we have made a profit in Brazil.

Shashank Tulsian: There are two more subsidiaries, one is Australia, which again the losses have expanded there, if you could explain that also and the last question would be on the ELGi compressor US business I think it grew phenomenally well, there was 76% topline growth in FY 2015, but the profits did not grow, so if you could explain that?

Jairam Varadaraj: The Australian subsidiary continues to have challenges because we have only three people, so it is not like we have carrying huge overheads, but the traction in the market combined with the current condition of the Australian economy is putting a serious challenge on growing the topline. If we are able to grow the topline, the costs are well within the control. We are doing a few things this year to rationalize some cost and also try to gain some market there. So in any case, the overall loss right now is about Rs.2 Crores that was there last year and I am not extremely worried about it even though I do not like that loss, I am not too worried about it. As far as the US operations are concerned, yes we grew quite significantly, but the losses have come down compared to the previous year, so I do not know what is the specific number you are referring to.

Shashank Tulsian: I am referring to the ElGi compressor US incorporated numbers and the number is 3 million in FY 2014, which is a positive PBT, which has turned to 39 million negative PBT for FY 2015?

Jairam Varadaraj: There is something wrong, I need to check that. It is probably an intercompany transaction between Patton and ELGi USA because the ELGi USA owns Patton, standalone operations of ELGi USA, we have grown and the losses have come down.

Shashank Tulsian: To conclude, Australia you are trying to bring down the losses, China too and Brazil has already turned around, and US is doing well.

Moderator: Thank you. The next question is from the line of Ruchir Khare from Kotak Securities. Please go ahead.

Ruchir Khare: Good afternoon Sir. First of all, congratulations on a decent set of numbers especially in the international subsidiaries. My question is what would be your total investments in China till date?

Jairam Varadaraj: Do not ask that number in front of me, but including losses we can give you that number offline.

Ruchir Khare: Secondly Sir with respect to restructuring in Chinese business, is it likely that we might incur some one time cost in terms of may be employee settlement or anything of that sort?

Jairam Varadaraj: We are navigating that process very carefully without having to incur these cost that is one of the reasons why it is taking a little longer. So we are engaged with lawyers to make sure that we navigate this compression of the operation from current level to a level which is most reflective of the present level of sales and we are trying to do it without any significant impact or one time expense, so we are not anticipating these being one time expense.

Moderator: Thank you. The next question is from the line of Manish Goel from Enam Holdings. Please go ahead.

Manish Goel: Very good afternoon Sir. Just wanted to know on the Brazil, last quarter we had significant impact on due to currency, so you have just mentioned that it is basically we have recouped some of those, so what could be that number? Has it reported profit in the quarter?

Jairam Varadaraj: There is a profit in the quarter. I do not have the number in front of me, Manish. The EBITDA is a double digit EBITDA

Manish Goel: In terms of margins you are saying?

Jairam Varadaraj: I am talking EBITDA, margins are quite significant.

Manish Goel: How is now Patton shaping up size after basically we have probably got our sales and marketing people and if you can brief on that factor?

Jairam Varadaraj: The sales of units, there are four categories of business of Patton, sales of machinery, service agreement, sales of parts and sales and service. Now, in sales of equipment, we are ahead, we are higher than our pre-acquisition levels. In service agreements we are at the same pre-acquisition levels. We have come back to the same pre-acquisition levels. In parts and service we are still behind by almost 20%, so we lost most of our people in service especially experienced technicians and because of that we are growing up from the lowest level of parts and services we are coming back up, but it is taking longer than in terms of service agreements and sales of units, but the organization is staffed, but there is still a few positions we are struggling to fill, but we are working on that, so overall it seems to be in the right direction, but it is going to be a longer recovery than we thought.

Manish Goel: Okay and patents also at net level would be making money?

Jairam Varadaraj: Yes absolutely.

