Punj Lloyd Limited

Investor/Analyst Conference Call Transcript

May 02, 2012

Moderator: Ladies and gentlemen good day and welcome to the Punj Lloyd Q4 FY12 Earnings Conference Call. As a reminder all the 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. If you should need assistance during this conference call please signal 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 the conference over to Mr. Gavin Desa from CDR India. Thank you and over to you sir.

Gavin Desa: Good day everyone and welcome to Punj Lloyd's Q4 and FY12 earnings conference call. We have with us Mr. Luv Chhabra – Director Corporate Affair, Mr. Shivendra Kumar – President and CEO, Energy, South Asia, Mr. Sanjay Goel – CEO, PL Engineering and Mr. Raju Kaul – CFO. Mr. Atul Punj and Mr. VP Sharma – President Offshore and Mr. PK Gupta - Director will likely to join us during the call.

A quick recap on the numbers. The current order book stands at ₹27,276 crore, revenues are ₹10,784 crore for the year. EBITDA at ₹1,124 crore and PAT at ₹112 crore.

Before we begin, I would like to mention that some statements made during this call may be forward-looking in nature and disclaimer to this effect has been sent to you with the conference call invitation. Also I would like to emphasize that while this call is open to all invitees it may not be broadcasted or reproduced in any form or manner. May I now request Mr. Chhabra to make the opening remarks and then we can start with Q&A.

Luv Chhabra: Ladies and gentlemen very warm welcome for our financial year 2012 annual results conference call. We have seen both global and political environment in the last financial year, being a pretty challenging environment and not withstanding that the results has been fairly good. Our revenue growth on the consolidated basis has been 32% or EBITDA numbers have grown by 30% and the PBT numbers has grown from ₹16 crore to ₹193 crore. So it has been a good number and as I said both the political and the economic environment across many markets where we operate has been very challenging.

Our outlook continues to be cautiously optimistic, though there will continue to be challenges in market like Libya where there is a still a lot of political uncertainty and infighting amongst the various tribes. India of course has some peculiar challenges particularly with some of our clients which earlier were very robust and we are now finding that many clients in government owned companies or government owned sectors are finding it more and more challenging to put them to paper and therefore there are difficulties in the realizable payments. Neverthless these are issues that we get resolved over the period of time and our own outlook for the future is that the oil prices are likely to continue at these levels our outlook continues to be cautiously optimistic. We do have a lot of backlog which is in the region of $5.5 billion so there is good traction and momentum going forward. So we now it open for questions and will be delighted to answer your questions.

Moderator: The first question is from Venkatesh Balasubramanian from Citigroup Global Markets India Ltd.

Venkatesh: What was your deferred tax liability net fixed assets, and the breakup of current assets and current liabilities?

Raju Kaul: Deferred tax liability is on 31st March, 2012 is ₹171 crore as against the asset of ₹16 crore in the consolidated books and the inventory is around ₹6,000 crore, trade receivables is ₹2,400 crore cash bank balance of ₹965 crore with loans and advances of around ₹1,600 crore.

Venkatesh: What is the current liabilities and provisions?

Raju Kaul: ₹5,900 crore.

Venkatesh: What are the total investments?

Raju Kaul: Investments are only ₹370 crore.

Moderator: The next question is from Sumit Kishore from JP Morgan India.

Sumit Kishore: Could you briefly outline the options that you're considering to pair debt level cost of borrowing and working capital levels?

Luv Chhabra: Cost of borrowing will only come out by a shift in debt to some of the geographies where the cost of debt is lower. The total quantum of borrowing will come down over a period of time with increased revenue and increased profitability.

Sumit Kishore: What about working capital levels?

Luv Chhabra: Working capital over a period of time has come gradually but not as quickly as we would expect it or we would have liked to come down. As I said they continued to be challenges in India in terms of realizing payment from the government owned entities and will continue to work hard. Libya is has been a big challenge for us. I do not think political situation in Libya has stabilized as yet they are going to hold elections in the month of June I believe it puts a question mark whether the elections will be held. There is a lot of infighting taking place from the tribal's; some money has released but it has been a very small on the upstream business about a $1 million being released they are finding it difficult to get people to go back to Libya because India has never supported, has supported too late the new regimen in Libya so getting visa the Indian are at the bottom of the pile every time we apply for visas with Libya and as I said that political situation is not very stable at the moment we are hoping in the next 3 to 6 months the situation will have some greater degree of stability so that work can resume.

Sumit Kishore: The pipeline order backlog that you have reported seems to have slipped from ₹59 billion at the of December quarter to ₹37 billion and now without the corresponding growth in revenue in the fourth quarter; have some orders been dropped from the back log?

