Transcript

"Vascon Engineers Limited 4QFY16 Earnings Conference Call"

VASCON

EVENT DATE / TIME : 18TH MAY 2016, 11.30 AM IST

EVENT DURATION : 60 MINUTES

PRESENTATION SESSION

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MR D. SANTHANAM – CHIEF FINANCIAL OFFICER
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Moderator: Good morning ladies and gentlemen, and welcome to Vascon's Engineers Limited Q4 FY2016 earnings conference call, hosted by SBICap Securities Limited. As a reminder all participants' 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 "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Viral Shah. Thank you and over to you Sir!

Viral Shah: Thank you. Good morning everyone. I welcome all the participants to the 4Q and FY2016 results conference call of Vascon Engineers Limited. We have with us Dr. Santosh Sundararajan, CEO, Mr D. Santhanam, CFO and Mr. Krishnamurthy, Chief Corporate Affairs of the company. We will commence the call with the opening remarks from Dr. Santosh to give an overview of the company's performance. I would request Dr. Santosh to start. Over to you Sir!

Santosh Sundararajan: Thanks Viral. Good morning everyone. Warm welcome to you all to the post results earnings conference call for Q4 and annual results of the company for the year 2016. I have with me senior team member, Mr. Krishnamurthy and Mr. Punit Bhayani and Stellar Investor Relations, our advisors for Investor Relations.

I am happy to say that our focus on cost optimization across all business segments, cash flow generated from rights issue and sale of some non-core assets has helped the company to turnaround during the financial year 2016. We recorded an EBITDA of Rs 75.2 Crores and a PAT of Rs 7 Crores in this financial year and an EBITDA of Rs 21.6 Crores and a PAT of Rs 8.4 Crores in this last quarter.

We are quite confident of delivering much better performance going forward. We continue to focus on improving operational efficiencies and strengthening of Balance Sheet. We remain committed towards cash flow monetization by sale of certain non-core assets. The incremental cash generation will help us improve liquidity in business and achieve higher growth.

We had successfully raised 100 Crores to rights issue during this financial year, the proceeds of which as you all would be aware has largely been utilized towards repayment of certain high cost debt and to kick start certain key projects which were starving for cash flows. As discussed earlier over our focus on generating cash flows we were successful to raise 8 Crores from sales of unit in Nucleus Mall.

We have further identified few other properties for monetization and expect around Rs.80 Crores in the next few quarters. In the EPC segment, the company has a third party order book of Rs 780 Crores as of March 2016. We received an order inflow of Rs 286 Crores this financial year. Our focus remains on design and built turnkey project and to build order books across segments from creditable client especially institutions like hospitals, hotels, industrial construction, and certain government agencies.

In the real estate segment our current land bank of 315 acres is fully paid for where Vascon's share of developable area is 17 million square feet. During the financial year 2016 we sold a total of 136,170 square feet for a value of Rs 90 Crores. The cumulative area sold by the company for the projects under construction is at 2.03 million square feet amounting to a sales value of Rs 1,078 Crores of which Vascon's share is Rs 638 Crores. Against this Rs 638 Crores, Vascon has received Rs 534 Crores and has recognised revenue of Rs 531 Crores up to March 2016.

The balance Rs 104 Crores is to be collected and Rs 107 Crores revenue to be recognised spending on these ongoing projects. Coming to our clean room partition, the business we have acquired in 2011 through acquisition of GMP Technical Solutions, which is a professionally managed company. Vascon holds 85% stake in that company. GMP has manufacturing facilities at Baddi, Himachal Pradesh and Bhiwandi in Maharasthra. Our Baddi facility is operating at full capacity and we are expanding manufacturing facility for clean room partitions at Bhiwandi to cater to high demand of the clean room partition.

The capex required for the expansion is about Rs. 9 Crores. We expect the facility to be operational in Q3 of the coming year. GMP is one of the leading manufacturers of clean room partitions, isolators and also provides HVAC and Building Management Services solutions. The products manufactured are extensively used in pharma and healthcare industry. Semiconductor and solar industry are also emerging opportunity for these products in India now.

Clean room partition, the manufacturing division is growing significantly and recorded a growth of 89% year-on-year in Q4 of Financial year 2016. In the Financial Year 2016 clean room partition grew by 33% year-on-year to Rs 130 Crores. Our focus on cost optimization and reduction in overhead has resulted in a better performance for the services division, which recorded revenue of Rs 38 Crores in Q4 FY2016 and Rs 117 Crores in the full financial year. Being a leader in clean room partitions manufacturing and varied clientele we are well positioned to capture the huge opportunity currently in clean room partition manufacturing business.

Let me give a brief summary of our results during Q4 and for the year 2016. The company on a consolidated basis recorded revenue of Rs 190 Crores in Q4 as against Rs 170 Crores in the Q4 last year. For the year 2016 the company has reported revenues of Rs 659 Crores as against Rs 638 Crores last year.

