“Elgi Equipments Limited
Q1 FY2021 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to Elgi Equipments Q1 FY2021 Earnings Conference Call hosted by Asian Markets Securities Private 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 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 from Asian Market Securities. Thank you and over to you Sir!

Kamlesh Kotak: Good day everyone. On behalf of Asian Markets we welcome you all to the Q1 FY2021 earnings conference call of Elgi Equipments Limited. We have with us today Mr. Jairam Varadaraj, Managing Director representing the company. I request Mr. Jairam to take us through an overview of the quarterly results and then we shall begin the Q&A session. Over to you Sir. Thank you.

Jairam Varadaraj: Thank you Kamlesh. Good afternoon ladies and gentlemen. Thank you for your time to be in our call. As is our normal practice, I will take you through the financial performance and then talk a little bit about the business situation. Focusing on our consolidated numbers for the quarter in comparison with the same quarter of last year, we had a revenue drop of close to Rs.180 Crores and just as a quick summary, we will talk more about this. The biggest drop obviously was in India, the positive thing is all the other geographies did very well consider the situation. I will come back and talk about it. I will focus now in the EBITDA bridge.

So if you look at the drop in sales was quite significant, on the other hand our contribution percentage is significantly improved almost to the extent of 2% and I will come back and talk about that also the causes are for that. Net-net, our EBITDA should have been a negative Rs.41 Crores, in reality we made a positive EBITDA of Rs.60 Crores which means we have been able to improve to the extent of almost Rs.47 Crores. Now the biggest contributor to that better performance under these circumstances is our variable cost, our contribution margin on variable cost on sales was actually 10% better, at a total variable cost, our contribution margin percentage were far better on sales, so that was the significant contributor to a relatively better performance under the circumstances. Our employee cost was lower to the extent of almost Rs.14 Crores and that had multiple dimensions to it. In India, our employee cost went down by Rs.14 Crores and the major contributor to that drop has been where we were able to reduce our number of contractors during this period, contract employees. We have changed our leave structure permanently, we are no longer allowing encashment of leave, so to that extent we have not provided for that amount and that we have asked employees to take leave rather then encash it and we have also reduced the performance pay because of the current situation, so all that contributed to close to Rs.14 Crores reduction in employee cost in India.

The employee cost compared to the previous quarter in Europe and the US was higher, it is not that we have added more in this quarter, it is just that more people were recruited in Europe as part of our strategic initiative in the second, third and fourth quarters of last year which was not there in Q1 of last year, so that kind of balanced out. The interesting part is in the US and Australia, we received subsidiaries from the respective governments to the extent of almost $3.3 million of which in this quarter we have used up $1.9 million towards job protection programs given by the two governments of US and Australia and that added up to another Rs.14 Crores, so net-net if you look at the total employee cost, it went down by about Rs.14 Crores and in addition to that our other fixed cost has come down by almost Rs.19 Crores and across all we have been able to come down strongly on our cost management, some of the cost reduced automatically under the circumstances of lockdown on restriction of travel, travel cost has been almost zero, very negligible that is not something that we did that was the circumstances, but on many things on repairs, on rentals, there has been active cost management by the team and as a consequence we have been able to reduce cost by about Rs.19 Crores, so net-net we have been able to through variable costs, a reduction with better contribution over variable cost, reduction in employee cost and other fixed cost, we have released close to Rs.47 Crores of cash and that is the one that is contributed to a positive EBITDA of Rs.6 Crores under these very difficult conditions.

I will now talk a little bit more about the sales performance that I talked about. It has been very interesting for us. The US and Australia which are two strategic markets, it is very heartening to see that the sales performance was almost the same as the previous years quarter. India was a washout, April was a washout for us, started improving from May and it was good in June as a consequence for the quarter, we were close to 60% lower than last year. In Europe, Italy was lockdown for most of April because of that ROTA had got affected, but non-Italian performance of Europe is actually 4% better than last year, so we have actually all our strategic markets that we have invested in over the years, it is helping us under these circumstances. So this is a very interesting situation for us, very positive situation. In the first quarter of this year, India has contributed to about 40% of the revenue whereas the rest of the world has contributed to 60% this is the first time there has been significant shift in the contribution of our global markets to the revenue of the company.

