



“Asian Markets Securities Conference Call”

April 13, 2020



**SPEAKER: MR. JAIRAM VARADARAJ – MANAGING DIRECTOR,
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MODERATOR: MR. KAMLESH KOTAK – ASIAN MARKET SECURITIES

Moderator: Ladies and gentlemen, good day and welcome to the ELGi Equipments Limited Conference Call hosted by Asian Market Securities. 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. Please note that this conference is being recorded. I now hand the controls over to Mr. Kamlesh Kotak from Asian Markets Securities. Thank you and over to you sir.

Kamlesh Kotak: Thanks Iysha. Good morning everyone. We welcome you all to the conference call of ELGi Equipments Limited, to have an update on the company’s business operations post outbreak of COVID 2019. We have with us today Mr. Jairam Varadaraj, Managing Director of the company. I request Mr. Jairam to provide us an opening remark regarding the business updates and posted which we shall begin the Q&A session. Over to you sir, thank you.

Jairam Varadaraj: Thank you very much Kamlesh and ladies and gentlemen, good morning to you. Appreciate the time that you’ve taken to participate in this call. I would like to give you a little bit of what has happened so far in the company and what we are anticipating and what kind of plans we are looking at. What are the challenges that we will face that could be unique to ELGi and what are the positives that are unique to ELGi that we are also looking at? So when the shutdown happened in March, we lost close to half the month revenue and as a consequence, what we had presented as an anticipated EBITDA in the last investors meet in February. We probably will miss that to the extent of between 10 to 15%. So that’s the reality, I don’t want to talk specifics till such time we have finalized and audited the numbers and presented to the board. So, rough direction is we are not going to be, we are not meeting the EBITDA that we had projected in the investor meet, but we are not very far away from that.

Now, when the lockdown happened, we had to take stock of how we visualize the world in the future, not just India, but the rest of the world because considering almost half of our revenues is outside. It was a very difficult situation because what to anticipate, how extreme will the situation be and how long will the situation last is something that we really had to go through individually in our businesses individually in each of the regions collectively through all the leadership team and we arrived at a certain view of the future that is probably about two weeks old. Now, basis that view of the future, we started taking initiative to bring our cost under control. And the goal was to manage the business for cash and ensure that the company remains financially strong as it transits through this period which is again, what is the extreme level what is the extent of the impact and how long the impact this is something, as the months roll by we will be able to, we will realize the actual, today it is all hypothetical and we are looking into the future with certain assumptions. Now, we have also creating a model by which we are able to quickly react to changing situations that are different from what we have anticipated. So, those models are in place, we believe that the speed and agility with which we will respond to situations that are very different than what we had anticipated is also there. So, these are some of the things that we have put in place, action has already been started, it has been started all over the world. In some countries, the governments have initiated subsidy programs for protecting job we have already enrolled in such of those countries that have enacted in such of

those other countries that are in the process. As soon as the clarity comes in, we will enroll ourselves what will be the benefit that we will get from all these legislations and subsidies, it's still very early. We will try to provide updates as and when a significant number of these things get crystallized. So, this is something that we are parallelly pursuing. Now, if you look at what is the challenge, that is that could be peculiar to ELGi, is you will have to look at it from the psyche of people worldwide in the context of this virus. Today, the psyche is extremely negative. People are wondering, how long will this last, and how extreme will this impact and nobody has an answer for either of these two dimensions and therefore, because of that high levels of uncertainty, the psyche is very, very negative. And our anticipation is as long as the psyche is going to be hanging over the heads of people, consumption is going to be reduced to the bare basic people are going to conserve cash. Now, when that happens, it will trickle down all the way. And which means nobody is going to be looking at either upgrading their facilities or enhancing their capacity and our business is dependent on upgrade and enhancement of capacity. So, when those two dimensions are going to be very subdued, we expect that the level of activity that we will experience for our products in the market is going to be extremely subdued. The plus side of that is considering that and this is really going to help us in a very significant way compared to other companies in India, which are very India centric. Assuming that all the economies in the world are going to operate at a very miniscule level of what they were in the past. We will be participating in those miniscule activities of all those countries, which means we will be able to bring in revenue that is not just centered around India but also around the other country. And as we speak, India is the only country that has locked down the country to the extent that it has. All the other countries have not locked down to this extent, in fact, even as we speak, our factory in Italy is still working. Our people in all our sales organizations in Europe and America, Australia, Indonesia and Brazil, they are still engaged with customers and we are still getting orders from customers in these countries to our subsidiaries. Even in India in some critical industries, like pharma and food which has to contribute to the current condition. We are able to conclude orders working from home. So we have all these things that are positives that are happening in ELGi. So, I think at this point in time, we have taken a certain view of the future to the best of our ability in terms of what will be the severity of the impact and what will be the duration of the impact. And basis that we have taken the initiative to rein in costs. And at this moment, we are managing the business for cash and what we have planned will keep our head above the water as far as cash is concerned.

