



“Vascon Engineers Limited Q2 FY13 Earnings Conference Call”

November 21, 2012



SGA Strategic Growth Advisors



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Moderator

Ladies and gentlemen good day and welcome to the Vascon Engineers Limited Q2FY13 Earnings Conference Call. As a reminder for the duration of the conference, 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, you may signal for an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand over the conference to Mr. R. Vasudevan, Thank you and over to you, sir.

R. Vasudevan

Thank you for accepting our invitation and sorry for my voice, having a bad throat and being with us for this con call. It is my pleasure in welcoming you all for this discussion on our unaudited quarterly results for Q2FY13. Along with me, we have our senior management team members, Mr. Santosh Sundararajan, Mr. Krishnamurthi and Mr. Santhanam.

Our revenue for the current quarter is Rs. 187.62 crores as compared to Rs. 186.5 crores for the corresponding quarter last year. The EBITDA for the second quarter is at 15.8 crores, 8.5% of revenue. Net profit for the quarter is at 3.5 crores, 1.9% of the revenue. The company is focusing on efficient management of the working capital. As of September 30, 2012. The net debt of the company stands at Rs. 284.15 crores. The company has retired considering debt due to which there has been a decrease of about Rs. 62.86 crores in the net debt amount as compared to March 2012. The company believes that global and domestic headwinds still continue to exist, increase in labor cost and raw material cost continued to remain elevated. In the real estate business, the company has registered an impressive year-on-year growth of 45% in real estate revenue recording revenue of Rs. 56.33 crores in Q2FY13 as against Rs. 38.87 crores in Q2FY12. The company has upheld accelerated sales momentum and registered consistent revenue growth in the real estate segment. During Q2FY13, we sold an area totaling to 1,25,161 square feet for total sale value of about Rs. 59.05 crores. There has also been a consistent increase in the area sold on quarter on quarter basis. The company currently has a land bank of 52.5 million square feet totally paid for available for development out of which 22.79 million square feet is already under construction. We have strong project pipeline out of which projects covering an area of 4.45 million square feet are expected to be launched soon. Some of these projects include residential development at Kalyani Nagar and residential development at Nashik Vista phase III and Oragadam, Chennai and a project at Coimbatore. During the last quarter the company has sold commercial building Almonte in Pune. The total sale consideration of the same was Rs. 29.38 crores, out of which we have already collected Rs. 28.88 crores. Now on EPC segment, EPC revenues recorded by company in Q2FY13 stands at Rs. 78.81 crores as against Rs. 105.79 crores in Q2FY12. The decrease in EPC revenue is mainly on account of focus value-add projects. We acquired order worth of Rs. 183.95 crores from reputed builders like Godrej, Unitech, etc., in the first half of FY13. The order backlog of the segment stood at Rs. 2506 crores as at September 30, 2012. Third quarter has also started with positive note on acquisition order worth about Rs. 121.5 crores. We are



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seeing improvement in various projects under construction, which we expect to improve order execution going forward. Clean Room partition and BMS compared this is from the GMP which company acquired, these companies has recorded a revenue of Rs. 49.82 crores in Q2FY13 as against Rs 35.97 crores in Q2FY12 year on growth of 38.5%. The company has been successful in getting turnkey projects jointly with GMP Technical Solutions and we are planning to expand further into this business. We would now like to open the floor for Q&A session.

- Moderator** Thank you very much. Participants will begin the question and answer session. Our first question from the line of Mr. H.R. Gala from Quest investments, please go ahead.
- H.R. Gala** I just wanted to know this Rs. 2506 crores which is the pending order backlog, does it include the slow moving projects of Renaissance, HDIL and Tamil Nadu Assembly?
- R. Vasudevan** Yes
- H.R. Gala** It is including that, excluding that it would be around Rs. 1100 crores.
- R. Vasudevan** Yes.
- H.R. Gala** My second question is that in the real estate development, although our revenue has smartly grown by 43% as reported, what is the reason for the sharp decline in the PBIT percentage, in first quarter it was 16.3%, it has come down to 6.4%?
- R. Vasudevan** Actually we have a sale, which we have mentioned in the opening remarks for our project Almonte in Pune, which fetched about Rs. 30 crores in top line in the real estate. This sale did not have margin, so it has pulled down the overall margin in this quarter.
- H.R. Gala** That was included in quarter 1, is it not? Rs. 41.94 crores?
- R. Vasudevan** No that was Phoenix, I think. This is Almonte.
- H.R. Gala** This is Almonte, so it almost the same element in cost and revenue, that's right?
- R. Vasudevan** That is right.
- H.R. Gala** Going ahead in real estate business, as you develop more and sell more, what is your expected PBIT percentage in that segment?
- Management** It depends on project to project to project, but residential it will be where we own the land it will be about 30%.



