



# “Vascon Engineers Limited Q1 FY13 Earnings Conference Call”

**August 18, 2012**



**MANAGEMENT: MR. R. VASUDEVAN – MANAGING DIRECTOR**  
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**MR. D. SANTHANAM – CHIEF FINANCIAL OFFICER**



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**Moderator**

Ladies and gentlemen, good day and welcome to the Vascon Engineers Limited Q1FY13 earnings conference call. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing "\*" followed by "0" on your touchtone phone. I would now like to hand over the conference to Mr. R. Vasudevan, Managing Director of Vascon Engineers Limited. Thank you and over to you, sir.

**R. Vasudevan**

I welcome you all once again for discussion on our company's FY13 first quarter results. Along with me, we have our senior management team members, Mr. Santosh Sunderrajan, Mr. M. Krishnamurthi and Mr. D. Santhanam. Our revenue for the current quarter is Rs. 202.94 crores as compared to Rs. 186.2 crores for the corresponding quarter last year. The EBITDA is at 22.62 crores, 11.1% of revenue. Net profit for the quarter is at 5.27 crores, 2.6% of the revenue. EPC contributed Rs. 115.8 crores to the top line whereas 41.94 crores are attributable to real estate segment, while GMP contributed to 37.39 crores to the consolidated revenue. As you are aware, the current environment is still clouded due to deteriorating gross inflation dynamics. The real estate sector is facing many challenges including global economic uncertainties and low investor confidence. On the monetary policy also, the interest rate has remained unchanged. Delayed policy measures, slowdown in industrial production, elevated interest rates, and liquidity concerns have moderated the growth prospects of the company.

Now moving to the details, the company has received an EPC order intake of 183.84 crores in the previous quarter. The same comprises of reputed names like Godrej, Unitech and post this order addition, our third party quarter backlog as of June 2012 stands at 2,623.68 crores. The revenue growth in EPC segment has been gradually recovering as compared to the previous periods. The slowdown in this segment still continues to some extent majorly on account of stalled projects namely the HDIL and Tamil Nadu Assembly. The margins are also impacted on account of escalation in input and labor cost and the overhead cost during the extended period of the EPC contract. However, as discussed in the earlier calls, due to us being extremely careful down in selecting the EPC contracts, we have been successful in achieving contracts in the last quarter which are associated with some reputed names and also we have taken these contracts with value addition of design build. These types of jobs will contribute in bringing EPC revenue run-rate back on track. The company has been successful in bidding turnkey contracts jointly with GMP Technical Solutions like ESIC Hospital, BPTP Residential Project, Sankara Eye Hospital, etc. Successful integration of GMP and the synergies of GMP acquisition make us more competitive in getting turnkey projects.

On the real estate front, we have sold area totaling 1,22,709 square feet for total sale value of 43.32 crores. The average sales realization per square feet has been consistent in the current



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quarter. The cumulative area sold is around 1.77 billion square feet amounting to a sale value of around Rs. 743.69 crores, of which attributable to Vascon is around 415.26 crores. Also the collection has been on track in comparison with the previous quarters. The total area under construction in residential segment is 2.95 million square feet. During the last quarter, the company has sold commercial building Phoenix for a consideration of Rs. 32 crores. Vascon holds 50% stake in this sale. We have also launched a residential project Ela at Hadapsar, Pune in the month of April 2012 with a total saleable area of 0.12 million square feet. The residential development will have 2-2.5 bedroom with sizes ranging from 1,115 square feet to 1595 square feet. The project will have the latest amenities. The construction is commenced and we have already sold about 45% of the inventory which we have launched. Going further we expect to launch some more projects in the current financial year in cities like Pune, Nasik, Coimbatore and Chennai.