Luv Chhabra: No there has been no drop in the pipeline orders there has been execution of pipeline orders there is no drop for every time this is a situation it is not an order book situation so order has been executed and recognized in revenue consequentially the order backlog number will reduce if there is no addition in that particular sector.

Sumit Kishore: I was referring to the quantum of sea drop in the order backlog in the pipeline segment from ₹59 billion to ₹37 billion the difference is ₹12 billion and the implied revenue for the pipelines segment as per your difference of full year and nine months numbers is much lower so hence the question?

Luv Chhabra: I have not done the comparison but I can ask to do the comparison and see if there is any error in the numbers that have been reported.

Atul Punj: Comparing these drops basically the functioning of the timing of project wins and project execution also trying to do a constant comparison about growth over a particular vertical on a regular basis is not the right way of comparing this particular subject. You have one major win tomorrow and you'll have the whole numbers of your skewed again in the other direction.

Sumit Kishore: We have been reading that Samsung trying for instance of $1 billion EPC contract with the oil Ministry and Duke Oil where the other bidders including Punj Lloyd had bided $1.8 billion, SNC Lavalin at $2 billion so the difference between the bids by the European companies and Punj Lloyd versus Samsung there seems to be a 50% difference; what I'm trying to understand is qualitatively why there is such a sharp difference between Koreans and the other bidders?

Atul Punj: The bidding philosophy of the Koreans is something that is a mystery to most of us in this space and whether it is Hyundai winning the nuclear projects in Abu Dhabi with the price difference of $8 million over Areva which even they are trying to figure out it is something we should not waste our time over. At the end of the day we have a win bid ratio, so the win bid ratio has been fairly consistent you'll find we regularly bid approximately 4 to 5 times the amount of work that we win so that is the kind of industry standard so if we're going to look at all the wins all the losses that is something that will take us into a path that is not really end up anything substantial coming out of. Main thing is order backlog has been growing continues to grow and other than Libya which is moving back gradually everything else is on track.

Moderator: The next question is from Rajesh Agarwal from Moneyore.

Rajesh Agarwal: Can we have the breakup of the other operating income and other expenses?

Raju Kaul: We will have Forex gain there and the other income of around ₹50 crore and other income around ₹42 crore.

Rajesh Agarwal: FOREX gain is how much?

Management: FOREX gain partly realized, partly unrealized on a full year is close to ₹180 crore.

Rajesh Agarwal: You are talking about ₹180 crore annual number?. I guess there has been some regrouping of items that has led to a transfer of around ₹120 crore from other income to other operating income if I'm talking about the December quarter numbers?

Raju Kaul: There has been some numbers are regrouped

Rajesh Agarwal: What is the regrouping?

Raju Kaul: This is primarily on account of partly FOREX gain was on 31st of March, 2011 and for the last 6 to 7 years it was part of the operating other income but post 31st March 2011 we had shifted it down to other income which is again regrouped to other operating income.

Rajesh Agarwal: So, now all of the FOREX gains and losses are translational?

Raju Kaul: Partly profit and partly realized loss or gains.

Rajesh Agarwal: So now we have all of them considering in other operating income?

Raju Kaul: Yes.

Rajesh Agarwal: What has been the order flow during this quarter?

Luv Chhabra: The total order backlog as it stands is approximately $5.5 billion

Rajesh Agarwal: What is the reason for such a sharp drop in depreciation quarter over quarter?

Raju Kaul: There is no decrease in fact it has gone up.

Rajesh Agarwal: From December quarter to March quarter? It was ₹90 crore in December quarter depreciation and it is currently quoting at ₹70 crore.

Raju Kaul: It is on account of change of depreciation policy on the rig in one of the subsidiaries which has actually reduced the depreciation in this quarter from the correction from day one and the depreciation rates have changed as a result of that the depreciation write back is there.

Rajesh Agarwal: Going forward should we consider ₹70 crore as the benchmark or ₹90 crore as the benchmark for quarter?

Raju Kaul: You can consider that as ₹70 crore based on the present asset base which we have it will be close to ₹70 crore.

Rajesh Agarwal: What about the other order traction in Southeast Asia?

P K Gupta: The South East Asia backlog will be close to $1 million. Are you asking south-east Asia or South Asia?

Rajesh Agarwal: Southeast Asia and we were expecting good orders from Indonesia and those regions?

Management: We have more than ₹5,000 crore worth of backlog in Southeast Asia.

Rajesh Agarwal: How the business environment and traction there?

