Punj Lloyd Limited

Investor/Analyst Conference Call Transcript
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Moderator Ladies and gentlemen good day and welcome to the Punj Lloyd Q2 & H1 FY14 Earnings Conference Call. As a reminder, all participant lines will be in the listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vinay Sood, Group Head-Investor Relations, thank you and over to you sir.

Vinay Sood Good afternoon everyone and welcome to Q2 & H1 FY14 Earnings Conference Call. Joining us today on the call are members of our senior management team, namely, Mr. Atul Punj, Chairman; Mr. Luv Chhabra, Director Corporate Affairs; Mr. PK Gupta, Director; Mr. PN Krishnan, Director Finance; Mr. Shivendra Kumar, CEO Energy-South Asia; Mr. Ravindra Kansal, President and CEO, MEA & CIS; Mr. Atul Jain, President and CEO, MEA & CIS. I believe you have received the investor communication and the results. Just to recap, current order book stands at Rs. 20,891crore, consolidated revenue for Q2 stands as Rs. 3,135 crore, EBITDA at Rs. 314 crore and PBT at Rs. 7 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 all with the conference call invitation. 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. We can now take your questions.

Moderator Ladies and gentlemen we will now begin question and answer session. Our first question is from Dhaval Patel of B&K Securities.

Dhaval Patel On transfer of share of profit & loss to minority, we have seen a huge increase in transfer of profits of close to Rs 709 million this quarter, so which subsidiary has seen such a huge jump in profitability, if you could give us an idea?

PN Krishnan Majority of this represents the Profits recorded by Punj Lloyd Dayim - which is doing a project in Saudi Arabia. Post recognition of additional revenue of USD 35 million, Punj Lloyd Dayim has recorded profits in contrast to reflecting losses in the previous quarters. The Transfer represents the interests of the JV Partner who holds 49% equity in Punj Lloyd Dayim Ltd.

Dhaval Patel In the last quarter, the loss that we have transferred of close to Rs 479 million was on account of this same project?

PN Krishnan Yes.

Dhaval Patel What is the quantum of order inflows for the first half?

PN Krishnan There are new orders of Rs 1,536 crore plus variation orders of Rs. 1,412 crore and also exchange fluctuations of Rs. 920 crore. The total is Rs. 3,868 crore.

Moderator Our next question is from Sumit Kishore of JP Morgan India.

Sumit Kishore Could you please comment on the ordering environment and the competitive landscape across your key business segments – infrastructure, offshore, pipelines, process and power?

Atul Punj Basically, we look at the different regions in which we operate, South Asia is probably the weakest right now for reasons that we read about everyday in the papers. There is not too much spending happening on the energy side right now. On the infrastructure side there is a lot of potential but we are not seeing it being converted into any order inflow right now, essentially, due to government policies not in place. Financing for projects in India also is an issue simply because of 13% pa interest rate. It is very hard for infrastructure companies to raise funds. South-east Asia continues to move fairly aggressively. On the energy side we are seeing a fair amount of work coming up in Malaysia, we are seeing some top up work happening on a regular basis in Singapore, Indonesia has the odd projects that keep coming up. In Burma, we are seeing a few minor projects popping up but the big thrust is really on the infrastructure side in all these markets. The Middle East is very strong for infrastructure; we are seeing a lot of push in south-east Asia as well for infrastructure, so we are currently seeing infrastructure forming about 37% of our backlog, we will probably see that growing fairly rapidly over the next year. As regards to the competitive landscape, we find that in every bid somebody is quoting a silly number. What their motives are, I don't want to speculate. We, for example, don't want to go below our minimum threshold just to secure business. Given this, we were successful in picking up some work for Chennai Petroleum in India, with Reliance for their expansion project in Jamnagar. So we have had some success on the energy side but the bid pipeline is fairly compressed at the moment. The competitive space on the EPC side is not so crowded but on the pure play pipeline for the smaller sections is fairly crowded, so it is a mixed bag right now. Overall, when we look at the capex spends of the international oil companies & the national oil companies that we target, that is fairly robust but those markets where they are spending, are far and wide so we tend to try to follow our clients around. Mozambique for example is a good opportunity that we are seeing coming up. Angola again is another opportunity on the energy and infra side. So far I think we are maintaining a reasonably healthy balance. We are not trying to show any major spikes in order inflow just to show order inflows but we are being cautious about the type of work we pick up, while at the same time focusing on efficiency improvement internally.

Moderator Our next question is from Pritesh Chheda of Emkay Global.