As a company, our focus has always been high quality growth. Company's commitment to timely execution and adoption of newer technology is focused at. We have also taken steps to reduce overhead costs and staff costs in lieu of the present situation and the order execution. In view of this, we are strategically focusing on niche turnkey EPC projects and our real estate development projects which will not only yield better margins, but will also help in generating steady cash flow in the future. I would now like to open the floor for questions and answers.

**Moderator** Thank you very much. We will now begin the question and answer session. We have the first question from the line of Keswinder Suri from Span Capital. Please go ahead.

**Keswinder Suri** Could you throw some more light on your stalled projects? I could not get the name and some more details about them.

**R. Vasudevan** One is the big commercial building which we were doing in Kurla for HDIL which was about more than 2 million square feet, of which we have completed about 1-1.2 million square feet of EPC work. Because of the slowdown in the intake of the commercial office spaces, this project is now being considered to be partly converted to residential. So redesign is happening and we hope recommencement may happen in the end of second quarter or beginning of third quarter of this year. The second one is a project which we were mid-way through in Tamil Nadu, which we had bid and taken Tamil Nadu Assembly Secretariat building work; that has been also stalled because they are thinking of converting that to a medical college.

**Keswinder Suri** What was the value of these contracts?

**R. Vasudevan** Both were about 230 crores plus.

**Keswinder Suri** Both combined?



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- R. Vasudevan** No, each.
- Keswinder Suri** Can you just throw some more light about the markets in which you are present in and in the real estate terms, how are those markets panning out and what is the scenario and pricing movement in the same?
- R. Vasudevan** On the commercial front, there is a lot of pressure in terms of movements. I think there is hardly any movement, better to put it that way. But on the residential front from location to location, it is quite encouraging, where prices have not gone up and where also ticket sizes are not very big, not more than 2-3 crores, there the movements are happening. However, the pressure of liquidity on the developer because of various other stalled projects is bringing in liquidity pressure on the developer and as a result when it happens to the developer, it gets turned on to us in those locations and that is why the projects are going a little slower paced than what would one like it to be. But it is not the same scenario everywhere. There are still some locations where we are also pressurized in not being able to complete it in the scheduled time in some of the locations because of the skilled labor non-availability which puts pressure on now.
- Keswinder Suri** Speaking of liquidity, how are you placed in terms of debt, cash and repayment schedule, if any?
- R. Vasudevan** See everywhere, we are no exception on the liquidity front also. We have heavy pressure on liquidity as things are happening because we have also huge outstandings happening, but on the debt level we are present at 344 on consolidated level.
- Keswinder Suri** This is the gross, right?
- R. Vasudevan** Net is 314. To improve this liquidity, we have also taken steps in terms of liquidating some of our finished inventories, which were moving, so focusing on them to get liquidated. We are also looking at some of the land banks where we have more than what we are going to, suppose in the same location we have excess land banks, in those land banks we are trying to liquidate them also. By the end of the year, we have plans of bringing in another 200 crores to 300 crores into the system.
- Keswinder Suri** In terms of the real estate, which has already been sold out how much do you think will be the amount collectable by the end of the year?
- R. Vasudevan** Totally, we are expecting to collect 200 crores, in this quarter we have collected around 44 crores.



