



“Elgi Equipments Limited Q4 FY15 Earnings
Conference Call”

June 1, 2015



Management: **Mr. Jairam Varadaraj – Managing Director, Elgi Equipments Limited**

Moderator: **Mr. Kamlesh Kotak – Asian Market Securities Limited**

Moderator

Ladies and gentlemen, good day and welcome to the Elgi Equipments Limited Q4 FY15 Earnings Conference Call hosted by Asian Market Securities Limited. As a reminder all

participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need our assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kamlesh Kotak. Thank you and over to you Mr. Kotak.

Kamlesh Kotak

Good afternoon everyone. On behalf of Asian Markets I welcome you all to the 4Q and FY15 Earnings Conference Call of Elgi Equipments Limited. We have pleasure in inviting Mr. Jairam Varadaraj – Managing Director of the company and his team. I request Mr. Jairam to provide us an overview of the company's quarterly results and the yearly performance and then we shall begin the Q&A session. Over to you sir.

Jairam Varadaraj

Thank you Kamlesh. Thank you ladies & gentlemen. It is a pleasure to be with you this afternoon. All the companies in India are going to be facing IndAS sooner than later, some of us little earlier, some of us a little later. So in IndAS one of the dominant features is going to be that consolidated results are going to be the conversation piece. So in preparation for that I am going to start looking at consolidated numbers. So I am going to take you through the consolidated numbers for the year in relation to the consolidated numbers for the previous year and I will try and reconcile the performance both in relation to expenditure as well as in relation to the regions in which we are operating. So the sales have been lower to the extent of about Rs. 40 crores, Rs. 36 crores to be exact. Out of this Rs. 36 crores exchange related change drop is about Rs. 18 crores. The Euro region compared to 2013-14 & 2014-15 the Euro was much lower vis-à-vis rupee. So when you just do that math we are losing Rs. 18 crores of the topline. So the real loss is about Rs. 18 crores on the topline on revenue. That has given us a decline in terms of about Rs. 15 crores in terms of contribution level. However our material cost control and overall variable cost control has been very good. We have gained quite a bit compared to the previous year. The net difference at EBITDA level is about Rs. 26 crores. So instead of Rs. 91 crores, which is what we have declared, we should have done Rs. 117 crores against last year's Rs. 103. Now in terms of what are the areas of gap? Our manpower cost went up by about Rs. 21 crores and our exchange fluctuation was to the extent of Rs. 14 crores. This is mark to market variations during the year. But we have actually saved on fixed cost to the tune of Rs. 12 crores. So the net result is about Rs. 26 crores. Now if you look at the manpower cost, in India because of gratuity, the annuity repositioning and leave encashment accounting which is all one-time in nature, during the year we had close to about Rs. 4 crores as a one-time kind of an expenditure. So the net effective is about Rs. 21 crores, that has gone in. So overall the moral of the story here on expense side is that we are pretty much in control over most of the cost. They look a little exaggerated, that is primarily because the topline has not really supported the company. Now when I look at the EBITDA, the gap in EBITDA between 2013-14 and 2014-15 across the regions, India has contributed to the extent of about Rs. 28 crores in the drop. Now I am looking at Rs. 103 crores versus Rs. 91 crores. 103 crores for 2013-14, 91 crores for 2014-15. India has contributed Rs.28 crores to the drop. The rest of the world, either through exports from India or through sales by the subsidiaries has contributed positively to the extent of Rs. 15 crores. And ATS has of course contributed to the extent of about Rs. 2 crores. So the net impact is about Rs. 12 crores, which is what the gap is between 2013-14 and 2014-15. Now overall assessment of the year has been like I mentioned also during the analyst meet. We took our knocks in the rest of the world, primarily

