"Elecon Engineering Company Limited Q4 FY '19 Earnings Conference Call"

**May 8, 2019**

**MANAGEMENT:** **MR. PRAYASVIN PATEL – CMD, ELECON ENGINEERING COMPANY LIMITED**
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**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the Elecon Engineering Company Limited Q4 FY '19 Earnings Conference Call. As a reminder, all participant lines will be in 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 telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Binay Sarda from Christensen IR. Thank you and over to you, Sir.

**Binay Sarda:** Thanks, Vikram. Good Evening to all the participants on the call and thanks for joining this Q4 and full year FY 2019 earnings call for Elecon Engineering. Please note that we have mailed out the press release to everyone and you can also see the results on our website as well as it has been updated in the stock exchanges. In case if you have not received the same, you can write to us and we will be happy to send this thing over to you. Before we proceed to the call, let me remind you that the discussion may contain forward-looking statements that may involve known or unknown risks, uncertainties and other factors. It must be viewed in conjunction with our business risks that could cause the future result performance or achievement to differ significantly from what is expressed or implied as such forward-looking statement. To take us through the results for this quarter and answer your questions, we have with us the management of Elecon Engineering represented by Mr. Prayasvin Patel, CMD; Mr. Prashant C. Amin, Executive Director; and Mr. Kamlesh Shah, CFO. Mr. Prayasvin Patel will give a brief overview of the quarter gone past and then we will open the floor to Q&A session. With that said, I would now handover the call to Mr. Prayasvin Patel. Over to you, Sir.

**Prayasvin Patel:** Thank you. Good Evening all. Ladies and Gentlemen, a warm Welcome to our Q4 and full year FY 2019 conference call. It gives me great pleasure to be addressing you once again to discuss our results for the full year. FY '19 has been a good year in terms of stability after we saw a very muted performance in the early parts of FY '18. While the overall environment still is not the level where we expected it to be, Elecon's positioning and its capabilities have ensured that we have grown at a steady clip. The platform is thus set for the future and we expect that the growth momentum will return strongly post the formation of a stable Government at the center. On a standalone full-year basis, the total operating income increased by 3.7% year-on-year to 953.7 crores from Rs. 919.5 crores in the previous year. The EBITDA increased by 13% to Rs. 135.5 crores and the EBITDA margin improved from 14.2% for FY '19 against 13% in FY '18. The profit before tax, PBT, increased by 447.6% to 27.9 crores. You have to look at the revenue numbers in the light of a very muted performance in the first nine months of FY '18, and we do believe that we have turned the corner as far as top line is concerned. What gives me more satisfaction is the fact that we have focused a lot on execution and operational efficiencies in the interim and this is evident in our profitability margins increasing both the EBITDA and the net level.

Just a point to note that the performance in Q4 '19 optically looks much weaker compared to the Q4 '18 quarter, but this has to be seen in the backdrop of what transpired in FY '18. The onset of GST and the uncertainty around the same pushed a lot of orders to the last quarter of

FY '18 and hence we seem to have a supernormal quarter in FY '18, which was one-off, accounting for what we do believe that Q4 '19 has been a good quarter and continues on the stage set in the earlier quarters of the year. Coming to the consolidated financials of FY '19, the total operating income increased by 2.9% year-on-year to Rs. 1223.1 crores from Rs. 1188.5 crores in the previous year. EBITDA excluding profit on sale of immovable property to the tune of 36.7 crores increased by 29.5% to 168.6 crores and the corresponding EBITDA margin excluding the profit on the sale of immovable property improved to 13.8% for FY '19 against 11% in FY '18. PBT ex one-off gain increased by 817.4% to 51.6 crores. Again, even on consolidated level, the story has been one of stable growth coupled with resilience in margin levels. We will continue to focus on increasing our profitability with a focus on growth in the coming fiscal.