Now moving onto the debt position, we have done exceedingly well, our opening debt in the first of April was close to about Rs.260 Crores, today our debt is hovering around Rs.200 Crores, so we have substantially reduced our working capital and this is something that I expect will continue to be even when business comes back to normal because some of the things that we have done are fundamental or not by virtue of a drop in revenue, we have managed our receivables far better and we have managed our inventory far better and definitely we will continue to do this, so our cash position is extremely positive at this point in time.

Now if you look at our standalone results, actually at the EBITDA level, our standalone EBITDA is high, it is a negative whereas consolidated EBITDA is positive. This is again an indication of the strength of the business and the company strategic investments to grow international business, so this is a very positive thing and strategically aligned to the future of the company. You will notice that there was a tax situation in spite of consolidated PBT being negative and that is because the consolidation of taxes does not happen across geographical entities, there are some geographies where we actually made profit and therefore they were tax paid there and there are some geographies where we have made losses so at a consolidated level, it is a little distorted under the circumstances. So this is really the summary of our performance. I will spend a little bit of time talking about the overall business situation.

Like I said, Australia has done well for us. They are very close to last year, they have grown very well, so it is a very positive thing. South East Asia continues to be a challenge, it is very similar to India.

Coming to India, April was a washout except for we ran the plant with skeletal staff just to support our subsidiaries, so otherwise business in India in April was almost zero. It started picking up in May, did well in June and it continues to look quite positive. When we started the quarter in India, we thought like everybody else that there will be only sectoral activity like in food and beverages, pharmaceuticals, chemicals, some of the essential products, but to our surprise we are seeing sales activity across the board, across all industry vertical and we are in the middle of reaching out to customers to understand what are the key demand drivers for our customers, so that we are well prepared for the rest of the year. So it is a very positive situation that we are in even in India in spite of April and May being quite weak. Middle East similarly was the same situation, April and May was weak, it is coming back up, Europe has been exceedingly strong for us except for Italy in the month of April everything is coming back and we expect to continue to grow as per our strategic plan for which we had invested quite a bit of money over the last year, year-and-a-half.

US has been very strong, like I said they have almost at last year's levels of revenue. All the businesses have done well, it is not just any one particular vertical, our portable business, our patents activity, Michigan Air as well as LG Direct, they have all done exceedingly well, so under the circumstances I would say though the revenues look quite low, the fag end of the quarter is really the indication of what to expect for the next year and that looks quite positive. As we speak July was a very positive number and based on that we expect a second quarter to be very close to what we did in the second quarter of last year and we expect that a cost containment that has happened to continue into the second quarter as well. So this is really the summary of our business and financial performance and I will wait for questions to provide specific clarification. 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 Ravi Swaminathan from Spark Capital. Please go ahead.

Ravi Swaminathan: Good afternoon. Thanks for taking my question. You had highlighted that food, pharma etc., were doing well in the domestic market, if you can touch upon how infra segment, water well even large industries like steel cement, how they are doing and if you can touch upon the other segments also qualitatively if you can do or they on par with last year or they below or above that it would be really great Sir?

Jairam Varadaraj: Ravi, I did not say that food, pharma are the ones that are doing we started the year thinking that is how it will be as with everyone in the rest of the country, they were thinking only these essential services will be firing, but to our surprise across the board we have seen investments happening by our customers right. Now the only difference I can say is large projects are almost no activity is there, but small incremental capital investment, balancing investment is very strongly there in the country and that is what we are seeing, because compresses are not large investment, but they sometimes go into large investments like a new power plant or a new steel plant, those activities are weak whereas the regular investment by an automative component manufacturer or an automotive, it is all quite strong.

