



“Vascon Engineers Limited Q2 FY'14
Conference Call”

November 13, 2013



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Moderator: Ladies and gentlemen, good evening and welcome to the Q2 FY14 earnings conference call of Vascon Engineers Limited. As a reminder for the duration of the conference all participant's lines are 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 the conference over to Mr. Santosh Sundarajan, Chief Executive Officer. Thank you and over to you Sir!

Santosh Sundarajan: Good morning everyone and a warm welcome to Vascon Engineers post results earnings call. Along with me, we have our M.D., Mr. Vasudevan and Senior Management team members, Mr. Krishnamurthi and Mr. Santhanam.

To begin with I will give a brief summary of our results and key developments in the quarter and then we will take question from you. With every quarter that passes by, the regulatory bodies are lowering their forecast for economic growth rate of India. Inflation remains high and expectations paged upwards. In latest monetary policy review, RBI has increased benchmark interest rates. This along with inflationary pressures has been adversely impacting our sector.

Overall we do continue to witness demand weakening and inventory building up in metro cities. However, the tier II cities like Pune, Bangalore, and Coimbatore are witnessing good sales and demand outlook is better compared to the metros.

Vascon for the quarter ended September 30, 2013 clocked consolidated revenues of Rs.160 Crores and an EBITDA of 8.35 Crores translating to a 5.2% EBITDA margin. Our profit before tax was at Rs.4.4 Crores and profit after tax stands at Rs.100,000 for this quarter as against a net loss of Rs.4 Crores in the previous quarter.

As we have already shared, we are focusing on improvement of cash flows in various business segments. This quarter saw some of the major breakthrough in our efforts of improving cash flow situations. We have collected more than Rs.15 Crores from long outstanding receivables, and also collected additional Rs.11 Crores from our stake sales in Zenith, Pune.

Moving on to the different segments starting with EPC. This segment contributed Rs. 63.6 Crores to revenue in this quarter. The positive development in this segment is that we have recommenced the work of TNLA project. The government has approved conversion of assembly into medical college and hospital and the provisional order has been issued in the last quarter.

We have also started collecting long outstanding receivables from this project. In this last quarter we have collected Rs. 3.8 Crores. On order intake front, this quarter we have received fresh



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orders of about Rs.73 Crores. This makes our order intake for the first half of this year to 117 Crores. With this our total order book stands at 911.5 Crores as on September 31, 2013.

As you are aware, a few quarters back we had commenced the process of reviewing existing contracts in the EPC segment and deciding either to renegotiate the terms of the contract to make it profitable or to exit loss making contracts. We have reviewed major part of our EPC contracts in our order book and completed discussions and renegotiations with many clients.

Now coming to the real estate segment, the real estate projects under construction are moving although a bit behind schedule. We have recognized revenue of Rs.31.5 Crores for these projects in this quarter. Last year same period the revenue was Rs.56 Crores, which included the sale of commercial buildings for a total sale value of Rs. 30 Crores. In operational parameter during this quarter we have sold total area of more than 100,000 square feet for total sale value for around Rs.61 Crores. Our average realization for the quarter was around Rs.6000 per square feet.

Cumulative area sold for the projects under construction stand at 1.6 million square feet. The total sales value of these areas is around 730 Crores. This quarter saw a few major developments in this segment. We launched Forest County phase II in Pune, residential project with a total salable area of 0.5 million square feet. This project has received a very good response. We have sold approximately 77000 square feet in this quarter itself with a total sale value of 44.6 Crores. Average sales realization for the project in this quarter has been Rs.5661 per square feet.

We have purchased TDR for our landmark Windemere Premium Residential project in Kalyani Nagar, Pune. With this TDR at our disposal, we can expect faster sanction of approvals for the sale. This will help us to maintain the sale momentum in this project.