If we look at the quarter on a consolidated basis, we have had a relatively healthy performance in the quarter largely driven by improved product mix and traction in the gear business as a whole. We continue to see improvement in the demand scenario and we saw significant ramp up in the order booking with orders worth 150.88 crores booked in the gear business and closed the orders worth 32.73 crores in the material handling business. This translates to an order booking of Rs. 716.98 crores for the gear business and Rs. 403.41 crores for the MHE business for execution in the coming fiscal year. Our overseas business, Benzlers and Radicon, registered a revenue of 78.5 crores with an EBITDA of 8.78 crores. Overall, we are seeing an increased activity in the manufacturing sector and demand outlook looks positive. Moreover, we are now seeing the effect of change carried out in our strategy and reorganization done during the last financial year in terms of improved performance. Owing to our continued focus on strategies to create long-term value for shareholders, we witnessed decline in debt and reduction in customer receivables and trade payables during the year. Moreover, we have consciously tried to shrink the size of our balance sheet and made it more robust. We continue to streamline existing operations which has led to improvement in EBITDA margins and overall performance. We maintain a positive outlook and remain confident of improved performance in the future riding on the back of improved demand scenario and internal process and strategy. Thank you all, we will be happy to address your specific queries about the business going forward.

**Moderator:** Thank you very much, Sir. Ladies and Gentlemen, we will now begin the question and answer session. We have our first question from the line of Zain Iqbal, an Individual Investor. Please go ahead.

**Zain Iqbal:** Sir, the first one is on the competitive landscape, correct me if I am wrong, I assume Shanthi Gears is one of your competitors, if yes, then I want to know how are you different from Shanthi Gears and to what sectors Shanthi Gears is catering to versus Elecon, that is my first question ? The second question is on the order book visibility and the sectors you are seeing good momentum in the transmission line?

**Prayasvin Patel:** Good Afternoon to you. Let me tell you one thing to start with. First of all, we are size wise almost two-and-a-half times the size of Shanthi and all the lines that they carry which means the various products, we also carry them apart from the loose and defense gears that they manufacture. They manufacture defense gears for aerospace while we manufacture for the defense and the naval requirements, so this is the major difference. While we have received a very large order which will span three to four years in the Indian Navy business, which is different from them, which is amounting to approximately 530 crores which we have received from the Indian Navy, so this is different plus on the industrial sector, the various product lines like helical gears, worm gears, couplings, and gear motors, our group has a much larger market share than what Shanthi has, so that is the overall comparison that we can give as long as Shanthi Gears is concerned.

**Zain Iqbal:** Sir, why is the margin profile so different, you versus Shanthi?

**Prayasvin Patel:** We are into the volume game and they are into a niche market where they select and choose, so it is a price that you pay for achieving higher volumes.

**Zain Iqbal:** Sir, what is your view on the order book, the sectors where you are seeing good momentum in the industry?

**Prayasvin Patel:** Right now in gear industry we have a total of 717 crores of outstanding orders to be executed this year, so we have a strong order book; however, in this includes the gearboxes for the Indian Navy, which have a specific timeline, so all of it cannot be executed this year, it will go into the next and next to next year.

**Moderator:** Thank you. We have the next question from the line of Sunil Kothari from Unique Investment. Please go ahead.

**Sunil Kothari:** Sir, mainly almost 20 crore interest cost in this current quarter, it comprises of what exactly, only this or something else is also debited in interest is what one thing I would like to know?

**Prayasvin Patel:** This includes not only the interest, it includes the bank charges also.

**Sunil Kothari:** Basically, Sir, what type of interest cost we should continue to pay because we have just to that we reduced debt also, so what type of interest burden for next year we should account?

**Prayasvin Patel:** Next year, we are expecting that our interest burden would be to the tune of nearly between 50 to 55 crores.

**Sunil Kothari:** In current quarter, we made a loss at EBIT level in the material handling, so do we expect next year there will not be any loss or maybe some profits should we expect?

**Prayasvin Patel:** We are expecting, yes, that a positive momentum would be there and so far what you are looking to quarterly loss also of 7.48 crores in the segment wise. There also we have taken the views to make it more tax effective in the process.

**Sunil Kothari:** Hopefully, next year we are expecting some growth in revenue of material handling division and there will not be any loss at EBIT level?

**Management:** Let me answer that Sunil, first let me say Hello to you and in the material handling business, there is a lot of transformation that is happening overall. We are trying to overhaul the entire business line and we believe that the turnover what we would like to do is only in the area where there has to be a good margin; however, the old projects and old supplies are still haunting us, so we have to take care of those aspects before we go on to the higher profit, so those are the things that we are likely to correct, but the volumes are likely to definitely decrease for the time being while we execute old orders and we take up new orders for products only.