Ravi Swaminathan: Got it and in terms of pricing so basically has there been any disruption in terms of pricing, have competitor cut prices during this period or it is just wait and watch and people maintaining price during this phase in the domestic market I am asking?

Jairam Varadaraj: We do not see any pressure on our pricing so far, anything that is significant and worrisome.

Ravi Swaminathan: Got it and with respect to international geographies will you be continuing spends in Europe as you had mentioned in the analyst meet close to around Rs.160 Crores, Rs.180 Crores over the next three to four years suck kind of spend is likely to continue or we will re-look at it and take a pause?

Jairam Varadaraj: No. We have slowdown some of the incremental spend that had got beyond what I had already gone in March, we had passed all that, but the cost like I explained the invest, this is the organic incubation, this is not an acquisition where we have invested in building a team of people to pretty much do business in almost every geography in Europe except Germany right, so that salary cost continues and the benefit of that they are beginning to realize now.

Ravi Swaminathan: Got it, but that Rs.160 Crores, Rs.180 Crores that will stay or it will be cutdown a bit, how is it Sir?

Jairam Varadaraj: Still early to say right now we have paused it in terms of not doing fully, but we will wait to see how the trajectory of growth is continuing, if it continues then we will selectively release some of those cost.

Ravi Swaminathan: Got it Sir and my last question is with respect to debt levels you had told current debt has reduced to Rs.100 Crores vis-à-vis Rs.260 Crores in the beginning of the year, what is our net target by FY2021?

Jairam Varadaraj: Ravi, at this point in time, I am very hesitant to give targets, because it is all a function of how the markets holds right, if they continue to hold at the level that they did in June and July, we are quite confident that we will be at a lower than Rs.200 Crores at a worst case.

Ravi Swaminathan: One small clarification you had mentioned some subsidiaries for employment which we had used it up this quarter, what is it this regards to local employment?

Jairam Varadaraj: US government and the Australian government provided certain subsidiaries for protecting local jobs and our subsidiaries were eligible for that, so we applied for it and we got qualified and we have got the money.

Ravi Swaminathan: Is it per head of employee as a proportion of the salaries they get or how is it, just wanted to get a sense?

Jairam Varadaraj: Different countries have different schemes. In Australia, a certain value per employee provided you are able to continue to hold them in employment and in the US also a significant part of it is towards employee cost, but they have also allowed for certain other cost like rental.

Ravi Swaminathan: I will come back in the queue Sir. Thanks.

Jairam Varadaraj: Thank you. The next question is from Renjith Sivaram from ICICI Securities. Please go ahead.

Renjith Sivaram: Congrats for good set of numbers given the challenging environment, it is good to see. One thing which we discussed during the last call was 20% target of reduction in overhead I think first quarter we have achieved our bit so, do you expect to continue with this run rate and is there any cut in the salaries of the overseas employees?

Jairam Varadaraj: So our fixed cost other than people cost has reduced by almost if I have to calculate quickly the percentage is almost by 40%, so like I explained part of this is because of business situation like travel, travel was a big part of our expense in other fixed cost that is almost negligible now, so once the business picks up some amount of travel will be necessary it is very difficult to estimate that, so whether we will continue to retain 40% throughout the year is difficult to say, but 20% reduction is certainly definitely possible on the other fixed cost besides people cost. Now as far as people cost is concerned, at the moment unlike other companies in India, we have not cut salaries nor have we cut headcount this is on the belief that we have responsibility to ensure that the financial well being of people under these circumstances are protected. But having said that we will wait to see whether the trajectory of growth that we are seeing continues and if we are confidence that we will get back to the normal run rate of last year, we will not touch it, but if there are indications that we are not moving towards the trajectory, we will certainly examine to see where all we can take cost out on people cost.

Renjith Sivaram: Okay and Sir we are seeing anti-China sentiment across the globe, so Australia is one big market where there is a huge sentiment against Chinese, so how bigger Chinese compressors in the Australian market and do you see any advantages because of that in those kind of market even in Europe?