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- Keswinder Suri** 200 crores you are going to collect in this year and how much do you propose to spend against that for construction?
- R. Vasudevan** About 120 crores would go.
- Keswinder Suri** Coming to your EPC, what is the kind of margins you enjoy there on the EPC arm of your business?
- R. Vasudevan** On the EBITDA front, we are very good; we are at 22 crores on this. 11.14% on the EBITDA front, but when it comes to the absolute PAT level, 2.6 or so.
- Keswinder Suri** Of your order book, how much is committed to be executed by the end of this year, because you would have a certain timeline on that which you would be committed to execute, so what are the milestones for this year and next year?
- R. Vasudevan** This year, we are looking at a top line of EPC about 500 crores, 800 plus is what we have on the consolidated level.
- Keswinder Suri** All your land is fully paid for, right?
- R. Vasudevan** Land has been fully paid for, there is no further payment.
- Keswinder Suri** You have presence in about four cities you said, Coimbatore, Chennai, Pune and Nasik?
- R. Vasudevan** At present on the real estate front, if you are asking, Pune, Nasik, Chennai and Coimbatore, it is in more locations.
- Moderator** We have the next question from the line of Sagar Parekh from Enam Holdings. Please go ahead.
- Sagar Parekh** From your two stalled projects, HDIL and TN Assembly, how much are the receivables still pending from them?
- R. Vasudevan** TNLA was 14 crores and HDIL 22.
- Sagar Parekh** Out of the 230 crores each that you have said, how much have you executed till date and how much is remaining, I wanted to see that?
- R. Vasudevan** We have executed on HDIL about 100 crores and in TNLA 85 crores.
- Sagar Parekh** Out of the 85 crores that you have executed, 14 is receivables?



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- R. Vasudevan** Yes.
- Sagar Parekh** What are your total receivables, if you can give me?
- R. Vasudevan** 257 crores.
- Sagar Parekh** How much was that Q1 last year?
- R. Vasudevan** 275 crores.
- Sagar Parekh** So it has come down like 257, 275, right?
- R. Vasudevan** Right.
- Moderator** The next question is from the line of Deep Mishra from Ever Stone Capital. Please go ahead.
- Deep Mishra** Of the EPC contracts that you are executing, the 500 crores this year, how many of them are fixed price contracts and what is happening in your view given the increase in costs, how do you see the margins of these going forward?
- R. Vasudevan** In all our contracts, the key materials like cement, steel and some other key materials are on a basic rate basis, but the variations in terms of the labor escalation comes on to us. And if there is a project overrun then in terms of time, I am talking or in terms of the value of work drops down, then that directly affects our overhead costs, the labor cost and the equipment cost which we had taken of the project. And these two factors are what are affecting our bottom line in the last two years scenario, it is not the escalation of material which has really affected us in the last two-three years, it is the escalation in the labor component. So we are now in the future taking steps in terms of not only providing for them, but also in terms of trying to cover it as an escalation clause. There has been a mixed response from here. Some of the clients accept, some of the clients do not accept and since today, all the EPC contractors are facing the same issues and the same problems, we are seeing a response from everyone else of not wanting to carry on work if those clauses are not protected. So going forward, we see that even in the competition level since everyone is going through the same phase and they are affected by the same unprecedented increase which had happened in the last two-three years, people are more careful and we see the clients also will have to be more flexible which we are seeing happening in terms of the contract conditions and going forward, we see that the pressure on the bottom line because of these escalations are not affecting us.
- Deep Mishra** Purely, if you were to take some of these older contracts, while you are showing sort of a gross profit of 22%, from what we understand from other contractors, they are actually operating



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now at close to flat or almost negative EBITDA margins, because of these reduced labor and handling charges which nobody is paying and the labor escalations where prices have gone up of labor by almost 15%-16% annualized. So are we seeing our old contracts actually losing money or what is your guidance on the kind of EBITDA margins we can expect from older contracts versus newer contracts that you are signing now?

**Management**

What you have raised is a typical scenario faced by all and including us. We are trying to be more proactive in locations where our margins are very low and taking up with the clients to revise these rates. In fact, we also put our own pressures of doing things in terms of trying to get those escalations cleared prior to we complete the project, because once it is completed, nobody is going to listen to us. And also in some locations, we are taking steps to see how best to bring down. But you are right, it is having pressure on the bottom line, you can see that in the issue, but it is also having the pressures two ways, as I said before also. One is the overhead cost which is affecting and because of the delayed payment, we are ending up part financing some of the projects which is not a scenario anticipated when we bid for the project. There is pressure on that line as well.

**Deep Mishra**

So of the 2,673 crores order backlog, how much by value would be projects that you are actually working on currently and how many do you think you will drop because some of these may not be profitable?