EBITDA for Q4 was Rs 22 Crores as compared to a loss of Rs 54 Crores last year and the EBITDA for the financial year is Rs 75 Crores as compared to a loss of Rs 80 Crores last year. The company reported profit after tax of Rs 8.4 Crores in the Q4 of financial year 2016 against a loss of Rs 74 Crores last year. For the entire year we have profit after tax of Rs 7 Crores as against a loss of Rs 145 Crores last year. Repayment of high cost debt of Rs 62 Crores from the funds raised from rights issue and conversion of Rs 68 Crores of loans of ICD holders into NCDs with zero coupon has helped us save interest cost. We reiterate our confidence in our business and its future prospects. Thank you. We would now like to take questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Sagar Parekh from Deep Finance. Please go ahead.

Sagar Parekh: Thanks for taking my question. My first question is on your other income for the quarter as well as for the year it seems to be pretty high for the year it has gone up from Rs 12 Crores to Rs 27 Crores and even for the quarter it is at Rs 9 Crores which is above. Is there any kind of one-off income or any write backs or any thing that you have booked?

D. Santhanam: One of the property what we developed, we kept unit for our use and that was under the fixed asset. We transferred it to fixed asset. Presently, we have sold it for 8 Crores. So it has gone to other income instead of the regular income.

Sagar Parekh: So that is one off kind an income, 8 Crores.

D. Santhanam: Right.

Sagar Parekh: For the full year except for 8 Crores any other one time income booked in other income?

D. Santhanam: No.

Santosh Sundararajan: We have some interest income which also comes in other incomes, but sale of assets is that one particular office space mainly.

Sagar Parekh: On your EPC division, are we L1 in any kind of orders? What is the order pipeline? Can you give us some outlook on the same? Have we won any orders in Q1?

Santosh Sundararajan: No we have not won anything in Q1 yet. So the order pipeline currently we are at the last stage of negotiation about Rs 600 Crores of order, but we do not know if we are L1 in any of these because these are not L1 orders. These are essentially negotiated. They probably will be L1 but these are not government orders where the L1 is declared.

Sagar Parekh: So is this related to UP?

Santosh Sundararajan: This is not related to UP. These are mostly projects in Mumbai and in Chennai and Bangalore.

Sagar Parekh: These are all residential projects or hospitals or hotels or any other?

Santosh Sundararajan: This is a mix. Goa is included. So we have about Rs 250 Crores of negotiations going on at Goa for port building for a small industrial building as well, and in Mumbai some big residential projects.

Sagar Parekh: On your real estate front, just wanted to get a sense of going ahead what kind of because since this quarter we had a loss, what is your outlook on the same?

Santosh Sundararajan: Real estate the loss that is reflected in the balance sheet it does not convey the real picture. See there is a bit of capitalization on certain expenses, which we were not able to, because most of these projects run into phase II and phase III. For example Vascon Pricol shows a loss this quarter that is because a lot of expenses incurred in completing phase II, the club house and infrastructure has been captured as expenses this quarter but we were not finding a method to capitalise these rightly. Now phase III is going to get launched soon and all these expenses are actually to be shared by the entire project. So all in all the real estate projects are definitely profitable even in today's market, even in today's sales rate, they are definitely having at least 20 to 25% minimum gross margins. I think it a quarter-on-quarter issue of reporting that is showing these losses this quarter.

Sagar Parekh: Sir, in real estate in terms of sales we had mentioned earlier about Rs 20 - 30 Crores for quarter kind of run rate going ahead so we maintain that run rate? Do we see some kind of pickup in real estate sales.

Santosh Sundararajan: We hope to maintain the same run rate. Pickup should happen only in Q3 or Q4 because the market is still dull and we are also awaiting approvals for couple of projects that we intend to launch. So if those happen by Diwali then we should pick up something in Q3 and Q4 further to the existing run rate.

Sagar Parekh: So in Q1 and Q2 possibly you will have the same kind of run rate of between Rs 25 and 30-odd Crores per quarter, right?

Santosh Sundararajan: Yes.

Sagar Parekh: In your manufacturing GMP division, we saw a substantial jump in EBIT margins. So are they sustainable or was there any one-off in terms of anything like cost reduction or anything or is it sustainable?

Santosh Sundararajan: There is both. GMP has two divisions. One is the clean room partitions and the other is services BMS and HVAC services. Now in the clean room partition in fact the demand is so high that our factory is running back to capacity and we are now looking at investing further in our capacities. So in fact there the profit is generated purely by high demand and us doing a lot of work, lot of business topline in the last six months. In the services part, we completed the turnaround. We had certain investments which we had to book as losses in the wooden department in the last two years which was reducing the EBITDA. This year we have done a cost reduction on the services side. We have become trim and lean so going forward even that should definitely be sustainable. So in fact the EBITDA levels of GMP should only improve.

Sagar Parekh: So what kind of sustainable EBITDA margins do you see in GMP going forward? What kind of revenue are you looking at for FY2017 from GMP?

Santosh Sundararajan: This year's revenue is about Rs 250 Crores. They have projected to us about 10%.

D. Santhanam: What is happening is the product division is improving. Revenue is growing at tremendous pace. So the service division we have trimmed it because some of the contracts are not so remunerative. That is why we were not able to make adequate profits in those divisions. So accordingly the total turnover though it remains more or less same, more profitable division we are increasing the turnover. Next year we will also focus on this way till the market improves on the service division.

Sagar Parekh: Sir can we expect 20% kind of growth in clean room partition and services probably remaining flat?

Santosh Sundararajan: Yes.

D. Santhanam: Clean room partition, yes you can expect.

Santosh Sundararajan: Yes. You are right.