P. K. Gupta: Business environment in South East Asia is good. We are currently working in Malaysia, Thailand, Singapore and Indonesia. Indonesia is a developing economy and we feel that in the times to come we will have more orders from Indonesia in addition to Malaysia and Thailand.

Atul Punj: To further put some weight on that comment that Mr. Gupta just made both Mr. Gupta and myself are in Southeast Asia as we speak. So that is the kind of attention that we are getting in Southeast Asia.

Moderator: The next question is from Srinivas Rao from HDFC Mutual Fund.

Srinivas Rao: You have been focusing on improving working capital for some time now. Can you tell us the initiatives taken, progress made and what can one expect over next 12 months on this front?

Atul Punj: I think, what we are really obsessed right now is bringing our cost of money into a reasonable zone. The effort really is to reflect the debts to the countries where we are actually doing the activities. Right now we have about 80% of our borrowings in India but almost 60% of revenue from outside India. What we are trying to do is rationalize it and raise the money externally which we used to repay at repair down some about Indian debt which is at very high cost. Also the one evenfall of course, so really looking to replace our debt with foreign borrowers which should be as much lower rate which should have impact on the interest burden coming down in the short term. That's where we are focusing right now.

Srinivas Rao: Can you tell us what is happening on the inventory and debtors collection side, what are the challenges there?

Atul Punj: I think the challenges really are in terms of the Indian PSU, I think it is a reflection of the oil subsidy on the oil companies ability to be as good pay masters as they used to be, somewhat compromised right now. So that is some area that we are feeling a bit of pain, payments are coming but they are coming in later than they used to come in so hopefully as time goes on the that situation will improve. We don't think the down stream companies in India can be allowed to stay in this condition. So we are hoping that the debt cycle will immediately impact the working capital cycle because right now we are running at levels of about 180 days which is unacceptable as far as we are concerned but our constraint is that clients are not making payments on time or before time like they used to.

Srinivas Rao: What is the outlook for the order inflows or big pipelines? What can we expect in this current financial year in terms of new orders inflows?

Atul Punj: I think bid slate is fairly long and the countries that we are working are fairly widespread. We have pretty much delist ourselves quite comfortably from the India story which is now pushing to be trying to be get broad brush with everybody else from our space but as I said that our order backlog is that $5.5 million - $6 million. We are seeing that definitely growth is coming here as well. We are not seeing any shortage in terms of bidding activity on projects which are financially closed. So we are quite comfortable in terms of what is happening. I think the certification of our approach is visible that now we are finding most of our peer group in India appearing internationally as well, which shows that our strategy over the last few years actually was the right one. So we are not worried about fresh order inflow, we are more worried about now making sure that our bottom line keeps on improving rapidly, our working capital days keep reducing our cost of money comes into a reasonable zone that is predictable, that's what our focus is. We are not concerned about order inflow that will happen.

Srinivas Rao: Which geographies you are focusing on getting new orders?

Atul Punj: Southeast Asia, Middle East, Africa these are the immediate areas other than India which is moving at its own pace but Southeast Asia, the Middle East and Africa are the major geographies we are focusing on.

Srinivas Rao: Given the competitive intensity, are you lowering your threshold margin limits to win projects?

Atul Punj: No, we are not. We are holding firm. Some of the questions that were put earlier about, some of the other smaller companies dropping prices, we are not compromising on our margins level at all. We are willing to do that much for the biding activity to make our win-bid ratio but we are not compromising on our margins.

Srinivas Rao: Can you tell me what the average interest cost was in the 4^{th} quarter for the company?

Raju Kaul: I will primarily talk about India and Middle East put together, our average cost of borrowing on the working capital was slightly over 11% and for the term loans also it was in the range of 11.5%. While applying for project outside India if you are basically lending in dollars and other currencies, the working capital front it was average of around 6% and on the term loan it was around 8%.

Srinivas Rao: What was the total capital spend in FY12 and what do you expect that to be in FY13?

Raju Kaul: In terms of addition to fixed asset, it was close to ₹500 crore right across the board.

Srinivas Rao: And in the current year, what do you expect?

Atul Punj: Just to response to this additional CAPEX, our CAPEX is linked with project wins. We are not planning any CAPEX that will happen unless we have won a project and based on the incremental investment that we will need to make on our existing equipment fleet that is how we calculate our CAPEX spent. So depends which vertical wins, what works, which vertical is being mobilizing at which point in time that is what determines our CAPEX spend.

Srinivas Rao: How is the current utilization rate of equipment both offshore and otherwise?

Atul Punj: Approximately 100% if not more.

Luv Chhabra: Other than period where there is difficulty in deploying these assets for example in the monsoons, often there is difficulty in deploying our barges, the asset utilization has been pretty robust across all sectors.