**Sunil Kothari:** Prayasvin what is your gut feel, material handling will be profitable current year or that should not be the expectation?

**Prayasvin Patel:** We are trying our utmost to make sure that we do not get into the red, but it is difficult for us to say that right now because it also depends on certain projects the way the client reacts to our proposals.

**Sunil Kothari:** Sir, any development in terms of exporting to US?

**Prayasvin Patel:** Yes, what we have done in the US is our Radicon setup that we have in the US, we have overhauled it and we are now trying to grow the business out there, but I believe that by the time we stabilize out there, it would show fruits by the next year.

**Moderator:** Thank you. We have the next question from the line of Ritika Garg from Aequitas Investment. Please go ahead.

**Ritika Garg:** Sir, I wanted to know in material handling, have we completed the two loss-making projects?

**Prayasvin Patel:** They are almost on the verge of completion, one of them is 98% to 99% complete while the balance we have more or less finished our supplies, however, there is civil work which is pending which we are confident that in a reasonable period of time by September it should get over considering that little work will get done during the rains.

**Ritika Garg:** Sir, I remember that we had said that these legacy orders, all the losses have been booked for them, so how come we are still having some losses in the MHE division?

**Prayasvin Patel:** Those are not the only two orders because while we go further on the contractual terms and conditions, there are negotiations that we are having with the clients for LDs and for balance payments and so forth, and therefore, we have found that though these two were where we had booked the losses, there were a few more that have come.

**Ritika Garg:** What growth do we expect in the MHE business going forward?

**Prayasvin Patel:** Madam, the growth is not to be seen. As a matter of fact, we may shrink in volume. We are focusing on products which will give us our profitability because what we have decided is we do not want to pursue the top line, but we want to pursue the bottom line, so there is a transition. Right now we are in the transition mode and going forward over a period of time, we will make sure that we take product orders only where there are reasonably good profitable margins.

**Ritika Garg:** What in that case would be the products we catering to?

**Prayasvin Patel:** It would be more to the cement, steel, and power sector.

**Ritika Garg:** Sir, regarding the gear division, when will that Navy order be complete by FY '21?

**Prayasvin Patel:** By FY '22.

**Ritika Garg:** How much has the Navy order have we executed in FY '19 and how much do we plan to execute in FY '20?

**Prayasvin Patel:** Right now, there is one shipset which would be executed by September and the balance one more shipset would be done by March, so there are two shipsets which would go this year in this financial year and the balance five shipsets which would be balanced would be going two, two each every year.

**Ritika Garg:** Sir, how much did we book in FY '19 out of this Marine order of 530 crores?

**Prayasvin Patel:** I am getting a confirmation, but approximately it is 78 crores.

**Ritika Garg:** Going forward, we are seeing traction in which industry from the gear segment?

**Prayasvin Patel:** Right now, it is very difficult to say, but we believe that cement and steel are the two industries which are showing higher growth potentials than before and we see that the traction should be coming in. The election period has kind of blanked us out.

**Ritika Garg:** What about sugar?

**Prayasvin Patel:** Sugar is a very seasonal requirement, which comes in more often. Right now, what it looks like is the sugar market seems to be reasonably saturated, so it is difficult to say, but the season for sugar procurement would start a bit later by about July or August.

**Ritika Garg:** Going back to the Navy order, are we also going to do any operation and maintenance for them?

**Prayasvin Patel:** Yes.

**Ritika Garg:** So what would be our annual revenue for that?

**Prayasvin Patel:** No, I will explain to you, the contract includes maintenance of the gear units during storage period and after that the installation is where we do the supervision. Beyond that, we would only be supplying spare parts to them and overhauling of the gear unit, then we would be involved in it.

**Ritika Garg:** Recently, Cochin Shipyard has announced that they have signed a contract for construction and supply of eight anti-submarine warfare shallow watercraft from the Indian Navy for 6000 crores, do we stand to benefit from this order?

**Prayasvin Patel:** The requirement of gearbox would come in as a second stage and we are reasonably confident that we would be told to quote for it or we would be asked or an inquiry would be presented to us and we definitely will quote for it.