Sagar Parekh: Since both are 50:50 right?

Santosh Sundararajan: Correct.

Sagar Parekh: In terms of margins what do you see the sustainable margins going forward from clean room partition business?

D. Santhanam: Clean room partition is generating EBITDA of about 13%, and services also we are working towards generating a similar EBITDA but at the moment they are not generating.

Sagar Parekh: So the product division is generating 13% and services would be flat or would it be on the negative territory?

D. Santhanam: It is not negative, but it is generating EBITDA of 3% to 4% now. So we are working on it. Last quarter some of the results is visible but next one or two quarters, it will also make about 12% EBITDA.

Sagar Parekh: So this will happen largely because of the cost reduction initiatives?

D. Santhanam: Cost reduction, product mix and we have done process improvement also. There were divisions. We have separate divisions for electrical, plumbing and BMS, so we have clubbed it. The process improvement also we have done in order for better coordination and better service delivery quality.

Sagar Parekh: For the EPC, what do you see FY2017? How do you see FY2017 shaping up in terms of revenues and profits?

Santosh Sundararajan: The order book that we carry is largely healthy order book, so the gross profits are in the range of 18 to 20% in most of these projects. So as we execute this order book, I think the GP levels of 18% to 20% will be sustained. What remains to be seen is how much topline we are able to achieve depends a little bit on how many orders we are able to book in the next six months, but I think we will do hopefully slightly better than this year.

Sagar Parekh: Margins over here possibly would be around 13% to 14% in terms of EBIT since we are 18% to 20% gross margins, in the order so can we expect about 13% of EBIT levels?

D. Santhanam: May be around 10% or 11%.

Sagar Parekh: 10% to 11% because we have seen about 17% to 18% EBIT levels also.

D. Santhanam: Our aim is to achieve it once the topline improves.

Santosh Sundararajan: We are actually at a position to be honest the gross profit levels would not drastically improve from 20 in EPC in general. You know those are already quite healthy. Now with our current assets that we have both in terms of human capital as well as in terms of shuttering and machinery, we are capable of doing twice this amount of construction. So that is where what we need to leverage actually, but however, having said that we are not wanting to make the same mistake we made four five years ago of picking every project that comes along especially from the private real estate side because there is no assurance of their funding and that is what puts us into trouble as we enter these projects. We are being very cautious in picking projects over the last couple of years so adding order book is a challenge because the quality of projects that we desire, but having said that if we add order book, this EBITDA would drastically improve because our costs below the line would pretty much remain the same.

Sagar Parekh: True. That is it from my side. I will come back in the queue, if I have more questions. All the best.

Moderator: Thank you. The next question is from the line of Akshay Barjate from Rubicon Capital. Please go ahead.

Akshay Barjate: Thanks for taking my question. Firstly congratulations on a very good set of numbers for the second quarter in a row, it is actually very heartening to see the visible turnaround in the clean room business. Sir, my first question is basically on your inventories we have about Rs 468 Crores of inventories, which is about 30 sort of a balance sheet today. So how much of this inventory is Windermere and what is our plan of Windermere? What is our exit plans? How many months of work is left and you know how much more investment would we have to make before we commence full blown marketing on this project?

Santosh Sundararajan: A good amount of it is in Windermere, you are right. We have about Rs 80 to 100 Crores inventory of Windermere and then we have another we are carrying as inventory in the Kalyani Nagar project so this are two big numbers that add up to that list so about Windermere as you rightly asked we have set aside about Rs 20 odd Crores from the rights to push this project part of good amount of that money has been deployed, but those are all deployed towards advances to agencies that need to kick start the work. We will see effect of this act site over the next six months, good amount is already seen at site. Over the next six months the building would get of the feel of completion which will convey confidence to the market. In the meantime, we are also focusing on the interior of the houses that has been sold so in a project high end project like Windermere the cost of interior is significant and typically the customer, prefers a lot of customization so we are focusing on completing interiors for sold houses and then six months down the road when we finish the exteriors we will then hopefully commence the interiors of the other houses so that is strategy for Windermere and as you rightly ask may be six months down the road the project will look complete in most affect and beyond there I think we should be able to sell.

Akshay Barjate: Sir, how much more would we have to pump in to complete the entire project assuming we do not have any incremental sales over the time of construction of this project? Assuming we do not get anything from customers by the way of sales or customer advances?

Santosh Sundararajan: Let us put it from these sold apartments we still have a decent amount of collect so if those collection plus this rights money put invested in should take the project to this stage I told you about six months from now whereby we finish the interiors of the sold flats and we finish the exterior work the fasad and the podium for the building.

Akshay Barjate: Basically they would not any external cash train as such?

Santosh Sundararajan: Going forward as I said, we are not spending, we are not spending money on the interiors of unsold flats so for that we would need money, but I think will take call of doing those as and when sales improve.

Akshay Barjate: My second question is basically on your interest cost what is the current interest capitalization policy, as seen that about 50% of the interest for the last two quarters is being capitalized?

Santosh Sundararajan: We have reduced our capitalization except for I think Windermere where there was specific project loan from IDFC which gets capitalized on that project other than that I think we have reduced in fact that is why you would see are interest expenses this year is higher than last year.

Akshay Barjate: You mean lower than last year?

