"Elecon Engineering Limited Q2 FY14 Earnings Conference Call"

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MR. H.C. SHAH

Moderator: Ladies and gentlemen, good afternoon and welcome to the Elecon Engineering Q2 FY'14 earnings call hosted by Ambit Capital. As a reminder, for the duration of this conference all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference, please signal an operator by pressing "*" and then "0" on the touchtone phone. At this time, I would now like to hand the conference over to Mr. Dharmen Shah. Thank you and over to you Sir!

Dharmen Shah: Good afternoon everybody. Welcome to the Q2 FY 2014 earnings call of Elecon Engineering. We have here today Mr. Prayasvin Patel, the Chairman & Managing Director of Elecon Engineering and Mr. H.C. Shah, the CFO of the company. I now hand over the call to Mr. Patel for his opening remarks and then we can take Q&A session. Mr. Patel, can you request you.

Prayasvin Patel: Good evening everyone and welcome to the conference call on the Q2 and half-year FY 2014 results of Elecon Engineering Company Limited. I have with me, Mr. H.C. Shah, the CFO. We had come out with the financial performance of Elecon Engineering Company Limited, which was duly considered and taken on record by the board of directors at its meeting held on November 2013.

You must have observed that though the total revenue in the second quarter and for six months in FY 2014 has been lower to Rs.128 Crores and Rs.238 Crores as against the total revenue of Rs.145 Crores and Rs.271 Crores respectively in the corresponding second quarter and six months of the previous year.

We had been able to improve earnings before interest, tax, depreciation and amortization, EBITDA margin in the second quarter and for six months in FY 2014 to 26.90% and 24.45% as against 22.76% and 20.18% respectively in corresponding second quarter and six months of the previous year. However, profit before tax has been lower in the second quarter and for six months in the FY 2014 stood at 10.21% and 7.63% as against 12.68% and 9.98% in the corresponding second quarter and six months of previous year mainly because of the high depreciation arising due to business restructuring exercise.

However, unaudited provisional consolidated revenue for half year has been 620 Crores as against 735 Crores in the corresponding FY 2013. Consolidated EBITDA for six months in FY 2014 has been 84 Crores as against 103 Crores in the corresponding six months of the previous year.

Profit before tax for six months in FY 2014 has been to Rs.17 Crores as against Rs.41 Crores in the corresponding six months of the previous year. New order booking in the current year up to October 31, 2013 stands at Rs.379 Crores as compared to Rs.295 Crores up to October 31, 2012 and pending order as on October 31, 2013 stands at Rs.279 Crores as compared to Rs.267 Crores as on October 31, 2012, pending for Elecon EPC Projects Limited remains at a highly comfortable level that is at 1223 Crores on October 31, 2013 compared to Rs.1157 Crores as on October 31, 2012.

The order book remained strong, but the challenge being faced with the delay in order finalization as well as delay in taking deliveries which are primarily from the customer's end. Elecon continues its focus on export markets and the company has achieved an export turnover of Rs.33 Crores up to September 30, 2013 as compared to Rs.24 Crores up to September 30, 2012.

Elecon Engineering Company has also set up a new manufacturing plant as an expansion of the gear division. The new plant named is Bhanubhai Memorial Centre of Excellence and will produce internal components of helical gearbox and has a capacity of manufacturing 1000 gearboxes per month driven by cellular manufacturing concept. This engineering plant has been built to double the gearbox manufacturing capacity using world class quality and to ensure on time delivery within a short span of time.

Our transformational initiatives along with cost control measures we expect to reduce the cost of employment by approximately 1 Crores per month in both the companies. Elecon Engineering and EPC Projects Limited as well as other expenses too. With these initiatives of cost control measures, we are very much optimistic to reach the same level of turnover as the previous year amidst economic slowdown, currency depreciation, lower credit etc., in the prevailing industrial scenario.

With this I would like to open the call for questions.

Moderator: Thank you Sir. Ladies and gentlemen, we will now begin the question and answer session. The first question comes from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.

Madan Gopal: Good evening. Good set of improvement in the margins in gear business. Just wanted to understand was it primarily contributed by exports or was it the improvement supported by the domestic market?

Prayasvin Patel: There are various reasons for this. First of all the company has initiated TPM program, certain margins have improved because of that. It has taken up, reorganized its manufacturing facility on cellular manufacturing concepts, which has also added certain margins. Then exports has helped considerably because of the Rupee depreciation. So there are a whole lot of things, which are there in improving our margins, but we are reasonably confident that the margins compared to the last year will remain increased at an increased level compared to last year for the couple of years.