Pritesh Chheda If you could tell us some of your activity or strategy on the cash flow management side specifically with debt? Secondly, about some asset deleveraging activity, if you could elaborate that in terms of cash generation and debt repayments or debt restructuring?

Atul Punj We are looking at various options for managing our debt costs and deleveraging. ~~,~~ We are in fairly advanced stages now on one asset sale which is significant. The potential buyer has already approved the acquisition in their board, but we have to agree on the final numbers. Now unfortunately, these things don't happen overnight. Other than that we exited some of our other investments like Samena Capital and Olive Group, which is a security company that we invested in. So we have recovered about $83 million on account of these exits. They have all been profitable exits for us and we are basically using the same for cash flow management & debt reduction. The second area of course is surplus construction equipment for which we have now assigned a company to do an open auction. We are consolidating equipment that is underutilized or not being utilized at different locations and the surplus equipment can be auctioned. The other most important one really is collection of outstanding from clients. That is taking a lot of time and effort and it is a significant amount that we expect to recover hopefully within this fiscal. So that, essentially, summarises our strategy right now.

Pritesh Chheda Does that include the ONGC related claim? Can you apprise us exactly what is the current status of the ONGC claim?

Atul Punj All I would like to state is that it is moving generally on track but as I say in India nothing happens till it happens. We are seeing no signs for us to doubt anything so it is looking fairly positive.

Pritesh Chheda Middle East side if you could give some color specifically in terms of tendering activities, investment activity there and your comments vis-a-vis what you saw in the last two years ?

Atul Punj For the last two years effectively, most of the countries went into complete introspection as to what they should be doing, so the classic spending that used to happen on oil and gas projects in an unabashed manner that kind of cooled down. That spending is now being diverted increasingly to infrastructure post the Arab Spring. Social infrastructure projects are getting attention that would include power plants, desalination plants, highways, schools, hospitals, housing so a lot of that is moving now, much faster than was moving earlier. The deal flow is fairly strong. Our bidding activity is again fairly active. For example, there are some road projects where we have emerged as the lowest bidder, for which we have been recommended. These should close out in the next three months. These are significant in size. So effectively, I think the strategy is, tweaking a bit from oil and gas to more and more on the infrastructure side simply because the size of the opportunity being way larger suddenly in the last two years than what it was earlier. Abu Dhabi is an example, they had gone into a bit of freeze post the Dubai real estate crisis but have now comeback fairly strongly. Saudi Arabia of course is pursuing the social infrastructure piece very aggressively. Qatar has got its own ambitions particularly around the FIFA World Cup on which a lot of spending is going on and so there are robust opportunities in pipelines. These are markets where we low-cost Chinese government companies are not present which we tend to find all over Africa.

Pritesh Chheda But as an aggregate, oil and gas plus social infrastructure put together would it see a higher activity mix overall or it is just that oil and gas is making way for social infrastructure?

Atul Punj It is actually a mix of both. In some countries, it is replacing the oil and gas spending, while in others it is on top of whatever was being spent earlier. I think till the world economy kind of displays an upturn, we have been reading about refining margins being under pressure for most of the majors despite a lot of refining capacity coming off the market in Europe. So spend on refineries is kind of cooling off. A lot of downstream activities are happening in the petrochemical space. A lot of liquefaction on the gas side is happening so we are playing in these areas and I think it depends on where we get lucky and when. So, as a strategy we are focusing on efficiency and a better value proposition for our clients.

Pritesh Chheda So if I read carefully at the aggregate level, the activity is much better than what it was last year at least in these countries?

Atul Punj Yes.

Pritesh Chheda The terms of trade, are they relatively better than what they were last year or the terms of trade have remained the same?

Atul Punj They are pretty much the same, it is very difficult to change those in most countries.

Moderator Our next question is from Inderjeet Singh of the Macquarie Capital.

Inderjeet Singh In the previous question you mentioned the spend on infrastructure and you actually also made a comment about the more competitive Chinese not being present in the space, if you could just add comments on what kind of operating margin levels are available in these kind of projects? And second the ticket sizes of projects in these countries are fairly large, so from Punj Lloyd perspective what ticket sizes are we qualified in each of these geographies and do we need to partner with some of the local players to get into these contracts, so if you could just add comments on that?