in Belair and in the US operation. Belair has come along but we still have many things to be done there. Patterns after all the problems we had because of the action done by Quincy and Atlas Copco which damaged the company. We are now rebuilding and things are beginning to come back. Elgi US has really got good traction and we are now expecting to see far better performance and this is what I said during the analyst meet and we are beginning to see that happening. We saw that in the last quarter and we expect in 2015-16 that same trend to continue. Our biggest source of concern in terms of growth is India. We believe that India has bottomed out i.e. remained at the bottom for a while but there seems to be minor indications that things may come back. There were some indications of this in the fourth quarter and we are hoping that what we saw, the blips that we saw in the fourth quarter will continue into this financial year as well. So overall I think we have come out of the woods. In most of the major areas we still have China as a challenge. We have started some initiatives to reign in the losses there and we have already started some initiatives in Belair to bring it down. So those are things under control. Brazil which has done very well for us on the revenue but we had a huge set back in the month of March, because the Real is just in a matter of one week depreciated from 2.7 to 3.1 to the dollar. So that was a setback. But we are now working with the banks there to try and move a big part of the debts that we have carried there into local currencies so that we do not lose on account of foreign exchange. So all these actions will protect our revenues and profits in 2015-16 and if India kicks in then India we will be really in a much better situation. So this is a brief kind of an overview of our performance. Just looking at the net position as on 31/03 is about Rs. 288 crores of which long term debt is about Rs. 206 crores, short term debt is Rs. 161 crores and cash and bank balances which keep fluctuating is about Rs. 78 crores. So that gives us a net of about Rs. 288 crores. So we are well on the way of progressively reducing this debt.

Our Capex expenditure for the new plant is complete so we do not see anything happening towards that account in 2015-16. Overall capacity related capital expenditure is going to be very marginal considering that we are not seeing anything happening in India. And we have started many initiatives to reign in cash that was deployed in many of our subsidiaries as a startup kind of inventory we are reigning them in. We are getting some good results, so overall we would have the cash management in the coming year would be far better than the previous year. So this kind of summarizes the overall situation of the company.

If there are any specific questions I will take them during the Q&A session. Thank you very much.

Moderator

Thank you very much. We will now begin the question and answer session. The first question is from the line of Umesh Raut from Equirus Capital Private Limited, please go ahead.

Umesh Raut

Actually I wanted to know about our topline contribution towards the end user industry, which industries do you have major exposure in terms of consolidated sales?

Jairam Varadaraj

Umesh I have explained this on multiple occasions during the conference call. We are a utility company. We do not have exposure to any one specific industry in any significant way. So we supply to steel, we supply to power, we supply to textiles, we supply to foundries, we supply to auto components, to the automobile manufacturers, to forging units, to food processing units, to rice sorting units. It is just across every industry spectrum we are present in. There is no significant exposure to anyone.

Umesh Raut As we are seeing a drastic slowdown in water-well industry and that is affecting our domestic sales. I mean how do you see the ramp up going ahead in 2016-17?

Jairam Varadaraj I really cannot predict the water-well business. The waterwheel business was very poor in even 2013-14. In 2014-15 just the first month of 2014-15 there was a spurt but after that it died down to levels even below 2013-14. And our exposure to water-well used to be very high may be 3 years ago, 4 years ago but if you really look at our revenue portfolio it has shifted quite drastically where now our dependence on water-well to produce the topline is no longer there.

Umesh Raut You mentioned in last conference call that you are developing new products for Chinese market and relaunching it into that market. So any status on that?

Jairam Varadaraj Well the development is progressing Umesh. We still need to do a little bit more work. While we get our product portfolio that is aligned better to the Chinese market we are also doing certain things to curtail cost and bring the operation more in line with our present strengths.

Umesh Raut How big is this opportunity for us?

Jairam Varadaraj In China?

Umesh Raut Yes.

Jairam Varadaraj China is the biggest compressor market in the world. So the estimates are very difficult to make very precisely, but it is estimated that 20-25% of world market is sitting in China.

Umesh Raut And sir how much of that would be held by foreign players and how much is from the Chinese players?

Jairam Varadaraj I would say in China not more than 30-40% is sold by the branded manufacturers. Rest of it is all by local companies.

Umesh Raut Sir just wanted to know EBITDA margins for different subsidiaries of first like patterns, Belair and Rotair.

Jairam Varadaraj You want to know the margins?

Umesh Raut Yes, EBITDA margins for FY15.

Jairam Varadaraj I do not have it in front of me Umesh.