In a soft deal, the company has also sold its 50% stake in Marigold project, Pune for a total consideration of 16.5 Crores and purchase 50% stake in Just Homes Project, Pune for a total consideration of Rs.6 Crores. This has resulted in a profit of 8.8 Crores in consolidated financials.

In October we have sold a stake in Zenith, Pune. From this sale we have received Rs.11 Crores. Earlier we had received 8 Crores. So till date we have received 19 Crores from Zenith and the outstanding amount of Rs.7.5 Crores further will be received shortly.

We are in the process of getting the required approvals for our Nasik and Chennai projects, receiving these approvals will also give us a boost to our sales.

Coming to our third segment, Clean Room Partitions and BMS. This segment is growing consistently for the last few quarters. This quarter it had contributed to Rs.60.4 Crores in



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revenue. Here we are focusing on increasing our footprint across domestic markets as well as overseas markets. With efforts towards increasing proportion of exports in sales, and building a healthy order book, we are striving to deliver stronger performance.

Finally, let me reiterate that we are maintaining our efforts on improving cash flows. We believe the sector is witnessing really require green shots of hope and with this we reiterate our confidence in the sector, our business and its future prospects. Thank you so much. Now we would take questions please.

Moderator: Thank you very much Sir. We will now begin the question and answer session. The first question is from the line of Nitin Idnani from Axis Capital. Please go ahead.

Nitin Idnani: Good morning. You said your order backlog was Rs. 911.5 Crores? Is that correct?

Santosh Sundarajan: That is correct.

Nitin Idnani: That is the third party contracts?

Santosh Sundarajan: Yes.

Nitin Idnani: You have added 73 Crores more in this quarter?

Santosh Sundarajan: That is right.

Nitin Idnani: 911 Crores is post the addition of this 73 Crores?

Santosh Sundarajan: That is right.

Nitin Idnani: Last quarter it was about 935 Crores, so we have canceled maybe another 20 Crores worth of orders in this quarter?

Santosh Sundarajan: We have executed a bit and yes we have canceled a bit, it is a combination of both.

Nitin Idnani: Would you be able to tell how much more have you canceled?

Santosh Sundarajan: Effectively we have executed 60 Crores in this quarter. So, out of that 935, 60 is executed, which brings it down to say 870 Crores and then if you add the new 70 Crores, it takes you to 940 Crores, so about 30 Crores is canceled contracts.

Nitin Idnani: Can you tell me what are the debts on the books is, gross and net?



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- Santosh Sundarajan:** The gross debt is 364 Crores and the net debt is 322 Crores on consolidated basis.
- Nitin Idnani:** Any of the sale of assets like your Marigold transaction, has it been entered into the accounts into this quarter?
- Santosh Sundarajan:** Yes it has.
- Nitin Idnani:** What would be the accounting effect of this if you can just help me with that?
- Santosh Sundarajan:** It is sale of investment.
- Nitin Idnani:** So, it comes under?
- Santosh Sundarajan:** Sale of investment, exceptional income. We have shown it under exceptional income.
- Nitin Idnani:** When do you expect the margins on EPC to start inching up again?
- Santosh Sundarajan:** As we said we have been revamping our order book to try to make it more and more healthy so, as it stands, I would say we are down to about 30% of our order book, 25% to 30% of our order book which is still I would classify as unhealthy and the balance 75% is the healthy order book with good margins. So, now as we go forward over the next few quarters, I am sure the GP levels of EPC should continue to improve.
- Moderator:** Thank you. The next question is from the line of Sagar Parekh from Enam Holding. Please go ahead.
- Sagar Parekh:** Sir, you mentioned that 35% of your order book is unhealthy, so what would be the margin range? Would it be in negative range or would it be like flat 0% or something?
- Santosh Sundarajan:** At the GP level it would be somewhere lesser. Ideally we expect between at around 15% for GP, here it would be probably in the range of 5% maybe.
- Sagar Parekh:** EBITDA?
- Santosh Sundarajan:** EBITDA on EPC and project wise it is difficult.
- Sagar Parekh:** Not project wise, 35% of your order book which you mentioned is unhealthy, so can we expect losses in those projects or how is it?
- Santosh Sundarajan:** No, it would not be losses. At EBITDA level we could say it should be a breakeven at least. It would not be losses.