Coming to our debt position from what it was in February, our debt levels have actually come down but as the months roll by without revenue. There will be some challenges in cash especially when customers don't pay us the receivables are going to get sticky and inventory which was there for prior levels of revenue are going to take a little longer to liquidate but nevertheless there will be liquidation of inventory. So while there will be transitions of cash flow challenges on an annual basis, we believe that we are in a reasonably comfortable situation, I don't see any significant challenges to our debt levels. Our term loan repayment schedules for 2021 are only about 16 crores. There are two installments that are due one in Italy and the other one in Australia. And we are well protected in terms of our ability to repay these loans, so I don't see any problems there. So this is a broad summary of what the situation is, what we have

anticipated, and how we have plan so there are any specific questions I'll be happy to answer them. Thank you so much.

Moderator: Thank you. We will now begin the question and answer session. The first question is from the line of Kashyap Pujara from Axis Capital. Please go ahead.

Kashyap Pujara: Clearly I understand and appreciate the need to conserve cash and cut costs. But to ask you a very pointed question, would it be fair to assume given that we are in lockdown mode in this quarters, what should be lost and things will take reasonable period of time to come back to normalcy. And globally, also, things are looking pretty bleak. So would it be fair to assume that we should be now looking at a 50% drop in revenues in this year with virtually, no profit kind of a situation or could we potentially slip into red as well?

Jairam Varadaraj: So, I don't want to, we have done a scenario plan Kashyap I don't want to get into the specific details by product verticals and regional verticals. So we have looked at a revenue drop anywhere in the range starting from 20% all the way up to 50% depending on products and region. So basis that we have, when we look at the bottom line, we are bottom line is still I wouldn't say it is still black, it is marginally red, but it's not significantly that it's very marginal. So, that is one part the point but we are doing also is we are saying that this is the scenario, but the actions that we have taken they are moderated rather than extreme. So we are taking these actions in steps rather than trying to take an extreme step which could destroy the morale, the psyche and everything in the organization and create a permanent damage. So, to avoid that what we are saying is, this is a scenario we have planned, we have taken some action that in April, we are going to watch how the situation unfolds. And if the situation is better than what we had anticipated, we will continue with those actions. If it is worse, we will cut deeper. So we have some arsenal's that are available to roll out and increase the intensity of our actions as the reality becomes a lot clearer.

Kashyap Pujara: And just to ask another question for on the overseas operations would you be, are there any layoffs or are they having salary cuts at different levels how are we kind of looking at that thing?

Jairam Varadaraj: So, as a principle, we looked at two things. Like I said, the first level of action, we said, we will protect jobs and the financial security of people in the lower levels of the organization. So, this is the first level action that we have taken. Basis that people above a certain level there is a deferment of salary, we have not cut the salary, yet we are deferring it, which will be compensated over a period of three years. When the situation improves. Now, this is the first level if it continues to be at or better than what we had planned, we will remain at this level, but if it gets worse, then we need to trigger, we need to go lower in terms of the levels. We have to go beyond deferment into actual cuts. And if it gets even worse, then there will be reduction in jobs. So we are looking at multiple levels of initiatives and trigger them as and when the situation emerges. We don't want to go to the extreme and then create a permanent damage to the organization.