Madan Gopal: Primarily supported by the cost saving program as well as the exports that is what basic thing?

Prayasvin Patel: We have come up with a new catalogue series, which has been recently designed and launched whereby the margins would further improved. That has also gone into the market. So that has also helped. So there are a lot of initiatives that the company has taken up and we believe that during these troubled times, the company has taken initiatives, which have now started paying dividends.

Madan Gopal: Sir, the revenue decline for the transmission business seems to be on the higher side. We are not hearing similar decline in other probably say industrial products or something. Is it anything specific to the gear business that we are seeing such 16% kind of decline year-on-year? I think first half you were at 16% decline in the gear sales, am I right about it?

Prayasvin Patel: The decline has been basically due to poor order inflow of last year. We have started seeing the changes, which are occurring since the end of first quarter. There has been an increase in order inflow and we are hopeful that we should be able to gallop considerably in the next two quarters.

H.C. Shah: Our order inflow in the first quarter was 185 in gear division and second quarter it was 136. So now the order inflow has started improving and first quarter 185 was the highest amount in the last eight to 10 quarters. So now that particular effect of those order inflow will be seen in the second half.

Madan Gopal: Normally we execute within six months, right, the order book in gear business?

Prayasvin Patel: Six to eight months.

Madan Gopal: How much was the exports in the first half?

Prayasvin Patel: 33 Crores as against 24 Crores in the previous year.

Madan Gopal: On the other business, just want to get some data, like what are the sales, EBITDA and PAT for the MHE business? If you can provide it will be helpful.

H.C. Shah: MHE let me put, it was 216 Crores turnover.

Madan Gopal: This was first half?

H.C. Shah: This was first half and EBITDA was 17 Crores and PBT was -3 Crores.

Madan Gopal: So in terms of performance the revenue has gone up significantly compared to Q1, am I right in what I am saying?

H.C. Shah: What.

Madan Gopal: The revenue from 89 Crores has gone to 127 Crores, but the margins have probably disappointed in the MHE business?

H.C. Shah: Yes.

Madan Gopal: So, what is the outlook second half in terms of execution as well as margin front? Full year our target was to do something like 600 Crores in this business? So, are we confident of reaching there and maintaining? Margins seem to be going down, because last year we did 14% margin in this business. This year we should be at less than 10% for the full year?

H.C. Shah: Yes. We are reasonably confident that we will reach approximately 600 Crores. The fact remains that again the same situation. The first two quarters have been slightly slower because though we had orders on hand, these orders we were not able to execute them because various customers were not able to lift the goods. So there was a situation where we had to practically not produce anything, but there are signs that things are improving and we are hopeful that certain customers especially certain major projects will now start receiving the goods.

Madan Gopal: On the margin front, can it improve, because second quarter seems to be only six margin? Can it move from here and can we finish the year with closer to 10% margins or we should be looking at lower levels?

H.C. Shah: We are definitely sure that it is going to increase more than 6%; however, it would be anywhere between 6% and 10% I would say.

Madan Gopal: Is this happening because of some write offs or is this happening because of delay in projects that is leading to cost escalation to probably continue for the second half as well, because last year we made 14% margins in this business?

Prayasvin Patel: See what has happened is there are two reasons for it. One is that basically due to delays in projects we could not further increase the turnover and which has also had an effect on the merger. The second thing is that there were certain jobs, which were off low profitability, which have come up during this time, which we are hopeful that we will be able to overcome this and improve the margins.

Madan Gopal: How is the scenario right now? I believe that in terms of order pipeline there are not much of the orders except for one or two state sector projects, but are the players in terms of pricing becoming reasonable or still the competition is cutting on the price levels?

Prayasvin Patel: The competition right now is extremely unhealthy I would say and you will see that among the material handling players who are announcing results recently, there have been considerable depletion of margins and most of them will end up making losses. Our intention is that at least at the end of the year we need to be positive and in black rather than in red.

Madan Gopal: Going forward since you are saying so much unhealthy competition in the project front will we be happy to hold on to the product level business. If so how is the pricing per se. I agree that projects is definitely seeing a lot of fame, are the products also seeing similar kind of unhealthy competition?

Prayasvin Patel: Yes and no. See the product supplies are relatively much less than project. So therefore the margins are relatively better, but in the tough times even those margins also do get depleted, but I am sure in selling products we would be able to get better margins than in projects.

Madan Gopal: Out of your order book how much would be products and how much would be projects Sir, in the current order book? I have this number. We spoke last month to Mr. Shah. I have this number, but on Benzler can I take some numbers on sales, EBITDA and PAT?

H.C. Shah: We can give you. It is around 155 Crores.