Santosh Sundararajan: Total interest is definitely lower, but what you see as interest expense in the balance sheet is higher because we have capitalized less.

Akshay Barjate: Are we accounting for any interest on the zero coupon NCDs which we have a maturity of 30 months or something?

Santosh Sundararajan: No.

Akshay Barjate: Is that a part of the interest expense, total interest expanse basically expense plus capitalized?

Santosh Sundararajan: On the NCDs we are not loading any interest in the books because that is the way the NCD is structured. It is linked to the sales.

Akshay Barjate: Basically what I am trying to get at is this that we have total gross borrowing of about Rs 270 Crores of which about Rs 70 Crores are the zero coupon NCDs so the interest bearing liabilities are about Rs 200 Crores of gross interest. So if I look at my total interest outgo for this quarter is about Rs 11.5 Crores so that works out to about Rs 40 plus Crores of interest cost on the annual basis so which means you are taking out 20% of blended no interest cost for the year, which is extremely high. How we are sort of trying to address this issue and bring our cost of funds down, materially down in fact.

Santosh Sundararajan: Actually it is not 20. Our cost of funds in the range of 16 or so, I think what is reflecting in this quarter towards the end I think the reduction of debt continues over the quarter in fact we have just reduced debt with SBI further by sale of two assets which happened towards the end so interest on that was loaded over the quarter I think, but in general our cost of capital in about 16% which is still high, but now I think the next focus to do with the financial institutions for us this two get are rating so we are waiting so this quarter has been go to this year as you given us positive results now we will approach and we have been clean with banks we do not have overdues with the bank so we will now approach the rating agencies to improve or rating and then we will be able to renegotiate with banks for in our limit renewals or interest rate reduction.

Akshay Barjate: From the presentation which is uploaded, there is difference in the land bank between the presentation for Q3 and Q4 there was 0.5 million square feet of land parcel in Goa which is not present the current presentation so any reason why that has been not all?

Santosh Sundararajan: Goa has been sold. There was one small land parcel in Goa which we sold.

Akshay Barjate: That has been sold, when did we sell this because it was there in the presentation for Q3, we saw it in the February presentation?

Santosh Sundararajan: This quarter only, we sold it in around January or something, quite recently.

Akshay Barjate: So what would be the gains booked on that? What is the total ticket size for this asset sale?

Santosh Sundararajan: Those are small parcels. I think Rs 2 odd Crores is what we generated as cash flows.

D. Santhanam: It is more for the generation of cash flows and we are existing in non-core areas. We are planning for the real estate development in and around Pune so other areas.

Akshay Barjate: We basically realised about Rs 2 or 3 odd Crores for this 0.5 million square feet in Goa is what you are saying during in the quarter?

Santosh Sundararajan: Yes.

Akshay Barjate: My last question is basically three businesses which we have, the EPC, the clean room and the real estate all three respond to fairly different risk factors now given that if the clean room business has turned around are we sort of considering demerging these businesses into a separate entities because this would ideally lead better focus on business?

Santosh Sundararajan: Financially there are a lot of things we can do in terms of either demerging or looking for the time being I think focus still remains on ground on ensuring that this is not one of performance and we continue this in GMP, we continue this growth so I think even Vascon management which was not actively involved within GMP over the last six months some of our senior staff have been actively concentrating on GMP to help them, guide them and ensure that they are lean trim and ready to grow further so I think that focus will continue for the next six months and once there are really on irreversible growth path let me say then consistent performance over the next two more quarters at least then we will definitely look at financially what other ways to create value for shareholders through this.

Akshay Barjate: Sir if I can just squeeze in one last question, basically we have done quite a bit of work for Godrej Properties in the past and we are currently executing about project for them. As we have noticed they have recently announced launch of pretty big project in Pune, 3 million square feet township project in their recent presentation in fact they have earmarked some major developments plans in both Mumbai and Pune. I wanted to understand given our association with them, what is our competitive positioning with Godrej vis-à-vis some of the other competitors who may be eyeing this project? Are we talking with them may be some of these projects?

Santosh Sundararajan: We are. I tell you honestly. We bid for a couple of projects in the last six months with them which we good not back although our relation with them is fantastic. They are very happy with a performance in the Pune project and the issues are coming with undercutting by certain other contractors. Now this is what I saying in terms of why I am finding it very difficult to do order booking so you rightly said we have client here, who is happy with us, we have good client, who was launching project in Pune, but if he was a competitor of mine is undercutting to the level which I know is going to lead to failure two years down the road, we get very conscious because we just come out of pit. I know exactly at what numbers we will bleed and at what numbers we will sail through so it becomes very difficult to take that aggressive call, I think it rather than call it aggressive in retrospect it might prove to be stupid call I would dare say. So that is where couple of projects we had let go where Godrej was asking us to take it, but the comparisons were not letting us but having said that Godrej is launching a lot more project in Bombay and Pune like you rightly said so we will continue to compete and hopefully back something soon.

Akshay Barjate: That is it from my side. If there are any further questions I will get back to you. Thank you.

Moderator: Thank you. We have the next question from the line of Neerav Shah from Geecee Investments. Please go ahead.

Neerav Shah: Good afternoon Sir. Congrats on decent set of numbers. You mentioned that you are expecting around Rs 80 Crores from in the few quarters monetization of assets can I just give the breakdown of it and the schedule by when it will commence?