**R. Vasudevan**

It is difficult to give you a figure as such, but roughly I can say about 20% of those will have pressure on our bottom line.

**Deep Mishra**

But is this 2,673 everything that you are working on already started or is there some of it which are old projects but you do not really intend to do?

**R. Vasudevan**

See, out of this, there are some contracts which are on cost plus also, there it is not that affected, but on cost plus basis our margins are also not very high, but at least there is no negative impact there. So some of them are on cost plus, some of them are a bigger list of basic rates and some of them where we have had conditions of now we are strictly putting conditions of labor escalation also as part of our escalation cost, especially if the project goes beyond the stipulated period, which are reasons beyond our scope of work. And more than 70% of the time we have seen where the project is delayed due to the client's requirement, either it is cash flow or it is change in design or other dynamics.

**Deep Mishra**

These are all external projects, not the in-house, this 2673?

**R. Vasudevan**

All external only.



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**Deep Mishra** So of these 2673, are there 10%-20%-30% whatever, that you do not intend to do at all, they are like renegotiated?

**R. Vasudevan** See especially, suppose the projects which have got overrun, we have sufficient reasons that the overrun was not due to us entirely. There, we are taking a sense that it is not possible for us to execute these jobs at those rates. All our contracts with everyone is a fixed item rate contracts generally with the provision of those basic rates, but for the project period which we have mentioned, suppose the project period is of 18 months and most of our project periods are between 18 months and 2 years maximum, if there are delays which are attributable due to the clients, and which is why I am saying that today about 90%-95% of our projects delays are attributable to the clients reasons, in such a case our fixed rate contract does not become enforceable or valid.

**Deep Mishra** If you have typical projects which are 18 to 24 months and if you are executing 500 crores right now, that means that you really have 1000 crores out limit of two years.

**R. Vasudevan** Correct.

**Deep Mishra** It is really 1000 crores worth of real live...

**R. Vasudevan** Yes absolutely right.

**Deep Mishra** So what is the balance 1,600?

**R. Vasudevan** See, what happens as I was saying that the order backlog position does not actually reflect how much we do in a year, the point which you have brought out very clearly. If you see all the backlog of orders which we have so far been done in the last year, it has been roughly one-third is what happens. Why it happens is, there are projects, there are order books, but it is not taken off not due to us because nobody will give us, our order continuously kept open if we are unable to perform, but due to reasons from the client's side where they are not ready with either permissions, they are not ready with their finances or they are not ready to take some hard decisions, so it is mostly due to that. That is why it is like an overcapacity situation if all the people ask us to do whether we will be able to ramp up and do, it will be a question mark.

**Deep Mishra** So even if you take one-third, it is really 1500 crores, but there are still 1000 crores of these sorts of zombie orders in there?

**R. Vasudevan** Yes, there are orders. Overruns, now again the orders are, let us say some of them could be three years, just as bigger orders usually... And TNLA is pending order, HDIL is a pending order. So there is going to be a change in decision there, where nine months everything was



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kept shut, now the revamping and redrawing and changing the commercial building to a residential building is not an easy task both in terms of redesigning and in terms of re-approvals and there is time loss during this period which is not attributable to us.

**Deep Mishra** And in terms of the capital employed in this business, that I think is there in the balance sheet, right, segmental reporting you do?

**R. Vasudevan** Yes.

**Deep Mishra** How is the growth trajectory of the GMP business, what is the prognosis, since it is coming the fold, how do you foresee that picking up?

**R. Vasudevan** This quarter we have done 44 crores and in the full year, we are looking at about 160 crores plus.

**Deep Mishra** What are the kind of margins, are they sort of better?

**R. Vasudevan** Today, the margins are almost same, but again here also we are re-focusing more on export orders and we hope to do better this year and coming year, more in the next year, because the percentages of orders from outside we have increased that.