Jairam Varadaraj: Globally Chinese compressor manufacturers other than in China have a very small share of the global market right, so we do not see any significant impact of this anti-China sentiment. Nevertheless for this anti-China sentiment to take route and cause some fundamental shift will take time, I do not think it is going to happen in a hurry.

Renjith Sivaram: Okay and in terms of the segments like the monsoon has been good so are you seeing signs of water well market picking up because that is dependent on monsoon?

Jairam Varadaraj: Water well market right now except for a big tender that is being talked about by the Andhra Pradesh government other than that regular contractors demands are all quite subdued, we are ready with very significant marketing program which we will launch in the next month or two, we have very strong products that we have lined up and we are very confident when the market picks up, we will have a strong position.

Renjith Sivaram: Okay and in terms of the European market if you can break up so you told Italy is bad so apart from Italy where are you seeing growth?

Jairam Varadaraj: We have started selling in pretty much every country other than in Germany in Europe and it is still very early days, but month-on-month improvement that we are seeing across the products that we have chosen for Europe is very encouraging.

Renjith Sivaram: And the US market share is also profitable this quarter?

Jairam Varadaraj: Absolutely yes.

Renjith Sivaram: Okay Sir, thank you and all the best Sir.

Moderator: Thank you. The next question is from Aditya Bagul from Axis Capital. Please go ahead.

Aditya Bagul: Good afternoon everyone and congratulations on a good set of numbers given this challenging environment. So I have two questions. One, very near term and the other more strategic, so in the very near term within the domestic segment when we talked about little in terms of food and pharma, can you talk about some of the end user industries where you foresee that you will see reasonable demand over a period of the next nine months specifically if you can comment on the railway segment?

Jairam Varadaraj: Specifically on what segment?

Aditya Bagul: Railways.

Jairam Varadaraj: Like I said in the beginning, we anticipated only food and pharma and the essential industry vertical would see activity, but contrary to that expectation in the first quarter as well as in the month of July, we have seen activity across all industry vertical. Now the only difference compared to the past is large projects whereas power or steel those are very subdued, but all other industries verticals are investing, this is what I said. As far as railway is concerned, it is a function of the budget that the government allocates, this is still early days because the government is grappling with using its total funds available to weather through the storm that has been created by this virus, so we will have to wait and see, so far they have been no significant changes in the budgetary allocation to railways, so we will have to wait and see so it is positive at the moment but again railways a very small percentage.

Aditya Bagul: Understood, fair enough Sir. Can you also talk a little in terms of status of our oil free disrupted series, how is the momentum there, it might be challenging in the current environment, but some thoughts of that would be helpful?

Jairam Varadaraj: Overall our oil free business in India and in the rest of the world has continued to grow, the starting base obviously was smaller, but in spite of all the circumstances, our growth has been good both for our conventional oil free and more specifically for our ABCD, which is our disruptive oil free, response from the market has been very good.

Aditya Bagul: Okay, understood Sir. Last question slightly more specific while we talked about product mix and EBITDA mix over longer term in February, just wanted to get your sense post-COVID scenario over the period of the next two years, how do you see the revenue mix between geography and the EBITDA mix within geographies move from where it is currently?

Jairam Varadaraj: At overall level if you look at our consolidated EBITDA has traditionally been significantly lower than the standalone EBITDA, we see that this gap will start converging to a point where a consolidated EBITDA will get slowly closer and closer to our standalone EBITDA that is the futuristic next two to three years kind of a direction we are looking at. Now as far as the revenue mix between India and the rest of the world, it is very difficult to say, first quarter there has been a big shift from almost 55, 45 India rest of the world to 40, 60 India rest of the world whether this will sustain as a function of how the Indian economy recovers and how quickly it recover, this still very early days to talk about it whereas in the month of July, which is beyond the quarter that we are talking about, the India share of the overall thing has increased beyond the 40% and whether it is going to sustain is difficult to say because now Europe is coming very strongly for us so, there are lot of moving parts right now in the economies all over the world, so we will have to wait and see how those shift happen.

