



“Vascon Engineers Limited 3QFY13 Results Conference Call”

February 14, 2013



MANAGEMENT: **MR. R. VASUDEVAN – MANAGING DIRECTOR**
MR. S. SUNDARAJAN – CHIEF EXECUTIVE OFFICER
MR. D. SANTHANAM – CHIEF FINANCIAL OFFICER
MR. M. KRISHNAMURTHI – CHIEF CORPORATE AFFAIRS

MODERATOR: **MS. CHHAVI AGARWAL – ANALYST, AMBIT CAPITAL**



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Moderator:

Ladies and gentlemen, good day and welcome to the Vascon Engineers 3QFY13 Earnings Conference Call hosted by Ambit Capital Private Limited. 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 this conference is being recorded. I would now like to hand the conference over to Ms. Chhavi Agarwal of Ambit Capital. Thank you, and over to you, ma'am.

Chhavi Agarwal:

Thank you. Good morning ladies and gentlemen. On behalf of Ambit Capital, we welcome you all to the 3QFY13 Earnings Conference Call of Vascon Engineers Limited. The company today is represented by its Managing Director – Mr. R. Vasudevan; CEO – Mr. S. Sundarajan; CFO – Mr. D Santhanam and Chief Corporate Affairs – Mr. M Krishnamurthi. I would like to hand over the call to Mr. R. Vasudevan for his opening remarks and then we can start the Q&A session. Thank you, and over to you, sir.

R. Vasudevan:

Dear friends, good morning. I welcome you all to Vascon Engineers Post Results Earnings Call for the December quarter. Along with me, we have our senior management team members, Dr. Santosh Sundar Rajan, Mr. Krishnamurthy and Mr. Santhanam. I will give you a brief overview of our results and key developments and after that we will be happy to take your questions.

Our consolidated revenue for the current quarter is Rs145 crores. The revenue for the nine-month period is Rs538 crores. EBITDA for the nine-month period stands at Rs36 crores. The company is in its endeavour to reduce all non-core assets and non-profitable projects. It has taken a conscious call to exit from some of the projects which have been slow-moving from a long period of time and are therefore economically unviable to continue on the same commercial terms.

In the current quarter, the company has exited some contracts with a backlog of about 1,124 crores which also includes a big contract of Renaissance Logistic Park at Bhiwandi, amounting to about Rs1,100 crores which was a very slow-moving project. Post the cancellations mentioned earlier, the EPC order backlog as on 31st December 2012, stands at Rs1,475 crores. As part of our business strategy, we are also reviewing some other contracts and exploring possibilities for renegotiation of the terms. We have achieved a breakeven in some of the contracts amounting to about 92 crores whose terms have been re-negotiated and revised. The projects currently under negotiation amount of Rs175 crores. We are hoping to achieve success in most of these projects, enabling us to continue with them at a faster pace and on better terms. This exercise has helped us in completely exiting from projects that were delayed, resulting in cost overruns or projects that were stalled due to non-payment by developers, affecting the execution cycle and resulting in a significant cost overrun. Due to this, we have



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taken provisions write-offs amounting to Rs13 crores pertaining to some of the projects in the current quarter, resulting in a loss at the consolidated level. We expect this exercise to be completed in the next few quarters, and after this, we would be working on a healthier order book which would bring in better revenues and profitability to the company thereby enabling us to avoid delays and improve the overall project execution cycle. The fresh orders are now being procured with better profitability, and the fresh order intake during the nine-month period is about 306 crores.

I am also happy to announce that the Tamil Nadu Legislative Assembly Project which was stalled earlier for almost two years has now been restarted. The assembly building is being converted to a medical college and the work on the same will proceed at full pace in the current quarter. We are pleased to witness, improved performance in our real estate and Clean Room Partition business. In the real estate business, the company has registered a revenue of Rs126 crores in nine months of the financial year '13 as against Rs93 crores in financial year '12, a growth of 33% in the current real estate scenario. The cumulative area sold for nine months in FY13 for projects under construction is 3,17,261 sq. ft., amounting to a sale value of Rs133 crores against 2,07,833 sq. ft., amounting to sale value of 118 crores in FY12, a volume growth of about 52.65%. The company is strategically focusing on the real estate development projects. We are trying to now leverage the strong land bank of 52.5 million sq. ft., which is totally paid for and available for development by working on strong pipeline of planned launches at various cities. This should yield us better margins and will also help in generating steady cash flow in the future.