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- R. Vasudevan** Typically commercial projects could fetch less, but fortunately for us we don't have much commercial going forward instead of old stock very, very small marginal amounts of old stock in hand. Going forward, it is primarily residential that we are developing. In residential we should be getting in the range of 25 to 30%.
- H.R. Gala** 25 to 30%, it is at PBIT level, after depreciation but before interest.
- R. Vasudevan** Right.
- H.R. Gala** What is your average cost of debt because your interest expense of course your gross debt has come down, because I understand that earlier we used to say that our average cost of debt is around 14 to 14.5%, and we wanted to reduce it, but if you see the half yearly interest charge in the P&L, it amounts to very small amount, 17 so 34 crores and you have a gross debt of around Rs. 330 crores, so do we have average debt cost of debt at around 10% now?
- Management** No, actually some of the debt is pertaining to the projects for which the capitalization happens.
- Management** Capitalization of interest is about Rs. 8 crores that is why it looks small.
- H.R. Gala** Okay, so for the full year what will be our total interest outgo this year?
- Management** It will be normal, double over. Capitalization also will double.
- H.R. Gala** Capitalization also will double?
- Management** Despite the Rs. 50 crores what we have told some of which is getting capitalized the balance will be coming to the P&L account.
- H.R. Gala** Around Rs. 50 crores we should consider the outgo. How is the prospect for the EPC business going ahead?
- R. Vasudevan** We have been focusing specifically as a strategy; we have been saying for the last two calls as well that we are focusing now primarily on value add projects on a turnkey basis, where we have ensured our bottom line are higher from day 1 and we are not aggressively going into the race of competing on item rate contract with low margins from day one, so having said that, so therefore the focus is on niche turnkey projects, there is a market for it. There are a good number of clients. We are focusing on turnkey contract, we have picked up almost Rs. 300 crores of order this year so far and most of them in fact all of them have been in this fashion only where operating value is from the design itself, so there is definitely a market for this kind of services, going forward we are quite positive that focusing on value added services we will be adding to our order books.



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- H.R. Gala** This inflow of order, is it mainly on the residential side or on commercial side or industrial side, how is it?
- R. Vasudevan** It is a mix, we have got a project from Godrej, which is residential. We have got a project in Ludhiana, which is primarily hospital and college related. We have also got a school construction in Pune and we have got a multilevel car park in Chennai, so it is a mixed bag, but the common point being it is all on turnkey.
- H.R. Gala** Okay, what would be your broad outlook for current year revenue, like at one time we were saying that we may have around EPC turnover of Rs. 500 crores type, do you think we will be able to reach that level?
- R. Vasudevan** Yes, we would do EPC of Rs. 500 crores this year as well and I think we would do a total of about 800 crores or so.
- H.R. Gala** Including BMS?
- R. Vasudevan** Yes and real estate.
- H.R. Gala** Can you give broad breakup like what would be the real estate like?
- R. Vasudevan** About 170 to 180 would real estate, about the same I would presume from the GMP from the BMS and partition business, and the balance would be from EPC.
- H.R. Gala** Hospital is a small amount in anyway. How is your near term outlook for say next one or two years?
- Management** Going forward as per strategies which we have also expressed last time, focus on the EPC business, real estate business since we have substantial real estate land bank treating on conversions of those and then bringing the levels equal like doing 50% real estate and 50% EPC and maybe next year and year onwards we should be able to up our growth, maintaining stagnating at this level.
- H.R. Gala** And you expect margins to be better than what they are currently?
- Management** Automatically by the mix itself, the margins will become better and also being careful on the EPC front, is further going to be the learning lessons of what we have learnt should help us in the coming years.
- H.R. Gala** Do you expect the gross debt to go down to around 300 crores or as we were planning earlier?
- Management** Yes, we are planning to do it even lower than that.



