"Schneider Electric Infrastructure Limited Q4 FY2019 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Schneider Electric Infrastructure Limited Q4 FY2019 earnings conference call hosted by Anand Rathi Shares and Stock Brokers. 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. I now hand the conference over to Mr. Bhalchandra Shinde from Anand Rathi Shares and Stock Brokers. Thank you and over to you Sir!

Bhalchandra Shinde: Good afternoon everyone. On behalf of Anand Rathi Shares and Stock Brokers Limited, I would like to welcome you to the Schneider Electric's FY2019 earnings call. The management today has been represented by Mr. Bruno Dercle, Managing Director, Mr Arnab Roy, CFO and Mr. Vineet Jain, Investor Relation. I now hand over the call to Mr. Bruno for his initial remarks, post which we will open up the floor for Q&A. Over to you Sir!

Bruno Dercle: Thank you very much. Good afternoon everybody. I am Bruno Dercle, Managing Director of Schneider Electric Infrastructure Limited. I am pleased to connect with you today to share and update about the progress of our company.

Today, I will present you with a few slides on the market outlook and then I will hand over the floor to Arnab Roy, CFO to update on the financials.

So, let us go to the presentation.

First of all, a few comments on the macroeconomic outlook, which would not be a surprise for you, it is globally a similar trend to the previous quarter, but in the year that we just closed, we had sustained GDP growth at 7%. The inflation on a decreasing trend, we could see especially on our field of activity with the AMR index, an index that we use very often in the street to manage long duration contact. This index was on the rise at the end of 2018 and the trend we had on the first quarter of this calender year and last quarter of our fiscal year so, with the decreasing trend including not only in inflation but also in our industry.

Interest rate continues to be easing with Bank of India. Domestic demand, our point of concern with some indicator going up and some of those going down, so we have some kind of volatility there and government spending was still at a healthy pace in the last quarter of the fiscal year, utilities showing some kind of slow down with the approaching elections.

In this field, we could see also continuing investment into the smart city or marginally speaking in the utility secondary network investment which is quite a sizeable investment driven by the government towards smart components in the secondary network of medium voltage which is the side effect of the smart city development.

By segment and market segment utility quite healthy development in terms of smart component and connected product, we could also see in some utilities sometimes private, sometimes government owned, a new trend towards advance offer of the e-house and self-healing. On both offers on which Schneider Electric Infrastructure is well positioned.

In power generation, this is the place where we have decreasing trend, basically the growth that we see in this subsegment is limited to the desulfurization of coal plants or the renewable new capacity of plants, but the traditional coal investments is in reduction except desulfurization.

I was just mentioning before we continue to see a very healthy growth of the renewable segment mainly solar and wind. We end up having some customers who has now several hundred megawatts of installed capacity of wind or solar, quite an impressive development in the past two years.

Transportation segment, mainly driven by urban transportation mainly metro, new lines or expansion of existing network, the government's recent move is ongoing. This is touching almost every part of our portfolio of product. Mining metals continue to have demand. I will zoom a little bit on this is an important segment in the following slides. I will not repeat that, bear with us, we will come back to this segment just after.

Oil & gas, we see development both in upstream and downstream subsegment with new production capacity in some states like Rajasthan or offshore on the eastern coast and also downstream with some refining capacity.

A very important segment for SEIL, Schneider Electric Infrastructure Limited is the CIB segment, Commercial and Industrial Building on which our strong positioning in smart components is allowing us to capture a sizable market share in this segment. We have also launched, you might remember last year, we have also launched some dedicated offers with shortage time in the secondary segment in the Ring Main Unit/RMU that we call MTO mode specific offers that we have launched last year to address specifically the CIB segment little engineering, but very short lead time of delivery and we start to bear the fruits in our order intake in quarter four of the fiscal year. The trend is ongoing. It is still a small part of the market today for medium voltage, but it is growing, due to the new regulation in the country to localize the data of the Indian customers in India. So, this trend is ongoing and will start to be visible of backlog from the second half of this year, not yet sizeable for the time being in our figure of last quarter.