Aditya Bagul: Fair enough Sir. Last question more of a data point just wanted to understand we talked about our improvements in terms of our contribution margin on a consolidated level, can you throw some colour as to the shift in terms of the contribution margin, how much of that was purely because of international doing better than the domestic, given that international has a significant edge in terms of gross margins?

Jairam Varadaraj: There are two contributing factors to the higher contribution margin in the quarter. One is obviously the higher percentage of revenue from international markets where our contribution margins are higher than in India. The second is even within India, the share of aftermarket was significantly higher than the product so therefore that also contributed to an improvement in our margin.

Aditya Bagul: But India after sales would be closer to 35% kind of?

Jairam Varadaraj: No, it varies by product, I cannot give you a one specific number, it is a percentage varies by product so overall it has been positive.

Aditya Bagul: Thank you and best of luck for the quarters to come.

Moderator: Thank you. The next question is from Harshit Patel from Equirus. Please go ahead.

Harshit Patel: Thank you very much for the opportunity. Sir, I just had one question on your European expansion plans, so you have outlined in very detail about your plan, so I wanted to know that would this be done through exclusive distributors or we are appointing multi-brand distributors over there?

Jairam Varadaraj: In most of the world except India close to anywhere between 60% to 80% of the distribution channel is multi-brand and therefore our strategy is one become one of the brands that they deal with and then the second phase increase the share of their wallet among all the brands, we have done this in the US where we have entered into distributors with multi brand and progressively over time by virtue of our product performance, our support and our warranty program and all of it, we have been able to increase the share of the wallets of these multi brand distributors, it is a same kind of a strategy in Europe as well.

Harshit Patel: So Sir presently as of now, how many distributors would we have acquired in Europe and what would be our targeted numbers let us say three to four years down the line?

Jairam Varadaraj: I do not have a specific number, but I have an approximate number from my recollection we have close to about 140 distributors in Europe, and in terms of our target number, I am sorry I am not able to give you a very specific target number.

Harshit Patel: Sure Sir not a problem. Thanks very much Sir. That was all from my side.

Moderator: Thank you. The next question is from Devang Shah ONEUP Financial. Please go ahead.

Devang Shah: Regarding the overall ability to cater to the demand, in the past you have alluded to the fact that we want to be among the top five compressor manufactures globally, in that journey have you transited almost all the touch points that would make your journey relevant for that positioning so that is question number one, and question number two would be you just alluded to the margins in the consolidated also moving more closer to the India part. So how far do you think would the completion of the entire portfolio help us so are there any new products that will help us transit to that journey or we are complete in terms of as far as product offerings go?

Jairam Varadaraj: I will try my best to answer the first question in terms of where we are in the transition. So if you look at the market, its products and markets. Now let me first address the markets. So the strategic markets that we have chosen to play in and go deep and be disproportionate in terms of our attention and resources, they constitute close to 60% to 65% of the total market opportunity. So countries like China, where China is the number one market for compressors, we were present there, we realized that our readiness to take on a significant share in the Chinese market we are not ready yet and the effort that we need to put in, in China cannot be deployed elsewhere, so we strategically decided to withdraw from China. So other than China, we are pretty much operating in most of the market and the strategic markets that we have chosen which is Australia, Indonesia, Thailand, India, Europe and America they constitute close to 60% to 65% of the market. So we are well positioned and in each of these markets, over a period of time, we have invested deeply, and our presence is not just superficial, a very significant substantial presence in these markets. So that is on the market side. On the product side, today except for centrifugal compressors we pretty much have the full range and centrifugal is probably they contribute maybe less than 10% of the total market. So I would say anywhere between 80% to 90% of the product is available for us, so that is really our current position and we are constantly investing in technology to close the gap between the 80, 90, to 100, that is an ongoing process. As far as markets are concerned, we are going to stay with the strategic markets for the next at least four to five years and go deeper into these markets because this is where the significant opportunities are there.