Moderator: The next question is from Pulkit Patni from Goldman Sachs.

Pulkit Patni: You mentioned that ₹180 crore is the FOREX gain in other operating income this year. Can you please highlight what was the same number last year?

Luv Chhabra: It was around ₹130 crore.

Moderator: The next question is from Abhishek Bhandari from Macquarie Capital Advisors.

Abhishek Bhandari: I wanted to understand the big pipelines in the oil and gas space in India given that ONGC is talking about spending $6-$7 billion and what kind of order pipeline do you see in FY13 and what is the competition over there? Are still the Koreans active in the space in India also?

Atul Punj: On the offshore side we have not seen too much activity. I think, Offshore side we have not seen too much of Korean activity. We are seeing a large amount of CAPEX spent that ONGC embarking on for the upgrade of their previous, in addition to some new developments. On the onshore side I think, the maximum activity really is coming out of GAIL. These are the two organizations that I think in India that are really pushing ahead with their CAPEX spends. I think there is enough work to go around. I don't think the offshore capability is limited really with the availability of barges. So it is not something that anybody can just pop into so we are fairly confident that this area should be pretty robust for us

Shivendra Kumar: On the onshore side there is opportunities with ONGC and there are some pipeline projects which are regulatory projects they will also come so there is a good pipeline available to us and we should be able to improve on our current order book.

Abhishek Bhandari: The net debt-to-equity is almost like 1.31-1.4 times and if you wish to increase your revenue growth by 15% to 20% keeping the working capital cycle at 160-170 days what it is right now, you may need to raise money or you may want to scale down on the operations. What is your plan to actually improve the debt equation specially?

Luv Chhabra: The overall debt will come down with growth in business and increased profitability and that is the way we used to pay down the overall debt. In terms of the interest cost as Mr. Punj explained, our debt profile must reflect where our business is done so 60% or 70% of our business from overseas and then debt has to shift from India to a greater proportion in the overseas debt market where the interest costs are lower and that is where our efforts are right now.

Abhishek Bhandari: If I look into FY12, the internal cash flow was around ₹400 crore and you are doing a CAPEX of ₹400 to ₹500 crore. So I am not able to understand where the free cash flow is coming from?

Luv Chhabra: Depending on the types of businesses that we get, it is possible that this current year there will be a much lower expenditure on CAPEX. It really depends on which project and which geography and the availability of equipment either within the group or equipment on hire. So our first choice is obviously to use equipment that is lying within the group if it is unutilized. The second choice is to hire equipments if it is available at competitive rates and if these two options are exhausted and there is no availability of the equipments or rates are so exorbitantly high we can go ahead and incur CAPEX. So it does not mean that ₹500 crore is a number that we will spend year-on-year. It is possible that this number could be lower this year but as I said and as Mr. Punj explained it is the function of project win in which sector and which geography.

Abhishek Bhandari: Are there any regulatory hurdles for you to convert the domestic debt into foreign debt like under the RBI guidelines?

Luv Chhabra: If you look at our business there is enough amount of debt that has been given to the overseas entities. So even if we have to raise debt overseas it can always be repaid back to repayment of debt that has been given overseas from India. But raising an ECB from India is a challenge because the application of ECB is limited by RBI guidelines.

Moderator: The next question is from Prerna Jhavar from Emkay Global.

Prerna Jhavar: What are the loans and advances outstanding figure in the balance sheet?

Raju Kaul: ₹1,400 crore.

Prerna Jhavar: Our interest cost has jumped significantly during the quarter on a quarter-on-quarter basis, whereas our increase in gross debt has not been proportionate. So could you please explain this increase in interest costs?

Raju Kaul: It is primarily on account of increase in rate on the Rupee loans. If you look at 31st March, 2011, the working capital loan the rate of interest has gone up by almost 2% and on the term loan it is up by almost 1.5%.

Prerna Jhavar: So all of this is entirely due to the increase in the rates?

Raju Kaul: Partly rates and partly the working capital utilization for the projects which are running, most of them are at their peak. The working capital utilization has gone up.

Prerna Jhavar: Do we have a target as to by the end of the next year as to what extent do we plan to reduce our working capital, if you could quantify that?

Raju Kaul: That is difficult to quantify, it all depends on the project progress.

Atul Punj: We have a significant amount of money that is stuck in various claims in the government entities. Our record in getting favorable judgments in our favor has been extremely good. So we are hoping that some of these claims that have been ruled in our favor which, unfortunately, they have gone and contested in court should be cleared in our direction as well. So we believe that this year should hopefully start seeing a lot of unlocking of those stuck money that will also help in easing a lot of these pressures.