The next slide is what we call Electo Intensive Segment and I chose today to make a special focus on this huge segment because we mentioned already in past communication, in the past calls, but this is where we can derive our portfolio of product is very well adapted to this segment of Electo Intensive Segment. We have specific solution and equipment, which caters to the different needs of the different subsegments of the Electo Intensive Segment. What we collect under this world of Electo Intensive Segment is the steel industry, the cement industry, rail/metro, infrastructure, the airport, oil and gas, four out of them are growing their share into our portfolio already in the last several quarters in the fiscal year that we just completed. Oil and gas, steel, cement and metro, each of them has increased. We are yet to work and we have a plan for that to grow in airport segment.

When we go into more details and I said that I would come back on the cement and steel industry, so these two segments are driving both from Greenfield project, new cement plant and new steel capacity, but also Brownfield extension of capacity of existing plants, both in cement and in steel industry. Knowing that we have already quite a sizable market share in the past, we can benefit from both Greenfield new capacity and extension of existing capacity, Brownfield development of project. So we are following the two with some success in two domains. To be noted, this field in sector plants in both medium voltage, low voltage and energy automation so, the different domain of our entity of our company are quite active and successful in low voltage, medium voltage and energy automation in both cement and steel.

I already mentioned some comments on oil and gas. I will not repeat, so it is driven both the refining and also the new regulation on Euro-VI rollout, which generate investments in the existing refining capacities and also some development upstream in the new production capacity, mainly Rajasthan and offshore East Coast.

I think I have already made the comment on the urban rail mid core segment, heightened demands for urban mass transportation, this is nothing new I guess, it was already there last quarter, but it continues.

With this said, I will now ask Arnab Roy to update on the financial with our closed year and our last quarter.

Arnab Roy: Thank you Bruno and good afternoon to all. I think it is a good time for us to reflect a little bit because it kind of finishes our first year of the journey of transformation, which we were talking about. If you do a little bit of introspection into the last few quarters and what we have been communicating to you, there are a few messages which we have been giving that we are looking at what we used to call in our parlance fix the basics which means, getting the plant capacity aligned to a more linear loading, so that part has really progressed well in the last few quarters and it is a journey and it continues to progress.

The second part was on the cost itself. How we have corrected the cost, the cost folders and wherever we have to price up, we have priced up, so that part of the exercise has been done. The third part was on how do we manage the forex? I think we have been highlighting to you the kind of forex losses the entity has been doing in the last few quarters and what we have been doing to correct the forex. So a lot of those actions have been put in place already. The fourth piece was on the cost itself wherein as we have communicated to you earlier, we were doing a restructuring exercise in the plant. So almost 85% to 90% of that restructuring is now done, which you see the reflection in this year and the fixed costs have been aligned and those actions have been taken. So combination of all of this along with the change in mix which Bruno has been talking for the last two quarters which is a step in the direction of profitability where we want to go you see the reflection of that in the numbers this year.

So overall very happy to report that before the exceptional item of the restructuring cost, we have come back to a profit on the profit before tax mark, which has happened for the first time in many, many years. So, if you see this a little bit in retrospect with where we were in March 2017 and the kind of exposures we had to take in March 2017 and then the journey of the change quarter-on-quarter, so the company has come back to a breakeven, to a position where we have 36 MINR of profit before exceptional items for the full year and of course we had the exceptional item as I said, about 90% is done, that 280 MINR exception this year.

So, that is overall the summary of the financials for this year. There was a modest growth in the revenue. The intercompany part grew really substantial. The OGV had a marginal degrowth due to some exceptions, but overall I think it is a good position point and a point where we came back to the breakeven. Quarter also is a similar reflection to that.

So without much delay, I would take a pause here and would open it up for the questions because we will take more detailed questions later.

Moderator: Thank you very much. We will now begin the question and answer session. Ladies and gentlemen we will wait for a moment while the question queue assembles. The first question is from the line of Renu Baid from India Infoline. Please go ahead.

Renu Baid: Good evening Sir. A couple of questions from my end. First, if you could help us on the P&L financials, if you look at the fourth quarter, there was a reasonably high other income component, so was there any one off of forex gain element sitting in that or was it regular as that looks a substantial number and key driver of the positive profit number, if you can elaborate on that. Also what was the kind of order backlog or order inflows during the fourth quarter and for financial year 2019?