Also, consistent growth is being registered in the Clean Room Partition and DBMA segment with a revenue of Rs136 crores in nine months in FY13 as against 106 crores in FY12 with a growth of 28%. The company has been making constant efforts to reduce this debt level, resulting in an overall reduction in gross debt to Rs322 crores in December 2012 as compared to Rs382 crores in March 2012. We are working on improving the liquidity position which would further contribute to debt reduction. We are also working on monetising our non-core assets which includes a couple of commercial building and equity stake in some of the hotels. We have already initiated the process and expect the same to be completed in the next financial year. We would now like to open the floor for the question and answer session.

Moderator:

Thank you very much sir. Participants, we will begin the question and answer session. We have our first question from the line of Nitin Idnani from Axis Capital. Please go ahead.

Nitin Idnani:

You said that this exercise of renegotiations of the contract should conclude over the next couple of quarters. I just wanted to get your sense in terms of the write-offs of the provisions that we have made of 12.5 or 12.4 crores this quarter. How much more of that do you think we could be seeing in the quarters to come before we can finally leave this behind?



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- R. Vasudevan:** I think it's difficult to exactly quantify, because there are projects where the clients are yielding because for them to replace with a new contract is going to cost even more. So we will have to do it this on a quarter-by-quarter basis, but roughly if you want an indication, it could be the same amount in the coming quarters.
- Nitin Idnani:** And just from an accounting perspective, even the ex-gratia provision for payment to employees or even this, wouldn't this just be more of a balance sheet item rather than coming in the profit and loss account?
- S. Sundarajan:** This is mentioned as a cumulative provision made during the current year, so the provisions will also affect the P&L while taking into the balance sheet.
- Moderator:** Thank you. Our next question is from the line of Mr. Mahesh Bendre from Quantum Securities. Please go ahead.
- Mahesh Bendre:** Just wondering if I have to take a view on our business over the next 2 to 3 years. How should I look at each of our business segments?
- R. Vasudevan:** We have about four verticals predominantly. I will start from the smallest one. The smallest one is the hotel vertical. The hotel vertical has been more of an opportunistic investment on locations where we have had our own developments and as a strategy we had done on two hotels and we are not running them and we had entered this to maximise our profits. The hotel scenario, what it is today across the country and also even before knowingly, we knew that this is a long cycle item and we will have to hold on to these for five years to really get full value out of the investments which we have made. Having said that, we are still looking at some of the locations whether there is an opportunity to exit at a lower return also. So that's the stand on hotels as such and we have roughly about 100 crores of our investments in the hotel portfolios. Now the next one is the GMP, which we have acquired 2 to 2.5 years ago. This business is growing in volumes and in value. The bottom-line improvement is what is needed here, and so we are working on a proper mix which will give us again the required bottom-line as well. This year I think we hope to end this at an amount of 190 to 200 crores, this GMP. And the next vertical is the EPC vertical. EPC vertical has been the vertical on which the company has grown from day one, and we come into real estate. As we had moved forward in the last 3 to 4 years, if you had seen, our concentration on real estate has been steadily growing but we don't want to lose out on our strength of the EPC business because we believe in the long run, the EPC business is here to stay because you need to execute your projects. So ideally strategically, we are going forward in terms of positioning ourselves to a 50:50 type of a situation or a 40:60 type of a situation where we do 40% of our revenues coming from EPC and 60% coming through real estate. And in the real estate, we have enough land bank and enough developable land which are immediately possible to put on development. When I mean immediately since the next one year or two years type of periods, some of course are ongoing, and so we are trying to focus and concentrate in getting this mix and getting a volume of about



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3 millions going forward to about 4 to 5 million per year in real estate business. That is the long-term strategy. So in three years, I think you have got a rough picture of where we are focusing and how we are trying to grow.

Mahesh Bendre: On the debt reduction side, what are the major things we are going to adopt? You had mentioned that asset monetisation is one way going forward. So, may be over the next year in FY14, what could be the possible date we will be carrying?

R. Vasudevan: For debt, our endeavour is to reduce the debt constantly, but at the moment it is difficult to say, so probably we will be lower by about 20 crores from 300 crores.

Mahesh Bendre: And just one general question. We have a huge exposure to the Pune market. What is our view on the Pune real estate market? Is there an overcapacity build-up or any slowdown we have witnessed in this particular geography?