Devang Shah: And for the margins do you think we have the ecosystem as far as the spares and all of that are concerned because spares would ultimately a spares/AMC would possibly form a significant part of the population once it is there in the system. So do you think we are very prepared for that kind of ecosystem already?

Jairam Varadaraj: Absolutely I mean parts and service capability decides the profit opportunity of that business vertical is a fundamental requirement to be able to sustainably win in all these markets. So without that you do not even have the right to play. So in all these markets before even being ready to sell products, we ensure that we are ready to provide service to the customer and support. So we are all well established on that.

Devang Shah: In the so-called journey to reach number three, number four player, anything yet significantly leaving a gap, or you feel that you need to possibly bridge something before that journey is really smooth for you?

Jairam Varadaraj: No, I do not think so. The foundation blocks are all in place both in terms of products and in terms of markets. Now it is a matter of just going deeper and deeper into each of these markets and gain more share of that opportunity.

Devang Shah: Perfect sir. Very kind of you, thank you so much for answering.

Moderator: Thank you. We have the next question from the line of Rithvik Sheth from ONEUP Financial. Please go ahead.

Rithvik Sheth: Just a couple of questions. Sir you mentioned that the cost reduction is sustainable going forward, so can you throw some light on this because how long will the subsidy from US and Australia last and also the other cost reduction that are sustainable.

Jairam Varadaraj: So the subsidy value that we have been entitled to and we have received is $3.3 million of which in the first quarter we have utilized $1.9 million. So in the second quarter we will see the balance $1.4 million getting reflected in our P&L. So beyond that the subsidies we have to wait and see whether these governments are going to renew their subsidies or come up with other subsidies and whether will be eligible for it, it is too early to talk about beyond September that is on the subsidy side. So as far as cost is concerned, like I said today the cost reduction of almost 40% in our other than people fixed cost is partly contributed by the business situation where travel is just not possible or even feasible or even required. But once the markets open up, once the confidence come up and once the impact of the virus is kind of mitigated, there will be some incidence of travel so to that extent the other fixed costs are going to go up, but it is too early to say what exactly that would be.

Rithvik Sheth: And the employee cost at about 90 odd Crores 85 and 88 odd Crores for the quarter this run rate will continue for the rest of the year and it will…

Jairam Varadaraj: To the extent of the subsidies being reflected, it will not continue if the new subsidies do not come for the second half of the year, we have got subsidies for the first half, the first quarter and the second quarter. Now so that is one part we do not know so if you look at the total subsidy value in the first quarter was about 14 Crores, which is about 60% of the subsidy value, the balance 40% will be realized in the second quarter. Now beyond that I cannot say whether it is going to continue. As far as the other cost in terms of reduction in India of contract people and our leave salary thing those will continue.

Rithvik Sheth: Sir just one follow up on the India part, as the demand picks up, do we not go out an employ the contract laborer or we are sufficient on that front.

Jairam Varadaraj: No we are in the process in the last three months we have been able to get to 80% to 90% of our normal output in our factories without these contract workers, so fundamentally even while we are struggling through making the deliveries at a best continuing good quality we have also been parallelly looking at how we can chain the processes so that even on a steady state basis we are able to work with much better optimization of people cost. Now I must say our backend operations team has just done an outstanding job under these circumstances.

Rithvik Sheth: That is very good to hear, all the best and thank you Sir.

Moderator: Thank you. The next question is from Kashyap Pujara from Axis Capital. Please go ahead.

Kashyap Pujara: Great to see a decent cost containment measures in such challenging times so clearly looks like you need topline now I think that is the only thing that remains. Just one question, more from a how you stack up or the performance that you have delivered especially in the overseas market versus whom we compete with. So just wanted to understand that while we did well in Europe excitedly and did better in say US, how does it compare it to how our competition is and how the markets there were because I did read in your annual report that we have gone on and set up dealerships and did conscious deliberate marketing across Europe and US in the last year so wanted to understand whether our performance is more a function of us doing better than the markets and competition there or whether we basically were in line with the market performance?