Madan Gopal: This is first half right?

H.C. Shah: First half, 155 Crores revenue, EBITDA is 10 Crores, PBT is around 1.5 Crores.

Madan Gopal: This quarter number if you have?

H.C. Shah: The quarter I will have to work it out.

Madan Gopal: Probably I will take it up later.

H.C. Shah: Consolidated for the half year is readily available, if you want afterwards then we can provide you.

Madan Gopal: Do you have the consolidated number you have for the Company?

H.C. Shah: The company's consolidated is 620 Crores because our Chairman has already referred in his opening remarks 620 Crores revenue, EBITDA is 84 Crores, before interest, tax and depreciation, profit before tax is 17 Crores.

Madan Gopal: Total interest cost for the first half consolidated?

H.C. Shah: That I will have to work it out.

Madan Gopal: PBT is 17 Crores.

H.C. Shah: Yes.

Madan Gopal: Sir, how is the growth is Benzler? Year-on-year first half?

H.C. Shah: I think last year total was 294 Crores for the whole year. This year we definitely can expect at least 7% to 10% increase.

Madan Gopal: Just a followup on Benzler, 323 Crores is the expectation with a margin of 5.5% so margins probably are there. I think margins are 6.5% that is compared to last year doing well, I think?

H.C. Shah: It has progressively improved.

Madan Gopal: Thank you so much for taking my question. I will follow it up if there are no more questions.

Moderator: Thank you. The next question is from the line of Niraj Somaiya from Span Capital. Please go ahead.

Niraj Somaiya: Good set of numbers. Quite an impressive quarter. First my question was that the debt has gone up to almost 1000 Crores is what I saw consolidated about 970, what is the main reason for this debt going up by about few 100 Crores?

H.C. Shah: Borrowing is only 660 Crores.

Niraj Somaiya: 660 Crores.

H.C. Shah: Because of this particular revised format I will give you Elecon Engineering is having a total borrowing of 286 Crores, EPC 258 Crores, and Benzler 116 Crores. So total is 660 Crores is the borrowing. It works out to around 1.15 to 1.2 approximately.

Niraj Somaiya: How much is working capital and long-term in this out of 660 Crores?

H.C. Shah: Long-term borrowing out of 660 is 215.

Niraj Somaiya: Generally how is the outlook? Do you think the numbers have improved, the order book is improving? Do you see the worse is over or do you think yes we would see a lot more pain? Just if you can throw more broad picture on both the business the DR and MHE?

Prayasvin Patel: In MHE I would say that the tough times, we are still expecting that it would continue for a while. Yes we are seeing that the order inflow has been improving; however, it is difficult to predict whether this will continue for a long period of time or not. We are hopeful that it should continue because especially the Prime Minister has been announcing that a lot of these projects and a lot of activities are on the increase, so we are hopeful that that should also bring in more business.

Niraj Somaiya: What about the international business, which you are planning to grow to about 100 million in the next three to five years? How is that been progressing and how is your experience in the US because that is a very significant 4 billion market? What are the steps you have taken to become more completely dependent on domestic market, any progress there?

Prayasvin Patel: We have laid out plans of increasing the sales in various continents. We are in the first phase where we will be going for more manpower deployment in the marketing area in various parts of the world and the strategy would be to increase the sales considerably. On the other hand, what we have done is we have started consolidating the supply chain from India to Europe. Thailand is also playing a reasonable good role in that. Our intention is that we have to make the supply chain lines stronger and more dynamic. We are having issues of having long delivery times from here to Europe to United States, may even have to look at partially getting components from Mexico into United States.

Niraj Somaiya: The market is quite significantly larger than India may be 20 times. Do you think you have all the product to actually attack the US market or do you think you need you have yet have missing parts or could you throw some light, because it is significantly bigger than India, right? Do you have the technology and the products today or do you think you are even working on that front?

Prayasvin Patel: As a matter of fact you would be surprised to know that on the technological front, we have the one of the widest product ranges that you would find among the global players. As a matter of fact if we benchmark ourselves against the world leader's one on one, we have equivalent products available in our basket. So, the advantage is that whether it is United States or South America or Europe, we have the products that we could sell in those markets.

Niraj Somaiya: Sir, the only concern is if you are able to get to the logistic side as a client then you could compete with the global players even in their home markets, right?

Prayasvin Patel: Yes.

Niraj Somaiya: Sir, in terms of your MHE business, one of the companies have gone for restructuring and they used to do a significant business with you and how is your opinion?

Prayasvin Patel: Products to the US.

