Punj Lloyd Limited

Conference Call Transcript
February 8, 2011

Moderator: Ladies and gentlemen, good day and welcome to the Punj Lloyd Q3 & Nine Months FY11 Conference Call. As a reminder for the duration of this conference, all participant 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 * and then 0 on your touchtone phone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Gavin Desa from Citigate Dewe Rogerson. Thank you and over to you Sir.

Gavin Desa: Welcome everybody to this Earnings Conference Call, we have with us members of the senior management team of Punj Lloyd, namely Mr. Predeep Kumar Gupta, President (F & A), Mr. P. K. Gupta, Director & CEO of Energy South Asia & South East Asia, Mr. S.S. Raju,CEO Building and Infrastructure India, Mr. Pradip Tandon, CEO Building and Infrastructure Africa Operations and Joint CEO's of the Middle East & CIS , Mr Ravindra Kansal and Mr. Atul Jain. We will commence this call with opening remarks from Mr. Predeep K Gupta after which we will have an interactive Q & A session. Before we begin I would like to mention that some statements made during this call may be forward looking in nature and a disclaimer to this effect has been sent to you with the conference call invitation. Also I would like to emphasize that why this call is open to invitees it may not be broadcasted or reproduced in any form or manner. I would now like to hand over to Mr. Predeep Gupta to share some perspective with you with regards to the company' s operations and the results of the quarter under review. Over to Predeep.

Predeep Gupta: Thanks, Gavin along with all the members of the Punj Lloyd Senior Management Team, I welcome you all to this call.

To quickly recap the revenue for this period (9 Months) ended Dec 31, 2010 is Rs. 5,840 crore . EBITDA is Rs. 428 crore and the loss before tax is around Rs. 29 crore. As we informed before, our order intake was very low for first two quarters of current financial year. This has significantly improved only in the last quarter ending December 10. Consequently while execution has been progressing for most of the orders ,it is too early to book any revenues. We believe that this is most likely to begin from the first quarter of the next financial year. Our order book continues to be strong and today amounts to Rs. 27,000 - 28,000 crore. We have won orders across all the verticals and business segments. We are seeing a good progress in the execution across most of our projects and we expect to improve the performance going forward. Thanks and now we invite the questions.

Moderator: We have the first question from the line of Pritesh Chheda from Emkay Global.

Pritesh Chheda: My question is on Libya those 3, 4 projects. What is the status of those three projects and the execution flow in the next two years? Secondly we have a lot of operations and projects from MENA so if you could spend some more time on the execution progress in the projects coming from MENA and lastly on the order backlog since every quarter the margin variations are pretty large so if you could give us some idea on the margins in the backlog.

Ravindra Kansal: In the Middle East and North Africa region, the prospects are looking very good especially with enormous opportunities coming from Iraq and Libya and sub-Sahara and Africa. We have positioned ourselves to intake more and more projects in Iraq. Projects are on track barring few hitches which is very normal in any project cycle and order book is healthy, revenues are on target.

Pritesh Chheda: Any project where the execution is extremely slow, where it is stuck up or the project is on cancellation, any of it in this particular region?

Ravindra Kansal: Not a single project in Middle East and North African region is going slow or is on the verge of cancellation.

Pritesh Chheda: My question is on the Libya side, what is the status of the orders and how should the execution be in those projects?

Atul Jain: We have got five infrastructure projects from Housing and Infrastructure Board of Government of Libya and these projects are basically infrastructure development in the existing settlement area. Two of these projects are in Tripoli area that is Arada and Souk Al Juma wherein, the Punj Lloyd portion is approximately $420 million because these two projects are being executed in joint venture with the Public Works Department which is a subsidiary of client, HIV, and we will be executing 85% of the portion and they will be doing only 15%. Another three projects are West of Tripoli, Ragdaleen, Zawara, and Al Jamail where Punj Lloyd has got these three projects worth about $350 million. So we have order backlog of $750 million in respect of these five projects and as I mentioned, the infrastructure has to be developed under the existing settlement area so the master plan which was to be provided by the client was delayed but now we have started releasing the master plan phase by phase and we have already carried out the survey and the engineering of those phases, the projects are therefore now moving. Also initially there was a delay in getting the advances against these five projects but now we have got the 15% advance against all the five projects so we believe now that these projects are on track and required resources have been mobilized and we should be actually generating the revenue in line with the execution plan and the schedule from next financial year.

Pritesh Chheda: Have you booked anything in the current financial year?

Atul Jain: That is to the extent of USD 16-17 million. We expect to book the revenue of 15-20% of order value in next financial year.

Pritesh Chheda: But the crew and the equipment mobilization has happened in quarter four of last year?