Umesh Raut Okay. I read somewhere that water-well business is generally a higher margin business, I mean what is the taking order do you see in different industries or I mean for compressor market?

Jairam Varadaraj I did not understand your question.

Umesh Raut Water-well business is generally a high EBITDA margin business for compressor industry. So according to that if I say construction, mining, textile, healthcare and railways then how do you order it in terms of EBITDA margin?

Jairam Varadaraj It is very difficult to say categorically that textile has got a lower EBITDA or a higher EBITDA compared to let us say pharmaceutical or food. We do not track EBITDA by industry vertical. If at all we do track we look at contribution from various categories of products, not industry verticals.

Moderator We have the next question from the line of Ravi Swaminathan from Spark Capital, please go ahead.

Ravi Swaminathan Sir how much would be our exports during this quarter and for the full year and could it have grown during this period?

Jairam Varadaraj For the quarter our export was about Rs. 18 crores and subsidiary sales is about Rs. 110 crores.

Ravi Swaminathan Sales of the subsidiaries is 110 crores, I mean this is for the quarter. And for the full year exports, because last year exports were around Rs. 165 crores.

Jairam Varadaraj Exports last year from India was Rs. 92 crores. This year it is Rs. 64 crores but the total business that we have done exports and subsidiaries is about Rs. 510 crores, roughly similar to last year, Rs. 510 crores this year, Rs. 510 crores last year.

Ravi Swaminathan Exports and subsidiaries both put together were flat you are saying. But individual exports alone it would have degrown?

Jairam Varadaraj Yes. But see, export to subsidiary which is replenishment of stock. So it is very difficult to use these numbers to say is it this way or that way.

Ravi Swaminathan Okay. And where I was coming from is for players like someone like Cummins exports is completely a common setting for the weakness in the domestic market. Would we also have such an opportunity -

Jairam Varadaraj Point is Cummins India exports through their parent organization, whereas our export happens through our own subsidiary and through distributors. So those ratios keep changing year on year. So if you look at today's performance like I explained at an EBITDA level even though India has contributed Rs. 28 crores to the drop to an EBITDA, the business outside the country whether it is export or through foreign sales through our subsidiaries has actually increased our EBITDA by Rs. 15 crores. So that is the key. So sales may have remained flat but we have been able to improve the revenue from such of those markets that more and more profitable compared to the earlier ones.

Ravi Swaminathan And regarding the domestic market, I mean the entire market in the fourth quarter how it would have been? Would it have degrown for air compressors as a market as such or -

Jairam Varadaraj I am not sure about the fourth quarter. Fourth quarter our performance in India was good. But our but our competitors' performance to the extent that it has been published and known has been not as good as ours. But you guys should know better because you are keeping an eye out on those things, much more than we do.

Ravi Swaminathan And for the full year also how it would have been sir, I mean the entire market?

Jairam Varadaraj You know sectoral growths have happened where we are not participating like large projects, ONGC and some of the past power project orders that got executed, those could have created revenue bookings in the accounts of competitors but as far as book and bill kind of business last year, I do not think the market was growing in any significant way.

Ravi Swaminathan And what about after sales sir, we are concentrating on it fully and as a proportion how it has moved say over the past couple of years and where do you see it because someone like Atlas Copco obviously has a pretty high share of after sales. So that would be a **(Inaudible-20.27)**?

Jairam Varadaraj Atlas Copco has a very high percentage of aftermarket in their global business but in India our percentages I believe are better than Atlas. I do not know because Atlas does not publish their results any more. So our aftermarket has grown quite consistently about 7-8 or 9 years ago our percentages were at around may be 14-15%, now we are close to about 24-25%.

Ravi Swaminathan Where do you see this moving to, somewhat of a saturation rate just to play something --

Jairam Varadaraj It is very difficult to say because the aftermarket is not a function of current year's sales. It is function of your installed base, your past many years of sales. And the extent to which you are engaging with customers. So this percentage to sales is more of a thumb-rule rather than an intelligent measure.

Ravi Swaminathan And would we do it for our own installed basis or for other?

Jairam Varadaraj At the moment we are doing our own. We are not really doing after market for other brands of compressors.