Manish Goel: Okay, sir one observation on first quarter number when I probably look at the only subsidiaries performance what I see is that historically like last two years Q1 is significantly better than Q4 like we see that Q1 is probably the best quarter we see probably look at only the overseas subsidiaries, so what could be reason for that?

Jairam Varadaraj: Nothing significant, I cannot attribute any reason for that money, the only thing is second quarter is bad in Europe because they have their holidays in August and third quarter is bad all over because December is a very lean month in most of those countries so because of Christmas and New Year and all that stuff it is quite lean, but so other than that it is too early to talk about Patton.

Manish Goel: Is it due to any spare parts or service agreements which we maybe doing in the revenue?

Jairam Varadaraj: No because April, May, June is the first quarter for India, not for anybody else.

Manish Goel: Okay, so there is no one time -

Jairam Varadaraj: No.

Manish Goel: In Belair you mentioned that 3% of the overall sales got impacted because of this one time product?

Jairam Varadaraj: No, 3%, 88 million that was there in the last year which significant portion of it was in the first quarter, so if you take that quarter alone yes the impact has been quite significant.

Manish Goel: 88 million what you are referring to?

Jairam Varadaraj: Is the **(indiscernible-29.07)** sales in Belair.

Manish Goel: Okay, in the quarter?

Jairam Varadaraj: No it was for the year which significant portion of it, I think almost 70%, 75% of it was in the first quarter.

Manish Goel: For the full year it was 88 million rupees sales?

Jairam Varadaraj: Yes.

Manish Goel: Sir how is now foundry operation, have it like we are getting the full benefits now from the foundry operations, have we moved entire sourcing from our own foundry, how is it?

Jairam Varadaraj: Most of the castings, almost 90% of the castings that we are buying have been moved to our foundry. We have also started adding a few additional part that were earlier made from steel that could have been made with cast iron and those are also been added to our foundry that overall demand is still lower that we have planned as the basic break even point, but it is getting slowly. In the first quarter compared to last year we have moved the volumes quite significantly in the foundry. I am expecting hopefully in the third quarter we would see that it is beginning to make a positive contribution.

Manish Goel: What would be roughly quarterly run rate or monthly run rate we should be running now?

Jairam Varadaraj: We are doing about monthly about 200 tonnes.

Manish Goel: Okay it is more or less at similar levels what we did last year?

Jairam Varadaraj: If you look at the sales has grown only about 3%, 4%, so it is not significant, so we would need to touch 3000 tonnes a year that is about 250, so we are right now at 200.

Manish Goel: Okay, fair enough.

Jairam Varadaraj: But we are moving up so it looks good.

Manish Goel: And what about our compressor facility?

Jairam Varadaraj: We have fully moved in. There is no production in the earlier factory for what is being currently made there, so it is settled down.

Manish Goel: If we look Elgi standalone the gross margin improvement what we have seen is it largely deflection of that foundry completely?

Jairam Varadaraj: No, if you look at it at a material cost level there are multiple things one is there has been value engineering benefits, there is better sourcing benefits, there is reduction. There are some commodity prices that have come down. We have been able to realize slightly better prices in our exports, in our sales to subsidiaries, so it is a combination of multiple things. I would not attribute it to one thing.

Manish Goel: And may be even your spares and services or spare parts business?

Jairam Varadaraj: Yes in India. So these are all sustainable, these are not one time.

Manish Goel: In railways now this government is probably building out too large facilities for locomotives, so do we also stand a chance to participate with such people?

Jairam Varadaraj: There has been a conversation that has been going on. We need to see who finally is the chosen partner and what is the level of localization that they proposed to do, so it is still the projects look very ambitious, the money that they talking about is really big, but it is quite slow in progression.

Manish Goel: At least I believe the electric locomotive one is likely to be finalized very soon?

Jairam Varadaraj: Yes we will have to see.

Manish Goel: And last question on the capex plan for current year and anything significant you are looking?

Jairam Varadaraj: No nothing at all. As usual everybody wants to spend money, but I do not have the ability to spend yet.

Manish Goel: And how is working capital, is it, are we seeing some improvement?