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- Sagar Parekh:** 100% of your order book has variable price contracts or is it fixed?
- Santosh Sundarajan:** We do not carry the risk of material and key metal escalations. So in that essence it is all variable.
- Sagar Parekh:** Everything is variable, in terms of material?
- Santosh Sundarajan:** Yes.
- Sagar Parekh:** That is it from me Sir. Thank you.
- Moderator:** Thank you. Our next question is from the line of Manju Bhashini from Sundaram Mutual Fund. Please go ahead.
- Manju Bhashini:** Good morning to all of you. On the EPC side, what is the nature of these unhealthy order books like what all industries it constitutes that and when were all these orders won? Is there a possibility of cancelation of 25% to 30% of your EPC order book from hereon also and what are your thoughts on that? If it is only going to just breakeven at EBITDA level why are we so adamant on executing them or what is the possibility of them getting canceled?
- Santosh Sundarajan:** We have been doing this process over the last two to three quarters, wherever we could sort of exit from these projects, we have taken those calls. There are couple or three projects in our order book where we do have risks in terms of performance, guarantees, assets lying at the site of the client, which would prohibit us from taking drastic calls of stopping work at site, so, it is a case-to-case basis. We feel it is probably prudent to carry on work for the time being, release our assets from site and take a call maybe at a later stage.
- Manju Bhashini:** But what are the industries. Can you give a split broadly about this 30% of order book in terms of are they between few four to five projects or how many projects?
- Santosh Sundarajan:** These are between about three to four projects mostly for developers.
- Manju Bhashini:** Some color on that? Where are they based out of or who are the developers or why is it getting delayed like this? Whose fault is this? Is it mobilization from our end, which got delayed or the client themselves are not wanting to execute it further? What is the issue there?
- Santosh Sundarajan:** There is a combination of issues in all aspects. It is very difficult to point one single exact issue and find the point of blame actually. Labor shortage is one issue, which is an issue from our side. As we stand there is no denying it that we are not able to mobilize 100% labor at all our projects given the overall scenario in the country itself. Having said that there is again no project we are



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executing where the client having delayed us with drawings or with funds. So, it is a combination of all factors.

- Manju Bhashini:** Do you think there is still a possibility of executing them and making breakeven at EBITDA?
- Santosh Sundarajan:** Yes. That is why if we just delay, essentially delay is what is hitting us, but we have done our calculations and our profitability analysis based on where we stand and we are executing these projects at a decent rate, so when we do finish this over the next couple of quarters maybe we are quite sure we would not end up in negatives.
- Manju Bhashini:** When were all these projects won? What is the tenure of it?
- Santosh Sundarajan:** These are all typically two year projects, which are now extending into the third year.
- Manju Bhashini:** On the future accretion of the order book in the EPC side of business what is that we are reading from the marketplace? Are we seeing a traction happening or is it still a lull period across because when we speak to real estate developers it is not all positive things that we hear? What is your sense of the growth in the EPC order backlog?
- Santosh Sundarajan:** It is definitely slow. Added to it we are also being very choosy in the kind of orders we want to take going forward. So, given both the market itself is very slow as it stands and given our choosiness, our accretion of order is very slow. There is no doubt in that.
- Manju Bhashini:** On the real estate side I think you mentioned in your opening remarks that you have already got TDRs for the Kalyani project in Pune, and also expecting some approvals for Pune and the Chennai and other projects. Can you elaborate it further in terms of what is the scope of this Kalyani project? If I am right this is a JDA? It is not 100% owned project of ours?
- Santosh Sundarajan:** Yes it is a joint developer with a land owner, joint development and there was TDR pending. TDR was in our scope as per the agreement. We had to procure TDR which would then let us build a lot more than we were currently on the project. So finally we did manage to secure the funding and the source of the TDR and this quarter we have closed the purchase of the TDR and applied for revised plan approvals based on this. So in the coming quarter, we do expect to receive those plan approvals, which will permit us to build the project in full flow.
- Manju Bhashini:** What is the expected area to be developed there and what would be our share there?
- Santosh Sundarajan:** Residential is about 400,000 square feet and another 100,000 square feet of commercial. So about 500,000 odd square feet is the project size, our share is typically about 45% on an average.