Atul Jain: We started our resources mobilizing as per requirement cautiously as we wanted to gauge the fund availability from the client. Now they have issued us the master plan phase by phase and we are getting the funds. Mobilisation of resources is done accordingly in line with project requirement.

Pritesh Chheda: What is the mobilization expenditure that you are incurring every quarter since the last three quarters on the Libya project?

P.K. Gupta : Expenditure incurred is in accordance with revenue booked as mentioned earlier**.** Further details can be replied on specific query separately.

Pritesh Chheda: On the order backlog there is a lot of volatility in the margin every quarter, if you could tell us what is the likely margin that this backlog can generate.

P.K. Gupta: With respect to the margin variation, yes in some of the projects we have the margin variation on closing of the job. This is normally due to the escalation of cost and these escalation of costs are due to the MTU variation, some extra works being carried out and extra claims are not settled with regular billing but after job closure. Most of these margin variations are there in projects where PSUs /Government companies were involved . As per accounting practices we cannot book revenues against these extra works or extra claims till these are approved finally by the client. In most of the cases of margin variations, we have registered our extra works claim or extra claims with the clients which are under review . They will take some time to settle and on settlement, these would add to the bottom line.

Pritesh Chheda: But if you could tell us a certain number in terms of the margins on an annual basis that this backlog can generate?

P.K. Gupta: This is a regular feature and every year it moves on.

Pritesh Chheda: Can you tell the exact number of projects?

Predeep Gupta: We expect project margin in existing backlog orders in the range of 9 to 10 % on average basis .This may vary based on progress of projects falling in specific slab of margins, segments, region etc. I also support views of Mr. P K Gupta that cost of extra work is booked as when incurred but revenue is booked against claims on acceptance of clients. This has impact on margin variation substantially at times.

Moderator: The next question is from the line of Venkatesh B. from Citigroup

Venkatesh. B: Can you tell me what went wrong in this quarter that you had to book Rs. 62 crore loss, where have you taken write-offs? Is it related to Simon Carves and what is the quantum of write-offs you have taken in this quarter?

Predeep Gupta: No there is no write-off. Nothing is related to Simon Carve .The only reason is very low intake of the orders in first two quarters . Major portion of Rs. 9,000 crore (approx) orders have received in the last four to five months only. So the execution is progressing but it is too early to book the revenue against that and due to absorption of fixed overhead, there is a loss.

P. K. Gupta: Yes ,this is correct**.** The reason for the loss which primarily is because of the low revenue. You see the first quarter, at some of the power projects execution have moved very slow against which the revenue could not be booked and second in our offshore division we could not book any order in the last year but we have continuous expenses such as Depreciation, regular maintenance expenses due to capital asset, interest payment towards financing . However, we hope that if we have the orders towards this offshore division ,we will have sufficient margins in the next financial year.

Venkatesh. B: Would it be logical to say that next quarter also given that lot of projects you know, there isn't enough pick up, we could see a similar loss in the next quarter also.

P. K. Gupta: I will not be able to comment on that because we do not give any guidance.

Venkatesh. B: Specifically to Simon Carves at the end of the second quarter when the conference call was held Mr. Atul Punj had said that in the second quarter Simon Carves had litigation with a subcontractor called Geldof whom we paid £1.8 million in the part of the second quarter results. We also mentioned that there were pending litigations with subcontractors totaling to £18 million on existing contracts. So have you taken any more hits because of this £18 million?

Predeep Gupta: No. There is no such hit to bottom line .This was provided in last quarter and there is no issue further . Rather the progress in two or three cases are very positive, however these have not reached a final decision .

Venkatesh. B: But there are still pending litigations for £18 million there.

Predeep Gupta: Yes, that is going on. The litigation normally takes long time .We will keep posted on progress of these cases .

Venkatesh. B: The second thing is on the Ensus project of Simon Carves still Ensus still holding £7.7 million retention money, £2.2 million of guarantee which is with Simon Carves. What is the update on this?

Predeep Gupta: Since the warranty period is still going on and reported defects from clients are being serviced by us. Warranty period would be over in end of the March .We expect to get Retention and BG back unless the client starts another dispute.

P. K. Gupta: Cash Retention money and BG with clients is as per the contractual obligation. and this money can be claimed back only after warranty period is over. We are holding on to that and this will happen only in March or April this year itself.

Venkatesh. B: Now you have an order backlog of around Rs 278 billion. Out of that 1/3rd of the orders are from Libya which have been won by Punj Lloyd and Sembawang. The average execution cycles of those orders are almost four years.

Predeep Gupta: yes **-**four to five years.

Venkatesh. B: The remaining orders on an average would be at least two years so an average the overall order backlog execution cycle should be somewhere in the range of around three years. So would it be logical to say that with a Rs. 278 billion order backlog and an execution cycle of say three years, we can possibly do only say Rs. 90 billion of revenues next year?