Jairam Varadaraj: Since December last year there has been a significant improvement, but this quarter a bit temporary bliss because we have dividend and taxes outflow this quarter, but overall we are on the right track, we should be able to. Our net debt is at around Rs.285 Crores, I think it should come down by at least Rs.60, Rs.70 Crores by this year.

Moderator: Thank you. The next question is from the line of Kamlesh Kotak. Please go ahead.

Kamlesh Kotak: Sir just can you help us to understand how the performance of Rotair and how you see that ramp up?

Jairam Varadaraj: Rotair for the quarter has been kind of flat and that is part one reason is because of course Euro has depreciated. The second is there are some challenges in Europe because coming out of the two things one is the situation with Greece there is a bit of a pause in terms of investment, the second is some of our key customers of Rotair are in countries which are oil producing. Now the oil prices has dampen the investment program in some of these countries, so that has been dampen for us in the first quarter, but industrial sales that is the products made by Elgi for Rotair that is our compressors that sales have grown quite smartly and looks very optimistic, so overall there will be some challenges in this year on the non-industrial machine, but industrials hopefully should play a role and partly off setting.

Kamlesh Kotak: Overall basis will it be a growing business for the company for this year?

Jairam Varadaraj: It will grow, but I do not think last year we grew about by almost 10%, I do not think we can expect 10% probably in the neighborhood of about 3% to 4%.

Kamlesh Kotak: Secondly sir domestically how you see the competitive intensity with even competitors also expanding operations so is it now being more of aggression from their side, how the overall market is looking?

Jairam Varadaraj: Well the market is always been aggressive Kamlesh. Yes there are more entrants, the market is kind of limited so everyone goes after all the opportunities a lot more vigorously than before, but we have a customer, we have some strength in the market. We are continuing to hold on to it and grow in specific areas. We have created this huge front end program to increase the intensity of our presence, so it is there, but I think we are responding quite well.

Kamlesh Kotak: What would be our utilization level at new plant as of now, net of foundry?

Jairam Varadaraj: See the new plant did not increase our capacity. We did not add any new machines when we moved from here to there. It is very difficult to give a capacity utilization because machines are used for multiple purposes, but if I have to take a rough either thumb rule of what was the peak production with the existing machines and what is the peak production now, I would say still we have about at least 20%, 25% headroom.

Kamlesh Kotak: Any further funding requirements we still have to support the overseas subsidiaries either of them?

Jairam Varadaraj: There could be some requirements in China to fund these losses, the rest of the things we are trying to workout programs, not dip in to the parent for any more funding.

Kamlesh Kotak: So incremental funding would not be that much required except China is it?

Jairam Varadaraj: Yes.

Kamlesh Kotak: How is the Middle East market growing, it is also always having some impact of the oil prices?

Jairam Varadaraj: Yes. There is a significant impact in the Middle East, countries like Saudi Arabia, which have been quite significantly effective because of the oil prices.

Kamlesh Kotak: Sir lastly how our centrifugal foray is I mean, how that business is now being seen to be growing?

Jairam Varadaraj: Well Kamlesh we have sold two of our machines. The machines are running exceedingly well. We are now developing the other range to complete them. So we are still in a very preliminary stage as far as that business is concerned.

Kamlesh Kotak: So we need to develop more products or?

Jairam Varadaraj: We need to complete the full range that will probably take us a couple of year to do them.

Kamlesh Kotak: Okay fine, great. Are there any further questions?

Moderator: Sir no more questions.

Kamlesh Kotak: On behalf of Asian Markets I sincerely thank everyone for joining for this call. Special thank to Mr. Jairam and his team for providing us the opportunity and getting the insight about the companies business and financial performance. With that, we conclude the call, thank you and have a good day. Thank you sir.

Jairam Varadaraj: Thank you everyone.

Moderator: Ladies and gentlemen on behalf of Asian Market Securities this concludes this conference. Thank you for joining us and you may now disconnect your lines.