- Moderator:** Thank you. The next question is from the line of Aditya Bagul from Axis Capital. Please go ahead.
- Aditya Bagul:** Sir couple of questions. Can we talk a little in terms of our fixed costs in various geographies? What is the kind of impact that we see there and you mentioned that there is a chance you can slip into red this time around. So if you can talk about a little in terms of your non-employee overheads as well and what are we doing there?
- Jairam Varadaraj:** So, for the non-employee overhead Aditya we have looked at, we have gone back to zero base, not only have we looked at zero base we have looked at the assumptions based on which we are incurring certain costs. So, all this has been tapered down significantly in relation to our anticipated revenue level. So, there is a significant reduction in all these costs that are anticipated as it is, so right now, all those costs are pretty much close to zero, right except power cost that we have to pay certain statutory expenses, rest of it is all because in India there is no activity, in the rest of the worlds also, where cost has been pruned down to the basic level of what the activities and in fact disproportionately it has gone further down in relation to the drop in revenue. So, this is how we are going back to individual items that constitute 85% of our other than people cost. And we are taking a zero based approach to re-reconstructing these costs in the current context.
- Aditya Bagul:** Sir and the second question, just wanted to get a little bit of your thoughts, while we may have clear issues with regards to our product. This could be an opportune time to push our service business in various geographies. Just some thoughts around that would be quite helpful?
- Jairam Varadaraj:** Aditya you need to speak up a little bit more. Can you repeat that, please?
- Aditya Bagul:** I'm sorry, I hope I'm audible now. So, what I was saying was that, well there are clear challenges with regards to our product business. This might be an opportune time to push the pedal in terms of our service business. If there's something that you would like to comment on that please?
- Jairam Varadaraj:** If you look it up in India, obviously that is not possible, except where we get special permission for manufacturers who are doing essential products, but that's a very, very **(Inaudible) 18:27** lever. But everywhere else, where the markets are still functioning, we are seeing a significant level of service business compared to our product. So even when India opens up, we expect that the aftermarket business be to be a lot stronger than the product business because whatever level of economic activity that will be there in a country to sustain that economic activity, there has to be a certain level of maintenance of compressor. So we think that, that will be the aftermarket will be a bigger chunk of our expected revenue than the product.
- Aditya Bagul:** Just last question on data point, just wanted to understand if we are looking at the inventory right downs or higher holding cost of inventory, many of these over a period of the next few?
- Jairam Varadaraj:** The quality of our inventory in all almost all the locations are very good as each other so we don't see any need to write down any of these inventories.

- Aditya Bagul:** I was referring more in terms of the holding cost and if you would believe that a particular product may not sell in a particular geography and hence will have to be transferred, something on those lines maybe?
- Jairam Varadaraj:** No, we don't have inventory of that kind at all, most of the inventory that we have in all of our locations are moving inventory. And they are not so esoteric that in terms of their demand, so the inventory profile is pretty solid.
- Moderator:** Thank you. The next question is from the line of Manish Goyal from Enam Holdings. Please go ahead.
- Manish Goyal:** Sir, just to take it forward on the cost cutting. So you did mention that on non-employ overheads we have cut the cost. So, like you had shared certain number during the last meet. So, how should we look at it that at least on base case, what is the level of fixed costs we have cut and maybe going forward what is something which you will be able to cut and sustain the operations like, is it that your fixed costs are cut by 15, 20% or how much if you can give us some sense on the base case and maybe the reasonable case going forward?
- Jairam Varadaraj:** So, based on whatever we have projected, we are looking at both people cost and fixed cost reduction in depending on geography, from anywhere from 30%, from anywhere between 12 to 30% is the reduction that we are seeing across various geographies, both on combined between people and other overheads.
- Manish Goyal:** And this would be visible from the current quarter itself sir?
- Jairam Varadaraj:** Absolutely, because some of these costs have already been initiated and in India, of course the other fixed costs are already nothing in terms of, literally nothing because we are only paying whatever is there to statutorily has to be paid. Other regions that other countries that are running, they're running at very skeletal levels, so, the other fixed costs are going to be very low.
- Manish Goyal:** Sure, okay. And also like, so you did mention that Italy factory is operating right now. So like at international level, what is the level of activity is it at 30, 40% of your normal or how is it?
- Jairam Varadaraj:** I would say it again varies from country to country Australia activity seems to be higher than Europe, Europe seems to be higher than America. So India, of course, India I would say it's not zero, we have got permission, special permission to operate the plant with skeletal people only for our export. So there is some activity here in India as well. But whereas our model assumes it's zero for the first few months.
- Manish Goyal:** Okay and are you probably reviewing your plants, especially if you're under Europe in terms of we were already hiring additional people on the front end?
- Jairam Varadaraj:** We have frozen, all those the new hires Manish. So what we had presented in our investor thing in terms of additional costs that we are looking for in Europe for the next year because of