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- Manju Bhashini:** This TDR procurement how much have we paid? Is it already getting reflected in the P&L this quarter or what is the cash outflow for this?
- Santosh Sundarajan:** It is having an inventory. It is added in the inventory and that is how the loans have also slightly gone up.
- Manju Bhashini:** According to us when do we think we can get the final approvals and start commencing work on this project?
- Santosh Sundarajan:** Windemere, we have got initial approvals.
- Manju Bhashini:** Not Windemere Sir, the Kalyani project?
- Santosh Sundarajan:** That is it.
- Manju Bhashini:** It is the same, is it?
- Santosh Sundarajan:** Yes. So, we are working on it already. The project is running. We only needed TDR to augment the upper floors beyond the eleventh floor we do in a building and we needed TDR to get the approval for the higher floors, which we have purchased the TDR and we have submitted for re-approval for the higher floors. We should expect it in maybe a couple of months, few months may be.
- Manju Bhashini:** Other than this I think, you were also looking out for another project, if I am right in the same Kalyani project? Is there another project?
- Santosh Sundarajan:** There is another project. But we are talking about here is Windemere project only.
- Manju Bhashini:** 100,000 is related to Windemere?
- Santosh Sundarajan:** Correct.
- Manju Bhashini:** Sir, what is the progress in that project with Kalyani Windemere project?
- R. Vasudevan:** The Kalyani Nagar Project is held up on the environment clearance because this is passing through more than 200,000 square feet and since the committee is just about being formed now, and there was the approval was held back because in between there was confusion regarding the road width height related to road width being different by the environmental committee compared to what is the local rules. So there is a slow approval being given at that point of time. Subsequently that has been clarified and plans and instructions have been given that the local rules should prevail, but unfortunately the team on this point, I think, resigned and then the new



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team which has just been about formed, they have not had their first sitting also. So all these projects, which are more than 200,000 typically are held up across Maharashtra state because of want of this environmental clearance. It is a larger problem issue on which we are held back.

Manju Bhashini: In that case going forward, and what was the progress on the Project. How much of sales have we done this quarter and cumulatively till date what has been done there and what is the expectation?

Santosh Sundarajan: We have not recommenced the sale after we were held back because of one litigation happening and it has got cleared now, and we should recommence in the month of December.

Manju Bhashini: What is this litigation about?

Santosh Sundarajan: The landowner had issues in the family as a result of which one of the brothers had on this distribution of land. He was given a particular portion of land, he objected to that portion although he had signed off the papers and settlement was done through the company law board so it took us a little longer time to get this judgment in our favor and that has been settled. Judgment has come in our favor.

Manju Bhashini: Is there any reduction in the developable area due to all these things?

Santosh Sundarajan: No. The land remains the same board and care facility it is only the way it was being demarcated we are objecting to that. It was more for the sake of objective it was done. It had no merits actually because it was already done on the basis of the understanding and mainly it was done through the company law board, so which could not have been challenged.

Manju Bhashini: So, in our view how much of sales can we expect in the residential business over the next one year to 18 months? What is the expectation from our end there?

Santosh Sundarajan: At present if you see the balance work on the commenced project, mean I have not included Talegaon for that matter. For the next two years we have about 600 Crores of revenues expected and recognized.