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- H.R. Gala** So maybe less than 300 crores?
- Management** Yes.
- Moderator** Our next question from the line of Chavi Agarwal from Ambit Capital, please go ahead.
- Chavi Agarwal** My first question is that when you are looking for building contracts, are you looking for turnkey including MEP contracts or just EPC part?
- R. Vasudevan** We internally because so far acquisition of GMP we have the core strength to deliver including the MEP part.
- Chavi Agarwal** Are there orders in the market which are given complete EPC plus integrated MEP or what we are hearing in the market that builders are actually giving both the orders separately, is the market moving towards an integrated turnkey?
- Management** Slowly it is happening, it depends, you are right. It depends on the client. Sometimes they want to separate the two, sometimes like for example from the project that I stated, the Chennai MLCP is only without services, but the Pune, Ludhiana and the Godrej project, we have backed on our turnkey including MEP as well.
- Chavi Agarwal** That you will be doing on your own?
- Management** Yes.
- Chavi Agarwal** So what portion of these contracts would be MEP 30% or below that?
- Management** I don't know less, but as going forward it will be more.
- Chavi Agarwal** Are you also bidding for individual MEP projects, HVAC projects or?
- Management** That we are doing already.
- Chavi Agarwal** Specifically in the MEP and HVAC, is there slowdown in the orders because the larger players are talking about a sharp 20 to 25% decline on a year-on-year basis? Is that true? Are you also witnessing that?
- Management** We are focusing on niche specialized project players, most to hospitals and pharmaceutical plants and also good amount of export orders are there in that, so we are not facing pressure in growth, but we are fully facing pressure in terms of achieving the bottom lines.
- Chavi Agarwal** In your current order book, what percentage would be pure MEP jobs, do you have that figure?



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- R. Vasudevan** Out of GMP turnover of let us say 180 crores; MEP jobs would be about 60 crores or so and with BMS contributing another 20 crores.
- Moderator** Next question from the line of Sagar Parekh from Enam Holdings, please go ahead.
- Sagar Parekh** You mentioned that in your Q2 Almonte project contributed to lower margins, right?
- R. Vasudevan** Right.
- Sagar Parekh** So how much of that is left going forward in terms of top line how much will it contribute in Q3 and Q4 and will that also be low margin orders?
- R. Vasudevan** It is fully sold off.
- Sagar Parekh** Fully booked in P&L?
- R. Vasudevan** Yes.
- Sagar Parekh** Any other project which we should be aware of going forward that will have no margin or let us say negligible?
- R. Vasudevan** We have a project in Nasik.
- Sagar Parekh** Going forward when is that going to accrue in revenue and how much revenue would that be?
- R. Vasudevan** About Rs. 25 crores again.
- Sagar Parekh** Rs. 25 crores and that would be in Q3, this quarter.
- R. Vasudevan** Not in Q3, it may happen in 6 months or next financial year.
- Sagar Parekh** That is the only project, right?
- R. Vasudevan** Yes.
- Sagar Parekh** Any other project in real estate, no?
- R. Vasudevan** No.
- Moderator** Next question from the line of Manju Bhashini from Sundaram Mutual Fund, please go ahead.



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- Manju Bhashini** I was asking about the EPC order intake during the quarter and the breakup between them in terms of the awarding clients and what is the timeframe within which we are looking to complete the existing order book of Rs. 2500 odd crores? I understand some part of it is not really picking up at the pace that we would like to?
- Management** This year so far we have already got an order booking of about Rs. 250 crores in the EPC front. The split of it being close to Rs. 100 crores is a residential project for Godrej, about Rs. 70 crores is an order in Chennai at our project which we are doing for Unitech, which is a combination of both residential as well as MLCP on turnkey and in Ludhiana we have got orders totaling to about Rs. 70 crores for a college and hospital and in Pune we have got an order for a school for Rs. 70 crores.
- Manju Bhashini** Where is this Rs. 100 crores residential project of Godrej, in which location is this?
- R. Vasudevan** It is near Undri, Pune only.
- Manju Bhashini** Going forward what would we like the EPC order book mix to be? Are we interested in pursuing more of residential projects because there is a little more stability over there and the cash flows are also better than the commercial ventures or going forward what is it?
- Management** Both, residential projects are also linked to the market and do go through their ups and downs within the project in terms of cash flows and so essentially what we are focusing on is whether it is residential or any type of building construction where it is on a turnkey basis as far as possible, so we can add value on the design, so that helps us have a better margin to absorb any issues that might come across in cash flows as we go ahead.
- Manju Bhashini** The residential project that we have just mentioned are they also again on a turnkey basis or we are only EPC contractors?
- R. Vasudevan** It is on a turnkey basis.
- Manju Bhashini** How is the margin difference between a pure play EPC project and a turnkey project, I mean, how different are the margins likely to be?
- Management** Typically EPC projects, on an item rate basis, it is very difficult to get beyond 15% EBITDA. On turnkey we should work in the region of 25.
- Manju Bhashini** But the kind of EPC margin that we have displayed so far does not seem to indicate anywhere close to those numbers, I mean what are missing?
- Management** What I am trying to say is that when you quote for an EPC project typically, you expect 15% EBITDA, I think with delays and with labor escalations, our balance sheets are showing in the