Ravi Swaminathan And recently we had done a tie up with Voltas for textile, how do we see that business?

Jairam Varadaraj Voltas is a very reputed company and they are reliable of engagement in the textile industry is very impressive, very few in India who can claim that level of engagement in that industry. So obviously it takes a while for a company like Elgi and Voltas to start producing – we have seen some good results but we believe that the potential is even.

Ravi Swaminathan Do we have any revenue target in first year of association we would like to do this much?

Jairam Varadaraj We do have that target but I would not like to reveal those in this. That's is too confidential.

Ravi Swaminathan Regarding our new product sir, I mean oil free and centrifugal compressors, how those are seen witnessing the demand?

Jairam Varadaraj Our oil free sales increase has been very impressive in India we are now pushing to increase the sales of oil free machines outside. Our product range now is I would say 90% complete. In the next one year we would have completed the other 10% as well. So oil free screw is good. Earlier we were focused on project related business. We are trying to now also looking at one off kind of requirements. So things are positive and it takes a while for these results to come. As far as centrifugal is concerned second three-stage machine is running extremely well. Customers very satisfied by the power saving that we have been able to put to the customer. So I think we are on the right track then.

Ravi Swaminathan I mean when we look at the difference between our console numbers and standalone numbers, we see that there has been a significant improvement in EBITDA margins. As you mentioned your losses have narrowed in your international subsidiaries, which one has actually turned around very well between your Belair and patters. And have they grown and how fast have they?

Jairam Varadaraj The reduction in the losses has been more significant in Belair.

Ravi Swaminathan How much would have been the loss sir at PAT level this year?

Jairam Varadaraj I do not have the number in front of me Ravi. But in terms of improved performance has been from Brazil, we have had much better performance. We have had better performance in from Rotair, had better performance from Elgi USA in terms of lower losses. Patterns has been pretty much flat in terms of profitability.

Moderator The next question is from the line of Manish Goel from Enam Holdings, please go ahead.

Manish Goel Sir just to clarify in your initial remark you mentioned that exchange fluctuations impacted Rs. 14 crores so that was the actual impact we have seen on the translation or this is notional?

Jairam Varadaraj This is mark to market.

Manish Goel So this is on account of borrowings outstanding?

Jairam Varadaraj Well one is borrowing outstanding, duce back to Elgi on stock that is sitting there. It is receivables from our parent organization, payables that we have those are very small but that also.

Manish Goel So this have been captured under other expenses?

Jairam Varadaraj Yes.

Manish Goel So for the quarter how much would it be? This is for the full year you said?

Jairam Varadaraj For the quarter, at a consolidated level it is about Rs. 10 crores.

Manish Goel Large part of Euro depreciation as – so this is largely due to Euro, right?

Jairam Varadaraj No, no the biggest contribution has come from in the month of March I was explaining in one week the Real has depreciated in Brazil from 2.7 to 3.1. And we have a loan outstanding from the subsidiary to the parent company in dollars.

Manish Goel But how big the loan would be?

Jairam Varadaraj I do not have the number in front of me. It is about \$3 mn from HO. This is almost 3-4 years old. We are progressively using the cash that is getting generated that we are able to repay.

Manish Goel And on the sales side because of Euro related you said there has been Rs. 18 crores impact and you said contribution level impact is Rs. 15 crores, so that is also due to Euro related?

Jairam Varadaraj No, no contribution has actually improved by Rs. 13 crores.

Manish Goel Because of material cost gains?

Jairam Varadaraj Yes, variable cost reduction.

Manish Goel And sir during the analyst meet, when you were talking about outlook for overseas you said that going forward we expect 15% growth so would you probably like to comment in terms of, is it on track or -

Jairam Varadaraj In the fourth quarter I would say it is towards that direction and what is continuing on in the first two months at least on our key subsidiaries it looks positive, which we should be able to do that.

Manish Goel Okay. And largely it is seen across the presence we have like US, Europe, Middle East?

Jairam Varadaraj That is what I said the primary subsidiaries which is Elgi US, Patterns, Elgi Brazil, RotAir, and coming from a lower baseline of 2013-14 in the Southeast Asian markets as well.