D. Santhanam: One we are looking at monetization in Goa. The discussions our fairly advance stage. That will bring about Rs 35 odd Crores and our land in Aurangabad that will bring us another Rs 40 Crores.

Santosh Sundararajan: To put it this case flow generation we have about Rs 15 to 20 Crores cash flow to be generated from assets, non-core assets that we have already sold. Like a hotel in Pune and the Nasik lands and the projects in Nasik so we have only about Rs 15 odd Crores I think from presale which have already happened and so cash flow will come over the next three to four months. The balance what we are mentioning Rs 80 Crores is projects yet be sold by us on that list we have office space in Andheri which was given to us by SBI, so that is also up for sale provided we find a buyer at a reasonable price. We have lands in Aurangabad which is worth more than Rs 30 odd Crores which is also up for sale if we get a buyer, we have hotel in Goa, as Mr. Krishnamurthy mentioned we are in advanced stage of discussion with the party, but having said that they have not entered into any agreement. We are at a term sheet and negotiation stage and due diligence is about to start so that is also again about Rs 40 Crores of cash flow that could be generated and to add to all this we have Rs 30 odd Crores to Rs 40 Crores of money to be generated from income tax refunds.

Neerav Shah: Sir, just give brief background about this income tax refunds?

Santosh Sundararajan: I think have been in loss for the last three or four years so obviously we have huge amount of TDS that was accumulated with the department so these refunds are all due. Now what happened was we had a raid I think three or four years about 2012 we had a raid and therefore we are in settlement commission as far as closure of that issue is concerned and so there was certain refunds before which they have blocked pending this settlement commission verdict but there are refunds even beyond that point which are due to be pay to us so we are using consultant and we are in talks with department to try and expedite all this. We are hoping that by September by Diwali we should see a good amount of this money coming in as well.

Neerav Shah: So we have net debt of right now of Rs 166 Crores so assuming these assets get monetized at the rates that we are expecting what is the year end debt that we are seeing for us on a consolidated basis?

Krishnamurthy: To be honest we would need a bit of cash flows. Last year we concentrated through rights to significantly reduce debt, now reducing debt further is definitely on the wish list, but we would also need a little bit of capital to create some order books, some new projects, new joint ventures in the low cost segment especially, so further cash flow generation would not 100% be focused on debt reduction, but having said that the focus still there may be another Rs 20 Crores would be target, Rs 20-25 Crores would be target for debt reduction over this coming year.

Moderator: The next question is from the line of Pawan Ahluwalia from Laburnam Capital, please go ahead.

Pawan Ahluwalia: Thank you very much, couple of questions and I will go in order of business, on the EPC side, I think there we have a very good overview of the way in which the industry is evolving and the competitive environment and given that you are functioning at half your capacity and that you appear to be losing orders with really murky anchor clients because of irrational bidding by competitors, it would be helpful for us to get your view of the state of industry right now and how you expect it to evolve in the next year or two, are the people that are bidding likely be able to complete this project but make no money, are they bidding out of complete desperation because they need cash flow or are people bidding so badly that they probably would not even be able to complete the projects. My guess is that a reasonably experienced developer, they would not want to push someone to the second threshold, so it is more likely a first threshold where they will make tiny margins or almost no margins or may be just generate a little bit of cash flow that might be able to help them out but I will be curious to get your take on this and also on whether the guys that are doing this are kind of upstarts who do not understand the business or are they just very experienced people with similar reputations and track records to yours but people who are in bigger and deeper holes because of debt overhang a lot of assets that are difficult to monetize etc, so I would like your take on that and also how you see this competitive scenario playing out in the next year or two, also it looks like the real estate market is slow and slowing, I was wondering if you had any view on pockets that might be growth pockets because you are one of maybe four, five really top class contractors with an excellent reputation and your order book size is small, so it was a little surprising that even in a slow environment you cannot grow faster, so I am curious about the extent of the slow down and whether there are any pockets, that is on the EPC side. On the clean room side, could you give us some sense of what you think industry growth is going to be and who your top two or three competitors are and how you are differentiated relative to them because it is not an industry that is well known or followed, so a little bit of colour on that would be helpful and I think you have already given us a good sense of reduction plans etc., on the real estate side but my guess is if I had to reinterpret what you are saying, you have done the debt reduction that you thought was critically necessary and at this point you are not in a hurry to reduce debt, so if you do not get the right price in the area of Goa you do not mind holding on a year or two carrying on with higher debt and waiting to get the right price, I would appreciate if that is a reasonable characterisation in your state of mind in real estate, those are my questions.

Krishnamurthy: I will take the last one first. The right price is always questionable but yes on these assets obviously we would not want to take a big hit, there is no desperation to sell at extremely low level, having said that we are ready to negotiate marginally from what the market thinks is the right price and so debt reduction is something which is not entirely on the last seat of the bus, it is maybe on the second or the third seat as I said we still want to bring down our debt levels if we can, we still recognise the power of interest on the balance sheet or on the P&L and so today with revenues at lower level debt reduction is still on the agenda, I don’t know, it is very subjective what is the right price to sell these assets but as we negotiate I think we would know, as we get offers and we start negotiating that is when we would kind of figure out at what price we are ready to sell and exit.