Jairam Varadaraj: Kashyap it is very difficult to make very deliberate statements about our share of the market at a highly reliable level because we do not have the specific numbers of our competitions. But having said that we look at in specific geographies we look at associations that we are part of which publish the overall market size for a particular period, what was the sales made by all the manufacturers. So in all the key markets where such associations exist that is Australia and, in the US, the markets have gone down, and we have grown which means we have gained share of the market. So that is one data point. The second data point is we look at the quarterly earnings calls and conference proceedings of our competitors and we look at what they have said and they have dropped numbers in some of the regions where we have grown or at least maintained last year's level. So which means again there is an indication that we have gained some share of the market. So if I have to take a few from these two data points which are not I cannot bet my house on it but they are very strong indications of our presence and our performance, I would say we have grown our share in the market.

Kashyap Pujara: Great. That is encouraging and that is all from my side. I wish you all best of luck and I hope that your cost containment measures are structural and whenever the topline grows the incremental margin really shows in the profitability. Thanks.

Moderator: Thank you. The next question is from Manish Goyal from Enam Holdings. Please go ahead.

Manish Goyal: Sir just couple of questions one on the subsidies what we receive so how we account it; does it go to the revenue line item and how does it work like.

Jairam Varadaraj: Well different countries it is different, Australia is a direct subsidy so it goes into a revenue item either you reduce, you net it off in your people cost or show it as a separate line item impact is the same. As far as US is concerned it was a loan that will be forgiven we have spoken to our auditors there and the law firms there and we are eligible to be forgiven, so we have accounted it provisionally even though it is sitting as a soft loan, we have accounted it in this quarter as a subsidy that has flown in proportionate for that period and proportionate to our eligible.

Manish Goyal: So where I was coming from is that the improvement in contribution margin what we see so was it a function of that these subsidies getting accounted…

Jairam Varadaraj: No. Subsidies are accounted below variable cost. So what you are seeing is contribution margin improvement is at a variable cost level.

Manish Goyal: So ideally assuming that worst case scenario that the subsidies does not resume in forthcoming quarter and if the operation seems to be on expected lines or normalizing we will continue on employee program like in terms of the cost structure what we have right now that is the worst case we can…

Jairam Varadaraj: So like I explained the numbers Manish 14 Crores in this quarter has come from subsidy right that represent 60% of the total subsidy that we are eligible for. In the second quarter the balance 40% will get booked. So beyond we do not know whether they are going to be there or whether we will be eligible.

Manish Goyal: No, no, I agree I understood I was just trying to paint a picture that if in case in Q3 onwards we do not receive subsidies, but on other side if we see normalcy returning to the operations in international market, we would not probably look to revise our plan on the employee cost. That is what I was trying to ask?

Jairam Varadaraj: No, no, no, our people cost that we have reduced so far in India will continue, that will continue, India has got no subsidy on…

Manish Goyal: But Sir that was a function of reduction in the contract employee so in case if business resumes and if your international operations are doing well, you need to export compressors from India so you may probably see this contract labors coming back?

Jairam Varadaraj: No, that is what I told you in June and July we have done 80% to 90% of our normal output of the factory without these contract people.

Manish Goyal: Great Sir and last question in terms of our plan in terms of the setting up the motor facility and on the backward integration we already have with the castings so how do we see it going forward in terms of their utilization?

Jairam Varadaraj: The motor plant has started producing and we are now cupline our compressors with our own motors in the Indian market, we have sent motors for Europe and for the US for field validation. Now our biggest constraint in the motor plant is one key machinery is stuck in Germany because of the COVID situation the plant there is shutdown and they are just going to start complete the assembly and testing of the motors and we have to figure out how to do the inspection of the motors remotely and we are hoping that the machine will reach us by October, November of this year. If that happens then we will be able to ramp up production of our motor facility and in India we have done the field validation over the last year and a half, we have had perfect performance of our motors so we will significantly increase the share of the motors to our motors once our production is established, now that is the bottleneck as far as the motor plant is concerned. As far as the foundry is concerned, like I said in the last call, we have decided to get outside customers for our foundry, we have started the work, we have already received drawing from outside customers and it is too early to say probably in the fourth quarter of this year or the first quarter of next year we will start seeing some revenue coming from the foundry from outside customers.