additional headcount that has been stopped. So that's not going to be there, in addition to that, we are also looking at reduction in cost people.

Manish Goyal: Even in Europe sir the recent hire what we have done?

Jairam Varadaraj: Yes, all over the world. And like I said, there are various governments are at various levels of enacting, job protection legislation. and as an when they are done we will take those into account as well.

Manish Goyal: Okay. And last question like in terms of being in India, what are your expectations in terms of from the government from say, any package on economy revival or anything like do you think that what do you think, what are your thoughts on that?

Jairam Varadaraj: Right now the main thing is to ensure that people's jobs are protected and financial security is ensured, if that is removed then economic activity is going to get even worse, right? So in direct measures, like investment in infrastructure, which will trickle down towards employment, those are all things that are not going to help us now. We need direct measures, and reducing taxes would be the wrong thing to do, because I don't think tax saving in this scenario, is the right thing. So therefore, the government's approach should be to say how to protect jobs and to protect the financial security of those jobs. Right, so the problem is how do you make it happen but that's the challenge.

Moderator: Thank you. The next question is from the line of Shrey Loonker from Motilal Oswala Asset Management. Please go ahead.

Shrey Loonker: Just wanted to know that your thoughts on looking past this one year that we are in right now, which is very unforecastable. If you were to just take a three year view, where you think your growth prospects will be better will it be India or will it be the exports?

Jairam Varadaraj: Very difficult question to answer, because it is a function of what each country is going to do to revive the economy, right. So, at this juncture, it's very difficult to say but I think the impact my expectation is the impact in India could be higher than the rest of the world.

Moderator: Thank you. The next question is from the line of Ravi Swaminathan from Spark Capital. Please go ahead.

Ravi Swaminathan: Sir an extension to Mr. Manish question. So basically, the spend that we were talking about cumulative is close 150 crore in Europe over the next three years. Are they all at hold or is it like, probably for a year and then we might?

Jairam Varadaraj: No, whatever the headcount that we have already taken on board day that cost is not going to go. The cost is going to go down, but that full amount is not going to go away, right. But additional that we had looked at close to about 30, 18 crore of additional headcount that is not going to happen.