Predeep Gupta: No . New order booking in first & second quarter of the next financial year would also add to said revenue numbers .

Venkatesh. B: Do you expect the sales to grow next year?

Predeep Gupta: Absolutely, we are very positive. The exact guidance cannot be given but we are hopeful of doing much better than this financial year.

Venkatesh. B: You had also bid for a 30% stake in Bharti Hexacom, can you give an update what is happening on that front.

Predeep Gupta: Mr. Punj explained last quarter that that was not a serious bid at all. It was one of the opportunities considered to reduce our debt quickly. We have no plans to come in telecom sector.

Moderator: The next question is from the line of Shrinivas Rao from HDFC Mutual Fund

Shrinivas Rao: Based on the current order book, even if I exclude Libya, what kind of revenues you have to book in FY11 and FY12?. I am talking about existing order book.

Predeep Gupta: As you know we do not give any guidance.But based on rough estimate and considering average period of 3-4 years completion and new orders in Ist half of next financial years , 20 to 25 % growth would be expected .

Shrinivas Rao: But what will be the number in FY11 sir?

Predeep Gupta: Due to nature of business and industry ,it is not possible to any specific guidance in numbers.

Shrinivas Rao: Can you tell us what are the borrowings at the end of the December on the balance sheet?

Predeep Gupta: As per consolidated accounts**,**the debt outstanding is Rs.4600 cr (approximately) & the Cash & bank balance is Rs.1200 cr (approximately) .so net debt is Rs. 3,400 crore (approximately).

Shrinivas Rao: What is the working capital situation? And particularly on inventory level, so you have been carrying very high inventory level.

Predeep Gupta: **I**nventory does not comprise only material items ,components or spares but that also includes the work in progress of the projects . Work in progress indicates work progress to be billed to clients based on milestones achieved .As compared to previous quarters, working capital levels are high .This would include WIP and Accounts Receivables pertaining to some cases under litigation such as Heera project of ONGC .We have focus on reduction of levels by aggressive collection drives and ensuring WIP to billing by pushing project teams to achieve miles-stones.

Shrinivas Rao: But my question is not on receivables, my question is on inventories.

Predeep Gupta: Inventory includes normal inventory and WIP both.

Shrinivas Rao: Inventory and WIP including combined numbers has been very high and I wanted to know is there is any improvement on that. Can you tell us the actual numbers?

Predeep Gupta: We are at higher levels as compared to the previous quarter and would work to reduce the same effectively.

Moderator: The next question is from the line of Kalpesh Gothi from Wallfort Financial Ltd.

Kalpesh Gothi: What was our cost of fund for this quarter and the previous quarter?

Predeep Gupta: Cost of fund on average basis should be below 7% in case of overseas and 9% in India so 8.5-8.6% (approax) on consolidated basis .

Kalpesh Gothi: On Q2 of FY11?

Predeep Gupta: It is slightly lower in Q2 FY11 as compared to Q3 FY11.

Kalpesh Gothi: We have the net debt of close to Rs. 3,300 crore for this quarter.

Predeep Gupta: Yes.

Kalpesh Gothi: And in second quarter is close to Rs. 3,200 crore but there is a decline in interest cost?

Predeep Gupta: We have different category of loans –NCD,working capital ,Borrowing in Rupees and USD etc.Cost might be slightly higher .However due to upward revision of rates by 50 basis points, cost may go up so we need to manage fund and its float efficiently to keep the cost control.

Kalpesh Gothi: We are seeing that the interest rates have been on a rising trend across all markets. What is the total amount of debt repayment that we did if any in these two quarters?

Predeep Gupta: As such debt repayment is not substantial except where project loan is closed Also new working capital would be tied up for new projects.We are expecting similar levels of debts outstanding in next quarter also.

Kalpesh Gothi: But we have gained on the total debt front.

Predeep Gupta: **T**here is no significant change.

Kalpesh Gothi: I think Rs. 121 crore is the total net debt that we have gained.

Predeep Gupta: This is on account of New working capital finance tied up on new orders.

P. K. Gupta: These are project based loans., so the old project are paid back and loans against against the new projects are sanctioned.

Kalpesh Gothi: Just wanted to understand about the entire unclear picture of the guarantees and liabilities that we have been facing since almost a year and a half now. When the air will get cleared and when are we going to breathe easy? The claims the bank guarantees of some, you know the entire picture.

Predeep Gupta: Your query is not clear to me .Bank Guarantees are given as per contractual obligations of the projects and are disclosed in Contingent Liabilities of audited accounts.

P. K. Gupta: No guarantee in SABIC is the outstanding. It is only one guarantee of £2.7 Million outstanding in Ensus **Predeep Gupta:** Reply can be provided separately for any clear specific question on that.