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range of 12, it is not showing 15, because you are not achieving what we intended to originally, so I am trying to say is in turnkey we are able to at least quote for a job expecting 25%, so maybe we do have problems of escalations and delays that 25 might come down to 22 or 21, but we would still be doing good.

Manju Bhashini

Are you seeing any hurdles, etc., limitations when we go ahead and bid for a turnkey project, are there any criterion that we may have to meet up with or win more of turnkey or what is the hurdle rate there? I was trying to understand what is stopping us from winning more of the turnkey project and is there anything that we would like to meet up with in order to bid for more of such turnkey or how much the competition reacting to it or what are we seeing there?

Management

To be honest, it is a good question. We in terms of capabilities, we are capable of bagging and executing more such projects. In terms of competition, there is not much competition who offer these kind of services, but having said that in terms of clients, it is still an education process where many clients invite tenders after they have appointed consultants and go through a BOPO process and so many clients are reluctant to change their mode of functioning and go for an order in this fashion, so we have been trying to give counter courts to clients where we can add value and that is how we have converted a few of these and going forward we are confident we will convert few more, but it is more from the client side as this method of contract becomes more and more popular, I am sure we would be increasing our order books going forward.

Manju Bhashini

I was just trying to understand how confident are we in achieving the 15 to 16% EBITDA margins on the existing order backlog of Rs. 2500 crores? Are you seeing any further pressure there on the existing order backlog or you think we have come past most of them?

R. Vasudevan

It is basically like this, on the older jobs, I think, we have got out of most of the older jobs, which were at those margins, but looking forward if you see it is difficult to predict. We do the costing and do the tendering and do the submissions based on the time period, now what is happening in many of these cases, the delay is happening not mainly because of us but mainly because of the changes in the clients and all because of the liquidity scenario or the projects not moving at the pace at which the client had foreseen it to be moving because of the market conditions. If that continues to keep happening, only thing now is we have got better protection after having learnt the experience of covering our downside, but it may not give us the margins which we are providing because overheads go up within the time stipulated period, that is why now we are being careful even when we are quoting for a job to find out how likely that project is to go ahead, whether it is a speculative project, whether demand is there, we do our own assessment and our experience in real estate gives us that advantage.

Manju Bhashini

Any issues that are yet to be resolved in the Shantigram project, what is the scope of this project progressing on schedule going forward?



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- R. Vasudevan** It is better than what it was in the beginning of the year, RCC we are fairly under control, but on the finishing front, we are just picking up at this point of time, there is also pressure in terms of labor availability there that is why the project is delaying. The finishing part has started now. The total pace at which the finishing should happen is still not reached the peak, but we are making efforts to see that we go forward further, but yes it is at a slower pace than what we had scheduled it or anticipated it to be.
- Manju Bhashini** On a monthly basis, how much of work is likely to be done in this particular project, and how much do we do here?
- R. Vasudevan** About 8 crores now, going forward, once finishing touches, we will do further.
- Moderator** Our next question from the line of Sagar Parekh from Enam Holdings, please go ahead.
- Sagar Parekh** When is the Renaissance project likely to start?
- Management** To be honest, we don't know. It is still on hold from the client side and there is no real communication on when it will really pickup.
- Sagar Parekh** Okay, so nothing as of now in terms of revenue has come from Renaissance, right?
- Management** No.
- Sagar Parekh** What about HDIL and TN Assembly project?
- Management** Both the answers are pretty much the same. TNA was talking to us about reviving the project this quarter, but again it has taken backseat, they are saying probably December, so we never know, they keep talking to us, but till it happens it is difficult to give a time.
- Sagar Parekh** So how much of it is still pending in the order book, the TN Assembly and HDIL both put together?
- Management** Both put together is about Rs. 250 crores. TN Assembly and HDIL put together, order backlog is about Rs. 250 crores.
- Sagar Parekh** Renaissance is Rs 1100 crores, right?
- Management** Yes.
- Moderator** Our next question from the line of H.R. Gala from Quest Investments, please go ahead