Arnab Roy: I think first your question on other income, yes, we have been prudently chasing the debts in the market and we were able to recover some of it throughout the year, but more substantially in fourth quarter, so that is the reason you see other income number higher in the fourth quarter, so it was recovery of some of the old debts which we had written off earlier.

Renu Baid: Quantum of this value Sir, of the 36 Crores or 364 IMR?

Arnab Roy: Overall I mean if you look at it, there were also some reversals last year. So the net year-to-year, Y-o-Y, we did talk about 20 Crores between the two years.

Renu Baid: Okay and in fourth quarter alone?

Vineet Jain: Actually the fourth quarter, it is a combination of reclassification of other expenditure as well because as per the new Ind-As all the negative expenditure reclassifies other income in the last quarter, so it is the reflection of reclassification as well. Earlier in the first nine months we had approximately 18 Crores to 20 Crores of reversal of the provisions and rest we recovered in the last quarter. It is not that we have recovered everything in this quarter. It is majority the reclassification of other expenditure and other income.

Renu Baid: Okay, so just to understand clearly, 18 Crores to 20 Crores of reversal of provisions or bad debt which you have written off earlier?

Arnab Roy: Correct. That is right.

Renu Baid: Which has come beyond that designated time length and hence the exception or other income gain there and there is as you mentioned would be a timing mismatch in terms of the numbers coming through?

Arnab Roy: Absolutely, now moving back to your next question on the backlog, the overall backlog as of March 31, 2019 was about 826 Crores.

Renu Baid: So which is a pretty good jump that we have seen compared to the previous quarters?

Arnab Roy: Yes.

Renu Baid: Does this in overall help us go on the same trend that now we should be heading close to the high single-digit growth or closer to double-digit growth of the FY2020 and as you mentioned, the drivers of growth would be mixed across oil and gas, capex, distribution, data centers, those categories and segments?

Arnab Roy: As you know, we do not give an outlook, but yes, we have a healthy backlog, so FY2019-2020 should be an adequate reflection of that.

Renu Baid: One more thing, your comments do mention the growth rates of IG and OG, but overall in terms of the mix of revenues and backlog today, how was the mix between IG and OG and overall systems and production portfolio?

Arnab Roy: As I told you earlier, as you rightly saw in my comment, the IG sales has been growing, but overall if you look at it and as I said last time also that now we are giving our definition of systems transactions and services including IG. So overall if you look at it, the systems business is about 71%, which includes an IG of 25% within the systems business. So without IG in an earlier parlance the systems business is about 46% now, okay. So 46 plus 25 makes it 71, the transactions is around 18 and services is around 11 for the full year.

Renu Baid: Sir any last comments from you in terms of how should we expect the demand momentum to pickup from the utility space, the hub T&D space in the domestic market?

Bruno Dercle: Without surprising in the quarter that we are soon closing we saw a slowdown of the utility aspect because of the election, so this is not a surprise we were expecting that. It does not give any indication for the full year that we are entering because usually the demand being sustained, it catches up on the following quarter. This is what we expect.

Renu Baid: Thank you so much Sir, I will get back in the queue with more questions. Thanks and all the best.

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

Manish Goyal: Thank you so much. Just continuing on the revenue mix change, you mentioned that intergroup is 25% so that is included in systems, but is there anything else in the intergroup?

Arnab Roy: No. It is 25% in the systems. So the overall 71% which I mentioned for systems includes 25% of intergroup.

Manish Goyal: What was it in the previous year please?

Arnab Roy: The previous year the intergroup was around 18%, so it has moved from 18% to 25%.

Manish Goyal: How do we see this trend going forward? Would it continue to grow, because the number we get is roughly 360 odd Crores revenue for the entire year, so how do we see this going forward?

Arnab Roy: Now it is reaching a more or less a stable situation, so a couple of percentage points here and there, but not a very significant change.

Manish Goyal: Can you also give us a perceptive that with lot many initiatives taken in the last four or five quarters, how do we see our margins going forward, particularly after offering VRS, what kind of employee cost benefit we see, number one? Number two, on the long-term strategy of increasing sales from the transactional products and services, how do we see that going forward? We had laid down certain targets for a couple of years hence, so how do we see that?