R. Vasudevan: Slowdown is there across, I mean, across the country in the real estate market, and so Pune is no exception, but the advantage for us in Pune is that we have locations which are good. We have priced our products in a manner that it is marketable and the consumption is happening in that, although it is happening at a much slower pace than what it used to happen. And again since Pune has been our birthplace for the real estate businesses, acquisition of lands across this is very low and whatever land we have acquired they are all fully paid up and at very low values. So we are in a situation where we are able to create the supply matching to the demand. So we are not really going ahead and doing the buildings. Of course the land bank is there with us but the completion of the building is all matched to the demand which is happening.

Mahesh Bendre: Sir, last question is how is the response to our Malegaon project that we had launched a few quarters back and when the second phase will be launched?

R. Vasudevan: On the Malegaon front, also there is a little slowdown and we have had one legal issue coming up there which is almost sorted out and maybe we should be able to push this project to pass. We are moving little slowly on that project both because of the market scenario and both because of this, we wanted to settle.

Moderator: Thank you. Chhavi, you may go ahead with your question.

Chhavi Agarwal: Sir after this cancellation of orders from the order book, what is the change in the company's strategy for bidding for new projects that you would be looking at outside, external contracts so that the cancellations do not happen in the future or is there any change that you have adopted in the bidding strategy or probably evaluation of the project for the EPC talks?

R. Vasudevan: What we are doing now is we are being little choosy about the clients which we are looking at for the projects—what is the need of the client in the project and what is his track record in terms of the project—before we are taking up. Plus what we are also doing, what was more



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hurting us in the previous period has been the conditions laid down in the contract and because there used to be no escalation conditions, there used to be no delay. In fact, there used to be penalty for delays from our side whereas when the client delays the work he also puts the blame on our side. So these are the conditions on which we are also very stringent today and not yielding, and so these are the things which we are taking care of in the coming days. And also we are making sure that the contract is for a fixed time and any overrun in the time then we need to be compensated both for overheads as well as escalations.

Chhavi Agarwal:

Sir, given that in the construction industries still the contracts remain fixed price in nature, one; and secondly competition is very high and opportunities are limited, are you seeing a change in the customer mindset towards these new norms which is stricter to EPC on the part of an EPC contractor in terms of asking for cost escalations and a proper timely payment? Are they agreeing to this or are there certain customers who are shifting to this kind of a working style?

R. Vasudevan:

I think customers who are knowledgeable and intelligent are agreeing to this because they find that in the net run if they don't agree they are the losers because the time overruns, you end up into litigations, you are not able to complete the project and not able to deliver what you have promised to your clients. So there is a good amount of people who have understood this. Now coming back to your question of competition, but really speaking it is very surprising that in this field there are hardly about ten operators, and all the ten operators are big-time contractors. When I say operators, I mean contractors; all the ten contractors are suffering the same pain across and are realising the folly and the gaps, and I think it is not very long before which everyone will take a strict view and many of them have started. We see that in our tender negotiations, people are not willing to budge on their terms and conditions. So we are seeing that change, the shift which is happening. And I think it has to be from both sides; it is not necessarily only from the contractor that he needs to be little stricter than what he wants and also it has to be from the client side that he sees reality and understands and provides for them. And this is happening at this point of time, though still at a slower pace but I think in a year or so you will see equitable contracts; you will see better terms and conditions which is going to help both the client as well as the contractor. Both are interested in completing their work at the shortest time.

Chhavi Agarwal:

What is the debt level at December end, both standalone and consolidated?

S. Sundarajan:

320 crores at consolidated and standalone will be about 280 crores.

Chhavi Agarwal:

Sir one more question. I understand that we have removed certain contracts and execution is slow because of the external reasons, but when do we see this turning towards EBITDA positive in the next quarter or probably it will take one or two more quarters to get back to our normal high margins?



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- R. Vasudevan:** Basically, actually it also depends on each quarter how the mix is happening. Now coincidentally in this mix, we don't have any greater real estate input than what we used to have. I am not talking in terms of the percentage we have improved but in terms of the real value with profitable margin projects coming in, has not happened. So it will actually depend on how many of those are happening. So, it is difficult to predict. It will be tough for us for this quarter and may be the next quarter. The way forward we are seeing better things to happen.
- Moderator:** Thank you. As there are no further questions, I would like to hand the conference over to Chhavi Agarwal for closing comments.
- Chhavi Agarwal:** Thank you. On behalf of Ambit Capital, I would like to thank the management of Vascon Engineers for giving us an opportunity to host their conference call. I would also like to thank all the participants for joining the call. Thank you.
- Moderator:** Thank you. Participants, on behalf of Ambit Capital that concludes this conference. Thank you for joining us.