Prerna Jhavar: Any timeline as to when we are expecting these cases to be resolved?

Atul Punj: Some of them we have got favorable orders from the arbitrators, the other party has gone to court. Now typically the courts are not entertaining arbitration awards right now but in some cases they have, but we feel that the cases are very strong and there is no reason for the court to take another view. So we are hoping that some should start happening this year and within next 1 or 2 years all these will be resolved.

Prerna Jhavar: So, you are not expecting something to possibly be resolved anytime soon?

Atul Punj: It could be soon but I would need to be a magician to predict the judicial process in India. If you have some better information I would love to sit and chat with you.

Moderator: The next question is from Venkatesh Balasubramaniam from Citigroup.

Venkatesh: What is the total net fixed assets on your balance sheet?

Raju Kaul: It is ₹1,685 crore.

Venkatesh: This number looks a little too low because last year itself your net fixed assets on a consolidated basis they were ₹2,465 crore.

Luv Chhabra: I think we have given you the stand alone numbers on a consolidated basis, it is about ₹3,100 crore, close to that, so it is ₹3,056 crore – ₹3,057 crore.

Venkatesh Coming to the matter of emphasis and the auditor qualifications, could you please share that, you have this ₹89 crore kind of a number accounting for claims for two projects, which are these two projects and also there is another number of around ₹309 crore, which is this project that the number pertains to?

Luv Chhabra: Two domestic projects in India.

Venkatesh: The other ₹309 crore kind of number?

Luv Chhabra: That includes 7-8 projects which are all Tier-2 clients.

Venkatesh: But this appeared only in the third quarter, started coming from the 3rd quarter onwards ?

Luv Chhabra: No earlier also it was there. It was part of the qualification earlier. Now it moved from qualification to matter of emphasis in December.

Raju Kaul: There were some movement on it so the auditors to pick up the qualifications and moved it to matter of emphasis.

Venkatesh: Can you give some kind of update on ONGC; when is the resolution likely to happen and also some update on when do you think this Libya related number of ₹593 crore will no longer be there in the matter of emphasis?

Luv Chhabra: I think I covered Libya in my opening remarks and I don't know if you had joined the call at that point of time. On the ONGC one, there has been some movement as you have seen that we have received about $8.5 million. At the behest of the client a request has been made that we should refer the matter to an Outside Expert Committees, OEC. So we have for the time being suspended the arbitration proceedings and has referred the matter to the Outside Expert Committee. This is a much faster process and if indeed we get a resolution of our issue with ONGC over the next 12 months then we should see some positive movement on this side. But on the monies that were withheld $8.5 million have already been released by ONGC as a consequence of our agreeing to their proposal to refer the matter to OEC.

Moderator: The next question is from Naveen Jain from JM Financial.

Naveen Jain: Your auditor's qualification LDs on Heera project is down from ₹65 crore to ₹7 crore; have we provided for this difference?

Luv Chhabra: It is the money that has come in which I explained.

Raju Kaul: We actually scrutinized all the payment which had come through against these projects from ONGC and we found that against LD there was a deduction of only ₹7 crore. There were other deductions, which somehow was clubbed with LDs. So the auditors got convinced and they decided to put only 7 crore with the balance qualification was removed.

Naveen Jain: In the project the LD charged by the client is only ₹7 crore. It was never ₹65 crore?

Luv Chhabra: No never ₹65 crore.

Raju Kaul: There was bank guarantee of around ₹62 crore which was lying with the ONGC which got expired in December 2011. So that ₹62 crore got eliminated from the qualification by the auditors.

Naveen Jain: Between 3rd quarter and 4th quarter the deductions made and amount withheld by clients have increased from ₹233 crore to ₹308 crore. So this ₹70 crore of increase is on account of which project?

Luv Chhabra: This has always been there.

Naveen Jain: But when I compare your 3rd and 4th quarter this particular qualification or matter of emphasis?

Luv Chhabra: We shall come back to you on this.

Moderator: Mr. Punj we do not have further questions, would you like to add a few closing comments?

Atul Punj: To sum it up, I think we are seeing the beginning of the turnaround that we have been expecting now, which we mentioned last year. As I said the issues that we are dealing with is really now bringing our cost of money under control, reduce our working capital days. The order backlog growth is continuing to be robust so we are not seeing any issues on that front and we are really focusing on the execution, in fact that we had a pretty smart uptick over last year, we are hoping the same trend will continue this year. So hopefully the next few calls we will start getting even more positive going forward and we look forward to interacting with everybody in time to come. Thanks so much everyone.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Punj Lloyd that concludes this conference call. Thank you for joining us.