Coming to your analysis on the EPC scenario, you are right, people are not exactly taking these projects at 20% lower than what I am quoting. They probably had 5, 7, 8% lower than my figures, so you are right in that they are probably taking it considering that there margins will be extremely low but they will finish the projects, so I don’t know, only time will tell. There are two kinds of contractors in the market today I feel, some of us who have actually gone through the cycle over the last five years who have actually been the real rammy effect projects stopping, payments not coming, your money getting stuck with the client and then you facing issues with the bank and all of this, so peers or Vascon who have gone through this scenario in the last five years are not being competitive to that level, they are being cautious just like us, but there are some new agencies that have been growing in this period who haven’t seen the bad side of business yet I guess, so they do take some more aggressive stand, how this will pan out, I am not qualified enough to comment on what will happen going forward but we still take a stand that what happens is, if you don’t have the margins and we are not expecting huge margins in EPC, we hope to get a 15%, 17% margin at the project level, maybe 14% margin at the project level and if we do not see those on paper on day one, these projects last two, two-and-a-half years, you never know what all you have to go through during this period because three months of nonpayment from the client wipes out half your margins, then you cannot project all these scenario, whenever we have been aggressive in the past and gone below those 10% level, we have eventually burnt our fingers and tried to exit at a minor loss and there is lot of pain that we carry because these will last two, two and a half years and it is not easy for you to run away once you have entered, so I think we are being cautious, but having said that yes order booking is a must, I only hope over the next six months we do get certain projects with our expectations.

Pawan Ahluwalia: Do you share the expected run rate in this slow environment may be Rs 400 Crores a year of EPC revenue?

Krishnamurthy: Yes, we are doing about 300 odd, 400 would be.

Pawan Ahluwalia: 300 to 400 a year at maybe 10-11% EBITDA margins.

Krishnamurthy: Yes.

Pawan Ahluwalia: In terms of the real estate industry slow down, 300 to 400 is not a lot and you have a stellar reputation, why is it so hard to ramp up to 800 to a 1000, I understand you have L&T and you have some giant order books, at that point you are levered to the Indian economy but for you guys should not you just be able to grow by taking share from worst players?

Krishnamurthy: We getting compared to players who are smaller than us, below us in reputation or size and they are taking orders from under our nose, I guess, as I said, see it is a waiting game, in our field, I have seen all of a sudden you will get a Rs 300-400 Crores order which is with decent margins a turnkey build order where we are able to improve on efficiencies and increase our margins and all of a sudden the order book and P&L everything will look different, having said that, yes over the last year we have still been focusing on non-core issues like monetisation, rights, cash flow, compliances, statutory issues with banks, all of these, now it is further time to be more aggressive in terms of marketing but again how cautious or how aggressive we want to be at the final stage in terms of bagging a job is something which I guess we will have to reflect on.

Pawan Ahluwalia: On the clean room?

Krishnamurthy: Clean room is improving, the market is maturing. It has a niche market but market is maturing from lot of players who are not at the quality level, so they were all doing with the new FDA norms. We are number one in India, we have one or two players other than us. There is no reported market data on that but we have substantial portion of the market share but it is improving because people want quality products today and we see there is a great scope for its improvement and we have also started exporting to African countries and Middle East Asian countries where we see lot of traction on the pharma factories.

Moderator: The next question is from the line of Ritwik Sheth from Span Capital, please go ahead.

Ritwik Sheth: Sir firstly you mentioned that you are expecting Rs 75 to 80 Crores from non-core sales, so if we are able to sell the two land parcels which you mentioned say maybe for Rs 80 Crores then do you think that you will employ it back in our businesses or you will reduce the debt with that, what is the strategy on that?

Krishnamurthy: It will probably be 50:50. We do need to create some more order pipelines in real estate as well. There is a dull scenario. For some faster projects that will happen within city or some low cost housing in the suburbs, so a little bit of capital could be focused towards real estate business but good amount of capital could go to debt reduction.

Ritwik Sheth: Next question is on the real estate side. You mentioned that we have 315 acres but I understand that our share of own land parcel would be 30 odd acres, so can you tell me what is the amount that we have paid for this 30 acres?

Krishnamurthy: Our own land is probably more than 30 acres. We have about 9 acres in Talegaon which is owned by us. We have 10 acres in Aurangabad. We have in Forest County we have another 30 acres which is not yet developed, so half of it technically belongs to us in Kharadi, that is another 15, in Coimbatore we have about 5 acres, in Thane we have about 70 odd acres which is paid for which belongs to us.

Ritwik Sheth: I am looking at slide 18 on the presentation, I think the under development projects are mentioned, the pipeline is not mentioned; the question is that what is the amount that you have paid for the land till date?

Krishnamurthy: I think we will have to calculate and see these few causes, Aurangabad we paid about I think 30 Crores, that has not appreciated much in the last five years. Kharadi has been in our books historically at a very low value, so the 15 acres in Kharadi I don't know will be close to zero in our books, I don't know how much.

Ritwik Sheth: That is the 14 acre one right?

Krishnamurthy: Yes, for Thane we paid about Rs 30 Crores and for Kharadi we would have paid Rs 20 Crores and Coimbatore about Rs 5 Crores.

Ritwik Sheth: So basically around Rs 100 odd Crores.

Krishnamurthy: Yes.