**Ritika Garg:** Then who else is qualified to quote for it?

**Prayasvin Patel:** There are a lot of national and international parties, list is of at least five to six companies.

**Ritika Garg:** What kind of growth do we see in the gear division, like I think you said that 700 crores of orders we expect to execute in this coming year out of our order book right, in FY '20?

**Prayasvin Patel:** No, we have an outstanding order booking of 717 crores which includes the Indian Navy order and beyond which we are still expected to get orders to fulfill this year's requirement.

**Ritika Garg:** Do we see H1 little muted in terms of order inflow because of the election?

**Prayasvin Patel:** Yes, you can presume that because this is a period where there is a bit of slowing down as long as order flow is concerned, but I tend to believe that as soon as the elections get completed, it again should pick up.

**Ritika Garg:** Has the US broken even in terms of operation and can you give us the breakup of this revenue and profitability for US and UK?

**Prayasvin Patel:** US has not broken even as yet, but the losses have been reduced and going forward we have a two-year timeline whereby we would be positive.

**Ritika Garg:** How is the outlook for UK?

**Prayasvin Patel:** The entire marketing team out there and marketing strategy is going through a sea change, so all this will fall into place and it will take two-year period to do so.

**Ritika Garg:** What is the losses in FY '19 in the US?

**Management:** In US, we had a loss of 12 crores in terms of Indian rupees.

**Ritika Garg:** What was the corresponding number for FY '18?

**Prayasvin Patel:** 19 crores.

**Ritika Garg:** What are our debt reduction plan?

**Management:** If we see this year in India we have reduced the debt by nearly 23 crores, and on consol level, we have reduced the debt by 43 crores.

**Ritika Garg:** What about FY '20?

**Management:** FY '20 we are expecting that we could reduce the further debt by nearly 70 to 75, it is minimum between 50 to 75 crores.

**Ritika Garg:** There was some retention money that was pending with NTPC, I think it was a sizeable sum?

**Management:** That retention money, we are expecting both projects of NTPC and Mauda will be completed this year. Once it is completed then retention will be released.

**Ritika Garg:** What about the money that was already pending to be received?

**Management:** That is already, others are ongoing projects, so we are getting as per due orders.

**Ritika Garg:** Have we got whatever was our due in FY '19 or has it been delayed?

**Management:** We can say 80% of the NTPC retention money is received and the new projects this year that again it will be increase in loss.

**Ritika Garg:** Are we catering to the railway industry in any of our segments?

**Prayasvin Patel:** The gear business is where we are pursuing supplies to the Railways and over a period of time our involvement with the Railways is on.

**Ritika Garg:** Like, do we have like an order from the Railways which we could quantify?

**Prayasvin Patel:** Right now, there are spare orders which are about 5 to 10 crores in nature and nothing substantial, however, there are lines which we are pursuing and over a period of time we are likely to do larger businesses.

**Ritika Garg:** In the MHE division for the Railways?

**Prayasvin Patel:** MHE division we do not have any exposure towards Indian Railways.

**Ritika Garg:** What would be our order book in the MHE division is 400 odd crores, so that would comprise how many orders like is it multiple orders or is it like one big order or two big orders?

**Prayasvin Patel:** Right now the MHE business outstanding orders are about 404 crores out of which I would say they would constitute about at least 15 orders having different values.

**Moderator:** Thank you. We have the next question from the line of Venkat Subramanian from Organic Capital. Please go ahead.

**Venkat Subramanian:** Sir, on the outstanding order book if we net off Defense orders, we are sitting on less than about 200 crores, how does it compare sitting in early May relative to past year, how does it compare specifically to give you confidence?

**Prayasvin Patel:** Last year, if you look at the first quarter, the outstanding orders were reasonably robust to make us go through the first quarter very smoothly. Even this year, we are seeing that there are orders worth 150 crores which are pending which can be executed during this quarter and therefore the rolling is reasonably smooth because the time cycles of manufacturing are reasonably short. The order inflow and execution is done pretty fast, so what I am trying to say is that the outstanding order list normally the values are relatively low because they get consumed very fast.

**Venkat Subramanian:** Broadly breaking up, how is the competitive intensity, is it a situation where there are more people chasing for every piece of business and therefore the margin percent are lower or is getting a little better?