Arnab Roy: I think you had several parts to your question. On your first one, on the employee cost, as I communicated a couple of quarters back, if you recollect we had a pretty detailed discussion, and we told you about the entire scheme, so we are roughly laying off about 190 odd people which is going to give an annualized benefit of about 16 Crores in the P&L. Approximately half of it has flown this year because of the timing of those separations, so next year we will get another half of it. So, we can expect another 8 Crores incremental benefit coming on the salary line next year. In the restructuring line, approximately 90% of the restructuring cost is taken, so last 10% remaining, so that is the answer to your first question. Now your second question was on the transactional activity.

Bruno Dercle: Here we have several projects running in parallel. The common aspect of this project takes time to develop transaction on activity out of the system activity. So both medium voltage line of activity are impacted by this transformation, but mainly fixed medium voltage which is primary distribution switchgear and the RMU, the Ring Main Unit, product line which is for the secondary distribution market for utility this time. These two products, we are currently developing and offer. We propose to partner medium voltage panel builders in order that they do the integrations, the customization and which applies to our components. It has two main impacts once it is put in place. You can consider it should be put in place in Q4 of calender year or Q3 of the fiscal year. It has two impacts. One impact is the negative impact on the topline because the value addition of Schneider Electric Infrastructure is roughly speaking divided by two, but the value addition is increased considerably because we refocus our activity on where we bring value, which is a core component. The development of the product is the core component in itself and as a consequence these higher added values generates also much, much higher margin on the residual volume. So, two impacts, topline decrease because we share the value with our partners and on the other side, the residual activity with a much more higher profitability by construction. There is a steady impact, but this you measure after one more year basically the growth because the competition and the multiplication of the access to the market can play a role and the overall Schneider Electric core component plus our licenses usually enjoy a higher market share than before. So these are the major changes, which are engaged. This summer we will have the new offer being ready. The network of partner is being identified these days and they will come to the market next winter.

Manish Goyal: One more question, in the presentation it is mentioned that there has been some reversal of sales on account of EESL, can you clarify what it is pertaining to and what was the amount?

Bruno Dercle: We have two projects where ESL is an intermediate customer. The end users are distribution utility. They use ESL as a vehicle to manage some projects for smart metering, AMI in our jargon, Advance Metering Infrastructure. And then ESL is passing contracts to system integrators. One of them was launched last year in early 2018, out of which we got a portion of it, software portion of this project, so our direct customer is a system integrator, part of L&T Group. Two projects have been signed in the fiscal year of last year, one with L&T and one with EDS System Integrator. The one at L&T has been cancelled and that is why we did some reversal.

Manish Goyal: Sorry I missed that?

Arnab Roy: What he is saying is that one project which was through L&T got cancelled, so this was recognized in Q4 the calender year, which was last quarter. That is about to 170 MINR which is what we have reversed this year because a solution could not be proven to the customer. So within the fiscal year, there were sales in one quarter and reversal in the other quarter.

Manish Goyal: 17 Crores?

Arnab Roy: Yes 17 Crores.

Manish Goyal: What about the other order?

Arnab Roy: The other order is continuing and it is progressing.

Manish Goyal: What is the value of that order?

Arnab Roy: That is approximately about 35 odd Crores and that is progressing through EDF which is another company, the system integrator.

Manish Goyal: EDF?

Arnab Roy: EDF, yes.

Manish Goyal: Okay, fine. Last question, can you give us a breakup of the order book in terms of systems?

Arnab Roy: I just gave to Renu sometime back.

Manish Goyal: That was revenue.

Arnab Roy: Our order is roughly in similar trend, so it is not very different.

Manish Goyal: Thanks. Thanks a lot.

Moderator: Thank you very much. As there are no further questions, I will now hand the conference over to Mr. Bhalchandra Shinde for closing comments.

Bhalchandra Shinde: Thank you everyone and especially the management for giving us an opportunity to host the call and answering all the questions. Thank you very much Sir. Do you have any closing comments?

Bruno Dercle: I would like to just to say that the market sentiments looks to be positive considering digitalization drive in most of our market segments. We are closely watching the evolution at the ground level to capture more growth in line with out strategy. Have a nice evening.

Moderator: Thank you very much. On behalf of Anand Rathi Shares & Stock Brokers, that concludes this conference. Thank you for joining us. You may now disconnect your lines.