Ritwik Sheth: What is the total equity that we have put in to the real estate business, debt is around Rs 76 Crores, so what is our equity investment in real estate business?

Santosh Sundararajan: We have paid some advances for tieing up the JV land, that will be about 80-90 Crores and again we have inventories in the real estate business and sold inventories. It will be about 400 Crores total.

Ritwik Sheth: Sir in the previous call and even in the previous question you had mentioned about the Rs 400 Crores EPC revenue that we can touch for FY 2017, so going forward over the next three years maybe by FY 2020, what is the plan on the EPC side?

Krishnamurthy: Our EPC strategy will remain two fold, one we want to continue to focus on projects with margins, having said that it means probably we have been able to add value on a turnkey, design and build basis and ensure that our margins are intact. Often enough, what happens while we have the capacity to execute much more than we are currently executing in EPC the energy is always diverted towards getting your money out and strategising every month depending on the cash flow coming from the client on what we want to do next month, so there is a lot of inefficiency built in a weak real estate market when you are working for clients who are themselves stressed, so and our margins are wafer thin, little bit of trouble at our client side wipes out our margins before you even know it, so ideal scenario, we would like to be constructing for ourselves where these stress levels of credibility of client is taken away where your cash flow you know very well what your cash flow scenario is, so if we are able to generate how the market pans out in the next three four years on the real estate side on the low cost housing side if we are able to generate construction for ourselves I think we would take that but we would still have to, if that does not happen at the pace we desire we would have to definitely be exposed to market to other clients and to a larger extent and so shrinking further is not an option.

Ritwik Sheth: But we are not exponentially looking to like increase our revenue to maybe two times or three times from current levels on the EPC side?

Krishnamurthy: We can do that by taking projects which are not going to give us bottomline four years down the road, three years down the road, so we do not want to do that, I will be happy to double our revenues, if we are able to back projects where we see credible bottomline and credible cash flows, that is the challenge, so capacity wise we are already capable of doing twice and if we do twice we will see bigger EBITDA and so all that is great on theory on the ground we need those kind of projects and there is nothing that is stopping us. There is no strategy not to do EPC, reduce EPC or any such thing, it all depends on the kind of projects that we get, if we get a Rs 400 Crores order which is good, I am going to jump on it straight away.

Ritwik Sheth: Sir regarding the Rs 9 Crores capex that we are doing for the clean room partitioning division, what is the turnover on that we expect per annum?

Santosh Sundararajan: We can expand it but initially we are looking at about Rs 40 Crores turnover.

Ritwik Sheth: So almost 4 to 4.5?

Santosh Sundararajan: Yes.

Moderator: We will take the next question from the line of Rajendra Mishra from IDFC, please go ahead.

Rajendra Mishra: Can you just tell me order inflow and order book for FY 2016?

Santosh Sundararajan: About Rs 300 Crores EPC order inflow and order book is Rs 780 Crores.

Rajendra Mishra: Within this order book if we have to dissect EPC in terms of your captives for your own projects and third party?

Santosh Sundararajan: These are all third party.

Rajendra Mishra: Coming back to the discussion that you had earlier that you would be cherry picking projects depending on margins so that you do not bleed at the company level, what is the minimum order inflow and minimum execution required so even if you do not get projects during the year sufficient projects at your margin you don’t bleed, is there a threshold number that we should keep in mind?

Krishnamurthy: In terms of top lines what we have been doing for the last three years is the minimum we need to target going forward which is about Rs 650 Crores all put together, so at EPC it is about Rs 300 Crores. We need to do at least this much to ensure we don't bleed. We will not see huge margins with Rs 300 Crores execution but we will definitely cover our interest cost, our overheads and see some profits in the books, so I think shrinking below that is not something we should think of or let happen, so to achieve that we have Rs 780 Crores order book, technically over two years that is more than Rs 350 Crores, Rs 400 Crores but we cannot rest on that because some of these orders could at any point of time depending on client situation stop and then that could backfire on us, so we should hopefully order book another Rs 400-500 Crores at least over this year but having said that we don't have a specific target, if I am able to book more than Rs 400 Crores of good orders I will go and take it because our capacity to execute is not a problem at all.

Rajendra Mishra: Yes that is understood, that you said, if you get a good order you will jump on it which is fine. On this Godrej Pune project can you just give some details as to what is the size of the project and who got it?

Krishnamurthy: There is a project in Keshav Nagar, the project is quite big, but I think they have launched the first phase which is about 10 lakh square feet, so they had a tender floated for the RCC work. The value of the order would have been about Rs 80 Crores, 70 odd Crores which I think, if I am not wrong has gone to Millenium and SJ Constructions, he is a local contractor in Pune.

Rajendra Mishra: Any contingent liabilities on the company, one you said is the income tax settlement which you are trying to get, so that is not a liability, but any other contingent liability which is non balance sheet item?

Krishnamurthy: Nothing.

Rajendra Mishra: On this real estate cycle itself as you yourself felt that a lot of inefficiencies get built up during the downturn, so what is the extent of this downturn and what is your sense, how long is it going to prolong, one year, two year, three years and when are you going to see a real estate cyclical bottom, can you throw some sense on that?