**Prayasvin Patel:** I would say that I am not seeing much of a difference, what I would say is that normally there are waves that come in, waves means there is quite often competitor who has a specific agenda to take care of, and therefore, he drops the prices substantially to get a few projects or large orders, otherwise, it is reasonably steady. I would explain that if there is a year-end or they want to achieve a certain turnover or a target that needs to be achieved that is when they give substantial discounts and take orders, otherwise, normally speaking there is a bandwidth or a range in which the discounts take place and the competition tries to see to it that they retain their own customers.

**Venkat Subramanian:** On our overseas business overall, how much would we have invested and in retrospect, how would you look at that investment?

**Prayasvin Patel:** Overall, I can say that the purpose for acquiring the overseas business, the objective was to increase the manufacturing in India which has been happening to a reasonable extent, but I still feel that there is still a very large potential that needs to be exploited in the near future. Right now, I believe that because of the money constraints that we had we were not able to execute our strategy to the fullest and which is the reason why it has not given the results that we were looking for which is growing the market, expansion into various countries and so forth, so that would happen still as and when the company’s financial position improves and the company is willing to take certain risk and invest more money into these markets.

**Venkat Subramanian:** You would not want to risk more the way the Indian markets are behaving right now, right?

**Prayasvin Patel:** Exactly, my risk-taking ability has reduced and I would like to play safe right now, however, I have seen to it that we kind of at least make profit in the foreign subsidiaries so that going forward the burden is not felt.

**Venkat Subramanian:** But are these liquid assets pricing by, if we get into a situation where you see Indian market growing and there are takers for that asset, will you look at it I know it is hypothetical, but would you be open?

**Prayasvin Patel:** No, I would not, I will tell you why because we have a very strong manufacturing base and our capacities are fairly large. We need to divide our risk, which means that we need to be in various markets simultaneously and while one market goes into recession, I am sure the other markets would be booming, so the intention is that you divide or do not put all the eggs in one basket, which is India.

**Venkat Subramanian:** Lastly, can you share your investments into overseas subsidiaries?

**Prayasvin Patel:** I could give those numbers or is it possible that we email it to you.

**Venkat Subramanian:** Thanks.

**Moderator:** Thank you. We have the next question from the line of Ritika Garg from Aequitas Investment. Please go ahead.

**Ritika Garg:** Sir, in the gear business what kind of growth rate can we expect going forward?

**Prayasvin Patel:** I would put it this way Madam that it will largely depend on the Indian economy for the Indian operations because gears is one kind of business which is I would say is the barometer of the industry where if you see a growth in the gear business, it is because the economy is growing at a reasonable extent. We are not much dependent on any particular industry, however, power sector has been one of our large customer but that does not mean we are not into cement, steel, sugar and so forth, rubber, so we have varied industry as a clientele, and therefore, it will all depend on how the economy behaves.

**Ritika Garg:** What about margins, do we expect to maintain the margins that we have had in FY '19 or we expect some decline going forward?

**Prayasvin Patel:** FY '19 we will definitely be able to maintain our margins for two reasons, one is that we have a reasonable good order inflow right now and post-election we believe that things will also start picking up and the other thing is that, we have been very aggressively looking at our margins and seeing to it that they are properly maintained while we pursue orders.

**Ritika Garg:** Sir, what is the focus of the company for FY '20 and say FY '21, is it debt reduction, what is our focus?

**Prayasvin Patel:** The focus is first of all to see to it that we are able to streamline our material handling operations and the operations in US so that they become positive, that is one of the objectives. The second objective is debt reduction and the third objective would be to grow further into our gear business.

**Moderator:** Thank you. Ladies and Gentlemen, that was the last question and I now hand the conference over to the management for closing comments. Sir, over to you.

**Prayasvin Patel:** Thank you for taking so much of interest in the working of our company. We are reasonably confident that the present year would be positive and we would be achieving higher growth than what we have done in the past and even the bottom line would further go through an improvement. We are striving to see to it that we perform well and our intention would be that the material handling business which is right now going through tough times would further improve by our change in strategy and the international operations which have started performing better over a period of time will further improve as US also falls in line, so we are reasonably positive and I am sure that if the economy further improves things will even improve further, so thank you all for taking interest in Elecon once again.

**Moderator:** Thank you very much, Sir. Ladies and Gentlemen, on behalf of Elecon Engineering, that concludes this conference call. Thank you for joining with us and you may now disconnect your lines.