Atul Punj The ticket size really, is got to be at a reasonable level. It could be a minimum of $50 million depending on the vertical you are looking at. So, with a building project you would not hesitate to take something between $50 mn upwards. Below that I don't think we will be interested. On the energy side typically we are qualified for projects up to a billion dollars or more and it is very rare that you will find a single project that is valued at more than that, so we are generally on track in terms of qualification we don't need to worry in most cases. Where we do like to partner is if we're getting into a new country without having local country experience. We like to find a local partner who can open up the local market for us in terms of the local uniqueness of that country. Other than that we try to work typically with sponsors. Sometimes, we will have a joint-venture partner if we want to reduce our risk on a particular project. So that is a project to project decision that we do take.

Inderjeet Singh But there is no the upper limit on the size of the contract that we are interested in?

Atul Punj As long as our risk is mitigated and we have covered all angles of it, there is no reason we should have a limit on that. Generally, the upper limit typically in our mind is a level of close to about $1 billion. Beyond that we would like to partner with somebody to mitigate risk.

Inderjeet Singh What are the margins in social infrastructure projects?

Atul Punj On a blended level the margins at EBITDA level range between 10% to 12%.

Moderator Our next question is from Kaushik Poddar of KB Capital Markets.

Kaushik Poddar Can you comment on your stake in Medanta? How much do you own in that company?

Atul Punj It is doing very well for us. We own about 19%.

Kaushik Poddar Do you plan to offload anything of that sort?

Atul Punj We see a potential area of interest for us is to be in the medical space. In all the countries that we go to we are always asked first to build a hospital or operate a hospital. Our being an-anchor investor in Medanta gives us a serious leg up in terms of the hospital piece of social infrastructure. So strategically, there is a significant advantage in our holding on to the Investment.

Moderator Our next question is from Hitesh of Span Capital.

Hitesh My first question is, can you please share what is the current status of your Libya projects?

Atul Punj In Libya, of the five infrastructure projects we have remobilized, the work has started in the Arada project. We are now expecting to see our first running payment being made. Once that happens and we know that the country is back on track, the other projects will start too. Earlier we have received some payments but now project work has started and certified invoices are going to be due for payment within next 2-3 weeks. So I think that will give us a good indication that the country is back on track.

Hitesh Second question is any development you are seeing in the defense segment in terms of ordering, bidding?

Atul Punj We have a license and are qualified to bid for work. It is not something that happens overnight but having said that our multipurpose engineering facility in Malan~~d~~pur is keeping itself fairly busy doing a lot of fabrication work for HAL and others. So for example, now we are doing wing part fabrication for Sukhoi. We are also doing the machining of the Advanced Light Helicopter gearbox which is a very critical component. We are now in the Tier 3 and the Tier 4 space in the defense establishment. So the headline contracts will take their own time to come through but the facility where we have invested is doing robust business.

Luv Chhabra Just to add what Mr. Punj said on the defense side, we have bid for quite a few programs. Trials are going on for a couple of programs. These are typically programs that take 2 to 3 years to decide because there is a trial period of 12 to 18 months. So it is only after the trials are over that price bids are opened when we come to know where we stand amongst others. But we are busy in that sector right now.

Hitesh By how much time will the trials be over?

Luv Chhabra It depends on the program and in one particular program we expect the trial to be over by the first half of the next calendar year and thereafter the price bids would be opened.

Hitesh What is your view on the competitive scenario in the defense orders space right now?

Atul Punj It is a difficult space but once you enter into a program it can run for well over 10 years. So the idea was to move into an area that takes away the cyclicality of construction. Once you get in you are embedded as part of Tier-1, Tier-2 or Tier-3 on a program. You are then busy for 10 to 20 years on delivering that particular program. So entry in this business takes a long time. We have our own set of learning's. The investment really as I said has been in the manufacturing in Malanpur in Gwalior which is busy, the rest of the investment really is in people, travel cost etc. So it's something that is on track, we are happy with what is happening there.

Hitesh Can you share some of your thoughts, how do you see Punj Lloyd in next 2 to 3 years down the line?

Atul Punj Well the path for the company is to be the best at what we do. To raise some of our developmental vertical exposures where we develop projects ourselves. But we are not looking to develop projects only in the India space we're looking to develop the projects internationally, where the pricing is much more robust than what we find in India without the kind of competition that you find in India. So, I think you will see Punj Lloyd Infrastructure becoming more active. We see the defense side maturing and on the construction side we see ourselves moving into more and more niche areas in more and more selected countries.

Hitesh Any concentration on specific verticals?

Atul Punj As I said earlier, the social infrastructure group is emerging to be fairly aggressive in terms of growth prospects in all developing markets, so that obviously will be a major focus for us going forward. We see that on the energy side we have pretty much all the qualifications we need. The idea now is to become preferred partner with as many international companies as we can, for example Shell, Exxon Mobil, Total and Petronas. That really is where our focus would be.