- Ravi Swaminathan:** And in terms of the demand environment in US, etc. Obviously it's early days, but how is it panning out normally? Is there any attraction at all for patterns and Michigan Air?
- Jairam Varadaraj:** Yes like I said Ravi, there is still activity of both service and tail of equipment happening in the US. As compared to zero or literally zero in India except for the export consignments that we are sending out.
- Moderator:** Thank you. The next question is from the line of Susmit Patodia from Motilal Oswal Asset Management. Please go ahead.
- Susmit Patodia:** Sir these two questions. One, I wanted to understand just from a global landscape perspective. Do you think China will lose out even in this segment or this segment could be immune from this entire backlash against China that we have seen? And hence it can benefit us from a bigger export opportunity?
- Jairam Varadaraj:** See, let me rephrase the question. Are you looking at, are you asking what will be the impact for China in compressor business, is that what you're saying?
- Susmit Patodia:** No, sir. Just from a manufacturing perspective, would they'll be certain customers who were, let's say buying from China if they were will now start looking at India as an option?
- Jairam Varadaraj:** It's a much larger Canvas, I will try to explain it in bits and pieces. In terms of our own strategy, we have taken a decision that we import very little from China. But we have taken a decision that strategically this is a risk. And therefore, over a period of time, we will develop alternatives by which we reduce or eliminate the dependence on China. That's ELGi perspective. Assuming that a lot of companies are thinking like ELGi, there could be an opportunity for companies outside of China to become the points of source for these companies that are looking at it. But that's not going to happen immediately because changing a vendor base for critical parts cannot happen overnight. That is point number one. So, I do see a change and an opportunity coming in. Second is the whole world has to look at China, in terms of the reason why China became the global source for the whole world is because the efficiencies and the infrastructure that they offered to anybody who wanted to source from there. The ability of competing countries, whether it is India or Vietnam or anywhere else to provide that is going to be a lot less they're not going to be able to match that. So companies have to take a conscious decision that from a risk mitigation point of view, they will switch their supplies and assume the inefficiencies and accept those inefficiencies as a cost for de-risking their entire supply chain in the context of what has happened. So there will be a lot of shifts, but I don't see the shift happening very quickly but definitely there will be opportunities that come out of it.
- Susmit Patodia:** And sir what percentage of compressors will be made in China. Just a broad number?
- Jairam Varadaraj:** Well, China is the single largest market, domestic market for compressors in the world. Now and quite a bit of it is supplied by local Chinese companies. They will try to see once the demand in China goes down they will try to see whether they can sell more outside the country, outside

China. So there will be a lot more of these Chinese companies coming into global markets. But to build those global markets for a capital goods a critical capital goods is very difficult. You look at our own experience, it's taken us a long time to establish ourselves in developed markets like Europe, America and Australia. So a Chinese company to come in and turn the switch on overnight, it's not possible. So, I don't see that as a big threat at this point in time.

Susmit Patodia: And sir second question, maybe too ambitious for me to ask but I will still attempt is that the whole 3000 crore top line. Have you done any scenario analysis as to how far that gets pushed out now?

Jairam Varadaraj: So like I said in the beginning of the thing we have looked at, scenario plan at a product level and a regional level and we are looking at a drop in revenue anywhere from 12 to 50%.

Susmit Patodia: That's for this year?

Jairam Varadaraj: Yes.

Susmit Patodia: That's what this year?

Jairam Varadaraj: Yes. And what about the long range plan that you had presented to us?

Jairam Varadaraj: So our plan is based on the assumption that we will get to January, February levels of this year, by March, April of next year. That is the plan at the moment. But we will see how it evolves, it's very difficult to predict the severity of the impact and the time duration of the impact.

Moderator: Thank you. The next question is from the line of Bhavin Vitlhani from SBI Mutual Fund. Please go ahead.

Bhavin Vitlhani: My question is, if you can just guide us on what's the aftermarket revenue for ELGi. And in the conference calls, Atlas Copco also mentioned that this has been impacted given that this cannot be controlled remotely and people cannot go and work at the site. So you can give some flavor on the aftermarket side of the business?

Jairam Varadaraj: See like our aftermarket as a total percentage of our revenue is at around 20% odd. Now if you look at India alone, it is much higher as a percentage of our India revenue. I don't want to talk about the specific percentages. Now when the economies come back up, I expect that the demand for aftermarket will be a lot more than the demand for products because companies are not going to upgrade their facilities with new compressors or nor are they going to add capacity in this current scenario. That being the case, whatever factories have to run they need maintenance and part. So, I expect aftermarket to be leading the recovery rather than product. But in the current situation, where it is a complete lockdown in India, we are unable to get the permission to go but wherever, whichever customer of ours is coming under the essential goods for the making medicines and stuff that are required for this current crisis. We are able to get the permission and render a little bit of aftermarket support. Whereas in other markets like Europe or Australia or America, there is still aftermarket that is being done but nowhere near the level it was before.