Manish Goel Coming to India sir, as you have mentioned that Q4 we did better than the competition, but generally for entire year as a whole India sales are down 6-7% so the market is also down similar number?

Jairam Varadaraj I have no idea, like I said the revenue that has booked by many of our competitors is orders that they had booked for large projects in the gas and power business that got invoiced in

2014-15. So the book and bill business that happened in 2014-15 I do not see any increase in the market.

Manish Goel And employee cost increase you said one time impact is Rs. 4 crores due to gratuity -

Jairam Varadaraj Yes, and leave encashment, yes.

Manish Goel And depreciation now, what could be the normalized depreciation for the full year because you had one time impact of company's act change. So we had Rs. 36.6 crores.

Jairam Varadaraj It is about 3% I think – no, at a consolidated level we are looking at Rs. 30 crores.

Manish Goel And on water-well you did mention that sales have not picked up but what we understand is that last quarter Cummins seems to have done well on the compressor sales, engine sales to compressors. So I was just wondering that is it that the competition has done well or -

Jairam Varadaraj No, we have also done well in the fourth quarter compared to the rest of the year. Nowhere near what it used to be that is the point I am trying to make.

Manish Goel But it is not significant improvement you are trying to say.

Jairam Varadaraj No, it is not significant. Compared to previous quarter it was better.

Manish Goel And on the debt side any expectation in terms of current year what could be the reduction we can see?

Jairam Varadaraj Well we have calculated, we believe that we can reduce to the extent of about Rs. 60 crores.

Moderator We have the next question from the line of Arun Bharti from Parry Washington, please go ahead.

Arun Bharti I just have a couple of questions actually. One is how many oil-free screw machines would we have sold in India in FY15?

Jairam Varadaraj I do not have the number in front of me. I can ask Sriram to send it to you later on.

Arun Bharti Then my next question is are you seeing any intensity in terms of competition from Ingersoll Rand and Fusheng? Any commentary there?

Jairam Varadaraj Ingersoll Rand of course has been quite active in the air compressor market and we are beginning to see them more often in avid customers than we used to see them before. I cannot say the same about Fusheng. I have not seen them. We have not seen them at least.

Arun Bharti The third one is basically the bookkeeping question. If you look at the second half of last year, that is 2014-15 tax rate has been quite higher about 36% to 38%. So I just wanted to know what is the context to that and as well as for the next couple of years what should be the tax rate we should look forward for?

Jairam Varadaraj I do not have the number in front of me but I am speculating now because this year the India Tax Rate was very high because the overall profit is lower. Last year the effective tax rate of India was 19% or 20% for 2013-14. In India tax rate has come down for 2014-15 because EBITDA has dropped and we have got R&D benefit. But your question is in the first half?

Arun Bharti In the second half?

Jairam Varadaraj In the second half tax rate has gone up?

Arun Bharti Yes.

Jairam Varadaraj I will have to check that.

Arun Bharti And going forward what should be the – should we assume the marginal tax rate?

Jairam Varadaraj The tax rate that we are looking at is going forward tax rate would probably be between 28 and 33% because it depends on where we will be able to recover our losses. Now I am suspecting the part of the reason why the tax rate could have gone up in the second half is because of the settlement that came from Atlas Copco.

Kamlesh Kotak When we expect this launch of centrifugal compressor on a commercial basis may be?

Jairam Varadaraj It is kind of launched in a sense because we are now going to be selling these machines Kamlesh but letting the customer – you said the first machine is now going to be sold to a customer is run more than 10,000 hours without any issue. The second machine will probably get sold in the next few months. So in a sense we are beginning to recognize revenue but what is more important for us is to build a full range and that is going to take us anywhere between 2-2.5 years. And once we have that then we become a more credible player in that market in terms of not only the range but also enough number of installations to give the customers a confidence.

Kamlesh Kotak Okay. Sir secondly on the overseas business could you touch upon RotAir's performance particularly for this year and may be this quarter, how it has been both growth on topline and profitability?