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- H.R. Gala** Just a follow-up one or two questions, how much would be the capital expenditure in this year, I believe, we were planning to spend something like 40 to 45 crores in this year, but looking at the movement in fixed asset, it does not seem we have spent that money?
- Management** We have put on hold all that.
- Management** We will not have any capital expenditure that foresee this year.
- H.R. Gala** So how much we would be spending this year?
- Management** Very less maybe 5 crores. We have put on hold. The requirements are not there so we are planning to create Assets Management Department and making use of the existing assets to the fullest extent.
- H.R. Gala** Basically the equipment?
- R. Vasudevan** Yes, equipment, scaffolding, shuttering assets.
- H.R. Gala** Okay, and you said that in real estate business, you expect margin at PBIT level to be around 25 to 30%, but when do you think we can realize that margin? Will it appear in our year end results from say current level of 11% that we have done so far in H1?
- Management** Actually to be honest, the retail selling that we are doing for houses are in those margin levels of PBIT only, but the real effect on balance sheet as Mr. Vasudevan had mentioned, increase in our real estate contribution itself to the total top line.
- H.R. Gala** My question was regarding this real estate PBIT that by year end if we do say revenue of 170 to 180 crores, what kind of margin can we expect to realize realistically?
- Management** I think going forward, again as we said, there is Nashik project which we foresee will not fetch us margins, so if that sale happens in this year that could again do like Almonte did this quarter, it brought down the margins a bit. If that sale does not happen going forward in the next six months then the balance 70 to 80 crores of real estate sales we foresee, should get us easily 20 to 25% margins.
- Moderator** Next question from the line of Manju Bhashini from Sundaram Mutual Fund, please go ahead.
- Manju Bhashini** Just one clarification, just wanted to understand if that Almonte revenue is included in the Rs. 58 odd crores of real estate revenue that we have disclosed?
- Management** Yes, it is.



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- Manju Bhashini** So then on a sequential basis, there is degrowth in terms of the real estate, like-to-like comparison, right? Excluding the sale value that we had realized, last quarter there was 42 crores reported revenue of which some 15 crores was again on of one-off, which was sale of Phoenix?
- Management** Last quarter also, we had this real estate sale of Phoenix, so categorize as real estate only. This is all real estate sales only, why do you want to....
- Manju Bhashini** This is the sale of commercial building, what I am trying to understand is how much have we realized from sale of the resident and commercial portion not the sale part, recognizing revenue from the residential part?
- Management** About 69 crores from residential half yearly.
- Manju Bhashini** Is that 69 crores for the first half and what is the comparative number for the first half of last year?
- Management** 63 crores.
- Manju Bhashini** In terms of volume sold, how are they different, first half of this year versus first half of last year?
- Management** Last year it was around 57,000 square feet was there, and this quarter it is only around 25,000.
- Manju Bhashini** We are talking about the first half of FY13 and first half of FY12 sale volume, am I correct?
- Management** We will give you purely residential, see the Almonte sale is considering the numbers in terms of square footage, we will have to work out purely in terms of residential comparison.
- Manju Bhashini** Sure, I will connect with you offline.
- Moderator** As there are no further questions, I would now like to hand the conference over to Mr. R. Vasudevan for closing comments.
- R. Vasudevan** I thank you very much for this call and if you can all feel free to send us any of your queries, if you have any further queries, we can answer them. Thank you.
- Moderator** Participants with that we conclude the conference. Thank you for joining us. You may now disconnect your lines. Thank you.