Kalpesh Gothi: My question was related to Simon Carves only.

Predeep Gupta: In Simon Carves we have only one guarantee at present pertains to Ensus which would be released after warranty period expired.

Amit Sharma: And are we in litigation with that?

Predeep Gupta: No, there is no litigation. As explained earlier ,the warranty period is going on and bank guarantee would be released on completion of warranty period in march or April **.**

Moderator: The next question is from the line of Naveen Jain from Indiabulls Securities

Naveen Jain: Just a small clarification actually on your order book. Was there any revision downwards in your Libyan orders ever I think in the second quarter.

Predeep Gupta: No, we have not done that.

Naveen Jain: So is there a risk of that?

Predeep Gupta: No, Mr. Atul Jain has explained about all the Libyan booked. Progress on execution is slow but going on .These projects are on their way ahead.

Naveen Jain: So this almost 9,655 cr of backlogs that is there in African region is all the Libyan orders right?

Predeep Gupta: yes Rs.9 Billion for Libyan orders.

Moderator: The next question is from the line of Sumit Kishore from JP Morgan

Sumit Kishore: My first question is on the Middle East order inflows, my understanding is that the South Korean companies have staged a near complete wash out of the process or tankage and terminal orders in CY10, in Middle East and they have won over 70% of the orders and they have under priced competition also. Is this situation is going to prevail in CY11 also?

Ravinder Kansal: You are right that the current financial year, Koreans have really taken away all the contracts whether it was refinery or pipeline or tank terminals and most of these contracts, they have taken it between 50% to 60% of client's budget and we have worked closely with one of the Korean companies to understand their strategy .However it was beyond our understanding that without covering any risk and contingency, they are taking the orders below their cost. It is not clear to us whether they are supported by their government. But they continue to be aggressive in the market, but recently the NOCs, the National Oil Companies have started showing concern over about their execution capability. So we may see change in future but not a significant change.

Sumit Kishore: So CY11 may also see domination by these South Korean players.

Ravinder Kansal: Yes.

Sumit Kishore: Is that the reason why you are now talking about Iraq also as a possible geography because you know may be in Iraq, the South Korean's might not compete so aggressively.

Ravinder Kansal: That is one of the factors . we are going to Iraq as Iraq has always been in our radar for finding business opportunity for some time now .Since the conditions have improved, business opportunities are looking robust, so we decided to move into Iraq.

Sumit Kishore: Sembawang order which is about Rs.58-59 billion and this was booked 1QFY10. My understanding is that the execution there has not quite progressed?

Predeep Gupta: **Yes ,t**here is no progress on that. Mr. Punj is in touch with senior authorities of clients company . So something positive is expected in the next financial Year .

Moderator: The last question is from the line of Indrajeet from Macquarie Securities

Indrajeet: I think Venkatesh asked the question about decline or any kind of losses and you said there is nothing, but if you look at material cost again on a yearly basis or quarter-on-quarter basis they seem to have spiked significantly. So what has been the key reason for that in this quarter?

Predeep Gupta: Our EBITDA of the 9 months is 7.2% .. The margins are not similar across projects ,business segments and geography . It depends upon revenue booked from different business segments. One of the reason is low progress in Libya orders and no business in Offshore as explained earlier.

Indrajeet: I am comparing Q1, Q2, Q3, and steadily you have seen some revenue increase happening in this year. If you look at your other expenses or the staff expenses, they more or less remain kind of flattish or slightly increased more or less in line with the revenues. It doesn't seem to be a bit margin pressure because of fixed cost. But are you suggesting that if you take out Libya, then the quality of the revenue or the margin potential of the order book would not be a sustainable 9-10% kind of a margin and would it be much lower? Because over a period of time on number of occasions Mr. Atul Punj and various other people have talked about targeting somewhere closer to 10% margin, for the company.

Predeep Gupta: We may estimate project margin between 9 and 10% .In the past margin more than 10 % was forecasted in orders like Libyan ones.

Indrajeet: Is your assumption of 9% based on including revenues from Libya which are at 14-15%?

Predeep Gupta: This is based on including revenue from new orders being targeted for bidding in forthcoming quarters and Libya Orders.

Indrajeet: I am asking about the current, existing order book. If we exclude this very high margin Libya projects, is it fair to assume that the margins would be in the range of around 6 to 9%?

Predeep Gupta: Yes, They would probably be in the range of 9% . If we book revenues on Libya orders then it would impact margins positively.

Moderator: Thank you. So would you like to make any closing comments?

Predeep Gupta: ladies and gentlemen- Thank you very much. The team is very attentive and strict internal review on projects are on. With focus on the cost innovations and good future orders We expect the good performance of the company for the next financial year. .