Niraj Somaiya: Just coming back to your MHE business where one of the clients, with joint partner gone for their three steps range and they have a significant amount of work with you, how is your payments coming in or is your money stuck or how is that with that one particular client? Is there any progress or are you fully protected because your end client is a PSU?

Prayasvin Patel: Let us put it this way that we are trying to untie the notch which have been created slowly and gradually with this particular company, because there has not been any significant movement, which has taken place from that end; however, final customers are directly approaching us and one on one we are taking customers.

Niraj Somaiya: Thank you very much. I will stay in the call. Wish you a very Happy Diwali and Happy New Year.

Moderator: Thank you. The next question is from the line of Bhalchandra Shinde from B&K Securities. Please go ahead.

Bhalchandra Shinde: Good evening Sir. I wanted to know like in segmental highlights what we can see is like transformation equipment there is an EBIT margin have actually declined and on the standalone basis, what we represent the margins however have slightly improved. Is it because of the post restructuring inclusion of AMTS and Prayas Engineering?

Prayasvin Patel: That has played a small part to it; however, there are various reasons, which can be attributed to better margins. The better margins are due to the exports increasing as I have mentioned earlier because of the devaluation of the Indian rupee, which has improved the margins. There are lot of measures that your company has taken in improving the margins by cutting down the cost. We have come up with a new series, which we have launched about eight months ago called Eon-Eon series, which are giving us better margins. Then the company has gone in for cellular manufacturing. It has restructured all the manufacturing and put into the cellular format whereby just in time and faster productivity takes place, so there are lot of measures. The employment reduction has taken place whereby the margins would further increase. So all these are measures, which the company has taken and which is slowly and gradually giving dividends.

Bhalchandra Shinde: In gear division, the order book which we have specified, does it include the exports order value or it is excluding it?

Prayasvin Patel: Total.

Bhalchandra Shinde: Means it will be including the export value also?

Prayasvin Patel: Yes.

Bhalchandra Shinde: Sir, going forward do we see a good robust growth on the exports market because of the rupee depreciation effect?

Prayasvin Patel: Yes. We will become more and more competitive and though we have a technological edge over our competition, in certain products that we sell in the international market, but over and above that if we are more competitive that further improves our chances of getting more noticed.

Bhalchandra Shinde: Sir in MHE business you specified the second quarter numbers. Can you give first half numbers for the MHE business?

H.C. Shah: First quarter?

Bhalchandra Shinde: First quarter or first half of FY 2014?

H.C. Shah: First half I have already told. For EPC it is 216 Crores, MHE business, EBITDA is 17 Crores, and profit before tax is -3.

Bhalchandra Shinde: Second quarter.

H.C. Shah: That I will provide you. You please send an email to me. I will reply to you.

Bhalchandra Shinde: Sure. Regarding the MHE business as you specified that conditions are still problematic and customers are deferring. What is exactly happening? Are we seeing any slowness in the investments or it is actually orders are there, but still their executions are getting deferred because customers are facing problems and regarding the liquidity conditions?

Prayasvin Patel: Yes, you are right. It is the liquidity conditions that the customers are facing whereby the projects were announced though they are trying to execute them, but the speed at which they would like to execute them goes through a considerable delay.

Bhalchandra Shinde: Sir, if we expect things to improve gradually, what kind of growth prospect we see in order intake?

Prayasvin Patel: We are hopeful that a lot of projects have been recently announced by the government in the infrastructure area and we are hopeful that this would ultimately lead to more orders in the material handling area.

Bhalchandra Shinde: Any ballpark number if you can provide?

Prayasvin Patel: There are nine enquiries of about more than 4000 Crores and we expect that in this scenario we will get the new order inflow by the year end to the extent of 550 to 600 Crores.

Bhalchandra Shinde: Thank you very much Sir.

Moderator: Thank you. The next question is from the line of Sudhakar Prabhu from Span Capital. Please go ahead.

Sudhakar Prabhu: Good evening Mr. Patel and Mr. Shah. I think this quarter result has been excellent. I had a couple of questions; one what would your current capacity utilization of gear plant?

Prayasvin Patel: The current capacity utilization is around about 50% to 55%.

Sudhakar Prabhu: So since the utilization is 50% to 55% what is the thought process going for this new plant in the gear business?

Prayasvin Patel: Various reasons, this kind of capacity was being utilized to the extent of 75% to 80%. The other thing is by going in for 1000 gears per month, this is going to be a game changer. The intention is that you start mass producing these type of gears whereby you bring down your cost and you become more and more competitive.

Sudhakar Prabhu: How much you plan to spend for this?

Prayasvin Patel: We have already spent, and the plant is operation from January 1, 2013 and we have spent around 55 to 60 Crores.