Manish Goyal: So how much of the capacity do you think that we should be comfortable with in-house operations and balance could be basically you saw it…

Jairam Varadaraj: We are setting aside about 1/3rd of our capacity for outside.

Manish Goyal: Great Sir, thank you so much.

Moderator: Thank you. That was the last question in queue. I would now like to hand the conference back to Mr. Kamlesh Kotak for closing comments.

Kamlesh Kotak: Yes before that some points I would not just want to understand. Sir could you help us understand how much is the capital investment that we have made during the quarter and what will be the plan for this year as well as any strategic investments as we stated in the European market we have gained and how we are going to make it this year?

Jairam Varadaraj: That capital investment in this quarter was almost nothing Kamlesh. We have certain open procurement that we have done in the past, last year, that we will have to like I told you about the machine for our motor plant there is one other machine for our compressor plant they are all very small in number, so besides that we do not see any further investment in Capex. As far as strategic initiatives are concerned, we do not see anything happening in this year, we do not have anything lined up nor do we visualize pursuing it at this point in time.

Kamlesh Kotak: So all those big costs which we were aiming to put in will only be accrued from next year you said is it?

Jairam Varadaraj: Which cost you are talking about, the European cost?

Kamlesh Kotak: Yes, European cost.

Jairam Varadaraj: No European cost is not Capex it is Opex Kamlesh. It is basically salaries and travel cost that we are baked in as part of our Europe strategy, that we have trimmed down when this whole situation came up but, whatever was sunk is continuing. Those costs are continuing and what results you are seeing is after those costs that have been considered.

Kamlesh Kotak: Secondly Sir you mentioned about US market across vertical can we get some color about pockets of the Europe by patents, Elgi Direct, Michigan and our distribution acquisition all that things how they played out?

Jairam Varadaraj: So all the all our verticals in the US are doing well they are almost at last year’s levels and they are continuing to grow. We have some very specific strategic initiatives that we have kick started in the US, not in relation for any Capex, but more of operational rigger, we are bringing in certain strategic focus and we expect that those will produce even better results in the future, but are they going to show up in one or two quarters no, but in the next three to four quarters we are going to see a significant shifting of the needle in the US. As far as Europe is concerned, we are already seeing the needle getting shifted by virtue of all our investment in people and facilities in various countries other than in Germany we are beginning to see results coming out and September really Europe shuts down for part of July and August so we are expecting to see a big uptick in September and that will sustain as well.

Kamlesh Kotak: So broadly Sir at this point in time the operational level across India, US, Europe, is what, is it normalized to 100% or there is still some kind of a uptick that is going to be seen in operations what is it, is it 60%, 70% what level we are seeing?

Jairam Varadaraj: So if you look at the first quarter India was at 60% lower if you cumulate it for the all the three months, but if you take June alone India was only about 25% lower and if you look at the month of July India was only 10% lower. Now if you look at our expectation for July, August, September quarter is we will be at a consolidated level close to last year's level, almost there. Now whether in the third quarter we will continue to grow beyond the second quarter is difficult to say at this point in time.

Kamlesh Kotak: Great Sir. So that is it for the call Sir. Any specific closing remarks you would like to make Sir.

Jairam Varadaraj: At this current point in time the situation looks a lot better than we anticipated, in fact if I have to look at the second quarter, the second quarter looks very good in relation to the second quarter of last year, but unfortunately, I am not able to make any clear statements of will that growth trajectory continue into the third or fourth quarter is still early to talk about.

Kamlesh Kotak: Great. With that we conclude the call. Thank you everyone for joining for the call. A special thanks to Mr. Jairam and his team for getting a valuable insight. With that we conclude the call. Thank you and have a great day.

Jairam Varadaraj: Thank you so much, thank you everyone. Thank you Kamlesh.

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