Jairam Varadaraj RotAir grew about, I do not have a specific number but I have a general understanding, RotAir grew about 12% last year and profitability is maintained in terms of percentage. And one of the key things that we are working on in the future is to increase the profitability there, and we have already identified the opportunities. So going forward while the topline growth will continue to happen, may be not at 12% but somewhere between 9% to 10% we will be focusing more on increasing the profitability of RotAir.

Kamlesh Kotak And thirdly sir on the overall overseas business if you have to see it this year, can we do a positive a PAT as an overseas business entity as a whole, Rest of India if you take as one lot, can we see positive number to that on the bottom line front net of all the entities?

Jairam Varadaraj Last year at EBITDA level we have done positive Rs. 6.5 crores EBITDA. Rs. 6.5 crores is the EBITDA from our international business consolidated across losses, profits everything. The depreciation in most of these is very low. So at a PAT level I would think that we are very close to being positive.

Kamlesh Kotak Because sir what I am just doing is from the console if I subtract the standalone number and the ATS number, the number comes to roughly around Rs. 27 crores odd of loss which was Rs. 40 crores plus last year.

Jairam Varadaraj I will need to look at that Kamlesh but what I am saying right now is what I said in the analyst meet. If you look at the EBITDA stack up what we did during the analyst meet is India being flat we will be able to cut our losses from many of the larger subsidiaries, improve the profitability in some other key subsidiaries and therefore today at an EBITDA level I think consolidated is about 7% or something like that. That could go easily to about 10% and 11%.

Kamlesh Kotak By what timeline we can see that?

Jairam Varadaraj I am talking this year. That is what I presented in the analyst meet.

Kamlesh Kotak And sir about the domestic business you said 25% would be our aftermarket, out of the risk can you quantify between product and project how it has been for us?

Jairam Varadaraj Project business in 2014-15 has been about 8% to 9%.

Kamlesh Kotak Of the overall business you say or of the 75%?

Jairam Varadaraj About the overall business.

Kamlesh Kotak So rest 60% would be products is what my sense is.

Jairam Varadaraj Right.

Kamlesh Kotak And overseas wise I understand the breakup. Do you have some sense in terms of how that would have been because we would not be that much on aftermarket overseas business.

Jairam Varadaraj Overseas after market is if you remove Patterns, because Patterns is a very after-market driven business. So if I take that out because that creates a huge queue. The average after market for the rest of businesses would be less than 10% and that is the opportunity for us to grow and our focus for us to grow.

Kamlesh Kotak Any further questions moderator?

Jairam Varadaraj I have some closing remarks to make. I just wanted to – the new SEBI Insider Trading Act has been implemented from the 15th of March and this was taken up quite seriously in the last board meeting. One was there was a compulsion to take past resolution adopting the code of conduct prescribed by SEBI for insider trading and provisions of that are pretty significant. I am not sure if all of you have had an opportunity to review it. The board debated and since we are responsible for managing to a significant extent any violations pertaining to this code we have had to now pass a resolution in terms of how we will engage with the public at large especially with relating to unpublished price sensitive information. Today we have three methodologies by which we engage with analysts and investors. One is post quarterly meeting conference calls like this one. The other is our annual analyst meet in our factory and the third is individual meetings that specific analysts have been asking but for the last six months we have been avoiding it specifically on informal advice that we have received from SEBI. Going forward we have been advised legally that any such meeting request has to be done only in the form of questions that are sent upfront. And such of those questions that are price sensitive in nature cannot be answered by the company. And that will be communicated and only on that basis further meetings can be held. So this is a resolution that has been passed by the board and we will circulate this to all the key analysts who have been participating in the various conference calls and I request you to help us because the laws are quite draconian and the consequences are severe. And we need to make sure that our processes are all very transparent. So thank you.

Moderator As there are no further questions, I would not like to hand the floor over to Mr. Kamlesh Kotak for closing comments. Thank you and over to you sir.

Kamlesh Kotak Thanks. On behalf of Asian Markets I thank everyone for joining for this call. A special thanks to Mr. Jairam and his team for providing us insight about the company's business and financial performance. With that we conclude the call. Thank you and have a good day.

Moderator Ladies and gentlemen, on behalf of Asian Markets Securities Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.