- Bhavin Vithlani:** My second question is on the package. So in the previous call, you mentioned that the compressor which goes for the medical was impacted, or given the current situation do you believe that has now bounced back?
- Jairam Varadaraj:** No, I didn't say medical was impacted. In fact, I was saying that we are able to close orders in the medical sector that means they are still buying, and patterns medical which supplies equipment for hospitals in the US. They they've had some pretty they've had significant inquiries and activity level.
- Bhavin Vithlani:** Sure. My last question is on the fixed cost, except the employee cost when I'm looking at the FY19 balance sheet, out of the 300 odd crore of other expenses. 180 odd crore looks to be the fixed cost and off that 48 crores was legal and consultancy charges. Would you be able to cut down on this in a considerable way and bring down the fixed cost level, or if you can give a flavor of by what level can you bring down the 180 odd crore or fixed cost?
- Jairam Varadaraj:** So, you are talking now standalone right?
- Bhavin Vithlani:** No, consolidated other expenses is about 300 crores in FY19. That's the balance sheet we have currently. So significant part of that cost there were large chunks of cost that we had paid to BCG both in India and in the US, which is over now, there is no cost anymore. So, under the legal and consultancy, a big chunk of it was that I don't have the specific numbers in front of me all that will be zero. In addition quite a bit of our other legal and consultancy expenses are also going to be zero. So, in terms of reduction in other fixed costs, like I said, it varies geographically it is anywhere from 12 to 30% odd.
- Bhavin Vithlani:** Okay. And this 12 to 30% is X of the variable fix cost just as a clarification?
- Jairam Varadaraj:** No, this is fixed cost I am talking about.
- Bhavin Vithlani:** Understand. Third is, are we changing any course on our product development for that goes unabated?
- Jairam Varadaraj:** All of our strategic initiatives in terms of technology, product cost reduction, quality improvement, they're all continuing without any lack of commitment or a reduction of commitment in both directions.
- Moderator:** Thank you. The next question is from the line of Jay Daniel from Entropy Advisors. Please go ahead.
- Jay Daniel:** Sir. You had said 50% of our revenues come from India. How severely compromised do you think our Indian revenues are going forward. I mean, vis-à-vis the international revenues how soon do you expect it to pick up with vis-à-vis international, if you could give a broad sense of that?

Jairam Varadaraj: We have planned that April and May will be a wash. This is how we planned it. And we are expecting marginal recoveries from June onwards getting back to our January, February levels of revenue by March, April of next year. Now, this is the plan that we have made and that converts to approximately if I annualize the numbers for 2021 for India, it comes to about half the current revenue.

Moderator: Thank you. Sir we don't have anyone in the queue, should I give more reminder?

Kamlesh Kotak: Yes, any further questions?

Moderator: No, sir we don't have anyone in the queue.

Kamlesh Kotak: Okay. So with that we conclude the call. Jai, any closing remark you want to make?

Jairam Varadaraj: The only remarks that I want to make Kamlesh is, the, the situation is very uncertain. So, I'm unable to make very precise statements about the future. But, what I wanted to assure everyone is we have taken a sufficiently pessimistic view of the future and started working on cutting our costs that are in line with that realistically pessimistic view. Now, while doing that, we are also saying let us temper the rolling out of these initiatives so that we don't destroy or permanently damage the company. So is a very close review that we are doing to see what is the emerging reality. And as and when the reality emerges, we are able to quickly move to calibrate the initiatives and cost reduction programs that we have started. So this is really what we can do at this point in time.

Kamlesh Kotak: Thank you sir. It was very insightful for you to provide us the data on the business operations and the impact of COVID-19. With that, we conclude the call. Ladies and gentlemen, thanks for being on the call. Have a good day.

Jairam Varadaraj: Thank you Kamlesh, thank you, everyone. Have a good day and be safe. Thank you.

Moderator: Thank you. On behalf of Asian Market Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.