**Deep Mishra** So what is your sense of what would be the exports versus the domestic out of the 160 crores?

**Management** Presently, we are working on 15%, so we are looking at increasing it to more than 30% in the next year.

**Moderator** We have the next follow-up question from the line of Sagar Parekh from Enam Holdings. Please go ahead.

**Sagar Parekh** Your Renaissance project of 1100 crores, how much has been executed till date, Q1?

**R. Vasudevan** It is going slow at present.

**Sagar Parekh** So in Q1, how much was executed?

**R. Vasudevan** Very less, 5 to 10 crores only. This is again another project affected.

**Sagar Parekh** What happened over there, if you can give some color on that?

**R. Vasudevan** It is the same liquidity issues, sales and further.



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**Sagar Parekh** So when do you think will this project start again, anything on the horizon?

**R. Vasudevan** We will come to know by the end of next quarter only.

**Sagar Parekh** And that was a low margin order, right?

**R. Vasudevan** Yes.

**Sagar Parekh** What are the margins over there?

**R. Vasudevan** 7%.

**Sagar Parekh** 7% EBITDA?

**R. Vasudevan** PBT.

**Management** Because it is cost plus contract, so whatever cost incurred we get that, because all the expenses are booked to them, profit before tax 7%.

**Sagar Parekh** On new orders that you have received, what kind of margins have you projected in those new orders or is it still at low margins?

**R. Vasudevan** We start off at 20%, but by the time the project ends, changes do happen on those. Today, we are not taking any orders at less than 20.

**Sagar Parekh** The changes happen because as you mentioned in the...

**R. Vasudevan** See, suppose the period of extension and due to the labor escalation which is continuously happening.

**Sagar Parekh** You said 90%-95% of your this thing is because of issue from the client's side?

**R. Vasudevan** Correct.

**Sagar Parekh** So do you provide the entire cost and then you recover it from the client or how do you do it or how do you account it?

**R. Vasudevan** This is a question of re-negotiating at that point of time by claims and by justifying those claims; that is a process which takes about six months to nine months with each of the clients. But nowadays what we are doing is we are starting these processes midway through the project



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itself, we do not wait for the fag end, because at the fag end, it becomes one-sided negotiation because we would have completed by that time most of the work.

**Sagar Parekh** So basically if the client does not accept your cost escalation then you have to account the entire thing or you stop the project itself?

**R. Vasudevan** As I said, it is a strategy from location to location, from contract to contract based on what is the scope of work with the client in the future or how it has been, so we take a decision based on that, it is not a same decision everywhere.

**Sagar Parekh** So out of the 2,800 crores odd of order book, 1,100 crores is slow moving and HDIL and these two together is 230. How much would that be a part of order book now? 100 is already done and ....

**R. Vasudevan** 250.

**Sagar Parekh** So about half of your order book is not moving at all.

**R. Vasudevan** Yes that is not moving at all, correct. The first one, in the third quarter we are likely to see some action.

**Sagar Parekh** That is in the HDIL?

**R. Vasudevan** Yes correct.

**Sagar Parekh** So going forward, would you like to give us guidance in terms of margins for EPC and consolidation is also fine, if you can? Like you said 800 crores of topline, so FY13 what kind of margins are you predicting? I would assume that since most of your orders are slow-moving and plus cost overruns, so your margins should decline?

**R. Vasudevan** I think we should be able to maintain the same thing.

**Sagar Parekh** EBITDA?

**R. Vasudevan** Yes EBITDA.

**Moderator** As there are no further questions from the participants, I would like to hand the conference back to Mr. R. Vasudevan for closing comments, over to you sir.

**R. Vasudevan** Thank you very much and if you have any queries you can get in touch with Mr. Krishnamurthi or Mr. Santhanam in email and we will be happy to respond back to you.



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**Moderator**

On behalf of Vascon Engineers Limited, that concludes this conference call.