Manju Bhashini: Sir this is over the next two years?

Santosh Sundarajan: Yes correct.

Manju Bhashini: On EPC side what do you think will be the fair assumption there? Earlier we were expecting around 800 odd Crores of sales etc., but now there seems to be?

Santosh Sundarajan: It is the front, we are looking at about 400-450 Crores this year and the coming year also maybe about 10% more. what is happening today is even this EPC order book is lost headed in the sense



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that substantial portion is still towards residential, real estate developmental work. Previously we had a better mix of lot of industrial jobs and IT jobs as well, IT building jobs. Now both those sectors not performing as much in parts of the country, we are in a disadvantage there. So our percentage of dependency on the development side has increased, which is what we want to change, but that change is going to happen only when other sectors improve. So we had good amount of contribution coming from institutional, but again now the institutional primarily any institutions these were colleges and schools which were going up, but even there is a stagnation in the institutional growth especially in Maharashtra, you must know that these are the substantially vacancies now both in engineering and management seats. So, now that sector is something again, which is diminishing. In fact this year we hardly have any exposure there. We do not have any contracts from there. But we have some hospitals and other institutions replacing those, but industry has been something which has been not been satisfactory for us and that is one area where we want to be more focused on, but that is dependent on how that sector improves.

Manju Bhashini: By FY 2015 how confident are we of achieving 10% odd EBIT margin in case of the EPC business? Is FY 2014 going to see all that 30% of order book getting executed and the pain getting over by FY 2014 or do you think FY 2015 will still have some bit of it and maybe only after that we may get to see some positive results on the EPC business?

Santosh Sundarajan: Some minor backlog and corrections maybe there but we hope to be at least on the operational level, EBITDA definitely 10%.

Manju Bhashini: From the assets sales part, how much is expected by FY 2014? How much of debt reduction can happen from these assets sales that we are pursuing? Anything that is pending or any status updates there?

Santosh Sundarajan: The assets sales are moving at a slower pace than what we had anticipated due to couple of our hotel assets are also in fact industry also is being stressed. So, we have plans of creating another 100 Crores plus from these portfolios.

Manju Bhashini: Thank you Sir. Wish you all the best.

Moderator: Thank you. The next question is again from the line of Rohit Natarajan from Indsec Securities. Please go ahead.

Rohit Natarajan: Thank you for taking my question. Actually I joined the conference a little bit late. So, I may have missed it. So, I just wanted to ask the question on Clean Room Partitions. My question is pertaining to in this division is have we received any new orders in this quarter? How are we progressing on the Bahrain export orders and what are the kinds of topline that we are expecting in the real estate in the next two years?



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Santosh Sundarajan: We are progressing well in the GMP Clean Room Partition. On new orders because our capacity, we are a little slow on that. Bahrain order is moving on well. They have commenced and we are expecting to pick it up in the third quarter.

Rohit Natarajan: Also on the EPC front I mean, I would have missed it earlier, what is the status on the HDIL project? Like do we have any hopes like what the project would restart again?

Santosh Sundarajan: We are in talks with HDIL. We are on the verge of recovering good amount of our dues from them. As regards to restarting they do want to restart the project, but they are also a developer who are not very sure on how and when they want to go about that project there. They were thinking of converting it to a residential from a commercial. So once they are clear on their decision and they want to go ahead, we are pretty sure that we could negotiate our rates again and start working.

Rohit Natarajan: That is it for the time being. If I have any questions, I will get back to you. Thank you folks.

Moderator: Thank you. As there are no further questions, I would now like to hand over the floor back to Mr. S. Sundarajan for closing comments. Thank you.

Santosh Sundarajan: I would like to thank everyone for coming on the call. Have a good day. Thank you.

Moderator: Thank you Sir. On behalf of Vascon Engineers Limited that concludes this conference call. Thank you for joining us. You may now disconnect your lines.