Sudhakar Prabhu: This is already factored in?

H.C. Shah: It has already been capitalized in the books.

Sudhakar Prabhu: Secondly what is your outlook for your gear business because last time when we spoke we were speaking about at least 7% to 10% growth for the entire year but after looking at the half-yearly result do you think that number is possible?

Prayasvin Patel: Not really, because we were hoping that things in the economy would improve. Gear is probably a reasonable good barometer like the electric motor of the economy. Unfortunately though we have seen a slight improvement we are not seeing a situation where order in various types of gearboxes that we manufacture will be uniform and in substantial quantities.

Sudhakar Prabhu: Out of your unexecuted order book of around 265 Crores what would be like the normal execution cycle?

Prayasvin Patel: Our normal execution cycle would be to the tune of six to eight months, but there are certain type of orders where the execution cycle is a year or year and a half also.

Sudhakar Prabhu: Secondly my question is on your material handling business. Could you just help us in understanding what is the working capital cycle? What is the debt receivables and stock etc. in the material handling business?

H.C. Shah: The debtors is mainly from major component of working capital cycle because I think we have already appraised you that the business model of material handling is like 10% advance we receive, but at the same time 10% retention money is being retained by the customer till the final execution and satisfactory handing over of the plant is done, so this 10% retention money amounting to 240 Crores are sitting as debtors on a consistent basis because right from the first invoice 10% is deducted and is being kept by the customer. So the major is the debtors, it is the major component of working capital cycle without retention money it will be around 170 to 180 days.

Sudhakar Prabhu: Mr. Shah, the point, which I am trying to make is some amount out of this retention money would come back to you, right because some of these were bit older than two years or three years, so at least some should come back to you?

H.C. Shah: Definitely, but on an average it remains with the customer for more than two to two and a half years and in that particular situation, after handing over the customer has to be satisfied in all respect and then and there it will give a clearance to release this retention money. In that particular kind of it gets further delayed to give a final clearance of release of this retention money.

Sudhakar Prabhu: Lastly this year you had plans of paying around 40 to 50 Crores of debt. Is that plans still hold good?

Prayasvin Patel: Definitely as per the repayment schedule repayment of term loan in Elecon is 43 Crores and in BR group is 25 Crores.

Sudhakar Prabhu: Lastly, this is just a request for you, last time, I had made this request that if you guys could come out with a consolidated result it would help us understanding it better. So just a request again?

Prayasvin Patel: What the board has decided because it is accurate final numbers, we are getting little late. So in that particular situations, what we have intimated to the stock exchange that we will publish the consolidated number at the year end. But at the same time this conference call, we have given all the numbers.

H.C. Shah: Okay. In terms of numbers if were to say what is the topline of the companies that we have acquired?

Sudhakar Prabhu: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Arvind Joshi from Batalur Advisory. Please go ahead.

Arvind Joshi: My questions have been answered. Thanks.

Moderator: Thank you. We have a followup question from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.

Madam Gopal: Sir, when you are saying consolidated number, you are mentioning 84 Crores EBITDA for the first half?

H.C. Shah: The EBITDA is 84 Crores.

Madam Gopal: 84 Crores.

H.C. Shah: Against a revenue of 620 Crores.

Madam Gopal: Is it including other income?

H.C. Shah: Including other income.

Madam Gopal: How much is the other income?

H.C. Shah: Other income will be because it is majorly in the Elecon only, it may be around 13 to 15 Crores.

Madam Gopal: It is in Elecon Standalone, you are saying?

H.C. Shah: Yes. 13 Crores is there. Around 15 Crores in all we can reasonably assume.

Madam Gopal: Thank you Sir.

Moderator: Thank you. As there are no further questions, I would now like to hand the floor back to Mr. Dharmen Shah. Thank you and over to you Sir.

Dharmen Shah: I thank the management for taking time out and candidly sharing their thought as well as answering questions in great detail. I wish the management all the very best for the coming quarters and request if Prayasvin would have any closing remarks to share with the participants.

Prayasvin Patel: What I would like to share is that the company has in these tough times has taken considerable measures to improve the performance of the organization per se and we are seeing the benefit of it and I can assure you one thing that the management is very keen to see to it that not only we improve our performance but we ensure that whenever good times come in, the company would be prepared to take up the challenges and see to it that the top and the bottomline further improves. With this I would like to thank you for the keen interest taken by all of you and I assure you that we will try our utmost to improve our performance and better realization. Thank you.

Moderator: Thank you Sir. Thank you members of the management. On behalf of Ambit Capital that concludes this conference call. Thank you joining us. You may now disconnect your lines. Thank you.