Krishnamurthy: What happens is Vascon has over the years been very quality conscious and has earned reputation and name for delivering a good product which we still carry largely in the real estate market in Pune, now that comes obviously at a cost of construction which is higher than our peer and therefore the sale price also goes higher, so we have always been focused on doing medium to high end projects in Prime City, Koregaon Park, Kalyani Nagar, Viman Nagar where in the good market we have been able to sell, now houses above Rs 1 Crore are literally not moving in the current market and so if you look at Kharadi we launched it four, five years ago when Kharadi was considered little bit of the outskirt, we launched it at sub 3000 levels, we sold a lot and we ourselves have created such a good project there that is the project is in demand and now the prices have gone up to about 6000 and a couple of other good builders have done good projects there. All of a sudden, Kharadi is quoting 6000 plus, three bedroom goes to more than a Crore and that is where the ticket size today reducing the traction of sale, so if today able to sell at 50 lakhs, for that you need to go to the suburbs, create smaller houses through low cost housing maybe at 20 lakhs, 30 lakhs, 50 lakhs, I think there is still movement. We are also focusing on, we have finished internally our workings on lean and low cost model that Vascon is coming up with. We are tying up couple of land parcels in fact in Talegaon our own land parcel also we have put in plans for approval, so these would be low margin projects but we feel there will be absorption in the current scenario, now when the 1 Crore plus, 2 Crore houses would come back in business is something I do not know how to predict.

Rajendra Mishra: Just very approximate sense as to how much would be your current business topline in greater than 1 Crore bracket and less than 1 Crore bracket, very approximately?

Krishnamurthy: We do not have much in the less than 1 Crore bracket because Ila in Hadapsar is also close to 80-90 Lakhs, 1 Crore, Forest County Houses in phase II we have two bedrooms, two bedrooms 1200 square feet, so those are still coming to about 75-80 lakhs and three bedrooms are going above 1 Crore, Windermere of course is in a different bracket altogether, so as of now we don't have inventory in these 50 lakh and sub 50-lakh range which is what we need to create.

Rajendra Mishra: Just wanted to understand the competitive intensity in the space, I understand there are so many local players but in terms of developers like Godrej Properties or Oberoi's**,** L&T, Tatas and Piramal, in terms of large developers organised players, who are the guys whom you really count as competitor, what is your sense of competitive intensity if we leave aside extremely local players?

Krishnamurthy: We ourselves as far as real estate is concerned we are pretty much a local player, we only have exposure in Coimbatore and Pune primarily. In Pune of course all the bigger players whether they are national level players or local Pune players we have the whole range competing and there is cutthroat competition no doubt, so today what happens is customers obviously pay a premium or at least go towards so called credible names like you mentioned like the Tatas and Godrej, they command a huge brand premium, even if they don't convert it to an increase in price they are able to at least convert it to sales, Vascon in Pune at least commands a similar brand premium, if we are able to come up with a product that is sub 50 lakhs I am sure customer would not think wise because Vascon is known for delivery and quality, so I don't think that will get questioned. Once we launch these projects we will be able to cut down a lot of competition from the other smaller guys.

Moderator: The next question is from Akshay Barjate from Rubicon Capital, please go ahead.

Akshay Barjate: Sir what is our operating cash flow generation in FY 2016?

Santosh Sundararajan: Rs 50 Crores.

Akshay Barjate: Is this excluding the asset sales which we have done?

Santosh Sundararajan: Correct.

Akshay Barjate: Second question with respect to inventories, how much out of Rs 450 Crores finished stock of flats how slow moving are they?

Krishnamurthy: Out of this Rs 450 Crores inventory bulk of it about 80 odd Crores is in Windermere and more than 100 Crores is in the Kalyani Nagar project which we have not launched, so Windermere is slow moving, the Kalyani Nagar I is not yet launched, once we launch it and we are working towards launching it we are the last stage of approvals and then we need a financial tie up to launch the Kalyani Nagar Project, so there we are not making, I would not call it a mistake, there we are not having huge apartments so we are focusing on regular two bedrooms and three bedrooms and 1200 and 1800 square feet level, so in spite of the high rate of Kalyani Nagar, these tickets would be in the 2 Crores 2.5 Crores range, so we feel there will be better absorption, those inventories would only move once we launch that project, so over this year I think a good amount of this inventory is slow moving. What is moving though is our project in Kharadi in spite of touching the 1 Crore bracket, sales is slower than it was two years ago, but it is still moving because the project has come out really well, it is considered the top project in this side of Pune and so there is a demand, there is a premium for that project itself and sales are still happening, so phase III or phase II of that project is still to be completed over this year, so we will still see revenues and we are hopeful we will complete the sales of that phase II over this year.

Akshay Barjate: How much is the interest which we are capitalizing on these projects for FY 2016?

Krishnamurthy: We capitalized about 5 Crores in Q4 and for the full year about 20 Crores.

Akshay Barjate: Okay which is basically an addition to my inventory?

Krishnamurthy: Yes.

Moderator: Thank you. Ladies and gentlemen. That was the last question. I would now like to hand the conference over to the management for their closing comments.

Krishnamurthy: Thank you everyone. Thanks for the interest and hope to see you all next quarter with continued better performance. Thank you.

Moderator: Thank you members of the management team. Ladies and gentlemen, on behalf of SBI Cap Securities we conclude this conference. Thank you for joining us and you may now disconnect your lines.

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