Hitesh What kind of risks exists for the company for achieving that kind of growth?

Atul Punj The risks for the company are like what we have faced in the past. Like Libya suddenly going from being the most-favored-nation to being the most un-favored nation. When it comes to territories there is very little we could do to control it. We go in with eyes open and try to make sure that all our risks are covered. But if a global event happens that really becomes the biggest risk. We are operating in 21-22 countries and thus, that is a risk we always run. Having said that, sometimes working in parts of India is a greater risk, so I don't know which is worse, so I think we are on the right track. I see no reason to change our strategy but we just have to focus on efficiency.

Moderator Our next question is from Viral Shah of Angel Broking.

Viral Shah Just a follow up on the debt reduction part, are we looking at replacing our debt with a low cost foreign debt?

Atul Punj We were in process of doing that and the rupee started sliding very dramatically, so we decided to just wait and watch and see where the rupee went and became stable before we went into that because we do not want to go into a low-cost debt and find that we are hit by the currency risk. So I think now we are coming to a stage where it is reasonably stable and if the current account deficit stays where it is I do not think that the rupee should slide much more and, therefore, this is the time that we are reactivating the whole thing.

Viral Shah Secondly, we have exited some investment roughly around $83 million, have you booked the entire thing during the first half or is something still left to be booked in on this sale?

PN Krishnan Part of Olive of about $20 million will be booked in the coming quarter, other than that everything has been booked in the first half.

Moderator Our next question is from Rajesh Agarwal of Moneyore.

Rajesh Agarwal If you take the other operating income of Rs 274 crore which is the claim and forex, so the margins have been under pressure, have we lost money on the other projects?

PN Krishnan That is not the exact way of looking at it, as per the accounting standards we are required to reflect the forex gain as a separate item as part of the other income whereas our expenditure is booked at the exchange rate at the cost, so there is no separate treatment shown for the exchange fluctuation on the expense side.

Rajesh Agarwal So we cannot assume the margins have been lower than 10%?

PN Krishnan EBITDA margins continue to remain at 11%.

Rajesh Agarwal So any loss which is sitting in any other projects which are under execution?

PN Krishnan All the projects are as per the schedule.

Rajesh Agarwal Are the margins more on the oil and gas side or on the social infra side?

Atul Punj I think on the blended level it would have been at the same level. One project could be very profitable; one project will be less profitable, so it'll be better to look at the blended level because every project has its own uniqueness and its own client and its own country.

Rajesh Agarwal But the turnover in the oil and gas is much better for working capital, as it can get completed in 18 months ? So the focus has changed from oil and gas to social infra we can assume that?

Atul Punj Yes, normally it is quicker. Both verticals pretty much will get equal attention. Thus far oil and gas has been getting a lot more attention than infra. We will now be raising the amount of attention we need to give the infra side.

Rajesh Agarwal $83 million you told that we have booked in the first half through sale of investments, all the money has been realized?

Atul Punj $20 million is yet to be realized and not booked.

Rajesh Agarwal Why the interest costs went up this quarter because the net debt has only gone up by Rs 100 crore?

PN Krishnan It is primarily on account of the hardening of the interest rates in line with the liquidity situation with the banks.

Rajesh Agarwal And what are the outstanding dues from the clients which we are following up, any figure?

Atul Punj Outstanding dues will be close to between Rs 2,000 to 2,500 crore including the ONGC one.

Rajesh Agarwal Why have the other clients not paid?

Atul Punj Clients typically try to delay their payments as much as they can in this environment because ultimately the interest rate is coming on our head and not on their head so it is a matter of convenience. In fact, the overall number at times hit over Rs 3,000 crore. So the challenge is that we need to get clients to reduce their IDC because if they reduce their IDC we're not paying vendors and contractors.

Rajesh Agarwal That is my concern, even if we reduce the debt but the client money does not come in time, the interest cost is on us and even with a 10% margin we will not be able to make net profit unless we reduce the debt by Rs 2,000 crore?

Atul Punj That's where the focus is. All my time is on outstanding collection right now as that is going to make a material difference in a very short period of time. The problem is in the mindset of clients that it is their money till they release it but actually it is our money based on the certified invoices sitting with them.

Rajesh Agarwal So you cannot take a legal recourse or something like that?

Atul Punj Legal recourse takes its own time, it will be a 10 year story and you guys will be beating us on the head every day. So it is better that we just find a way to resolve it using whatever other means we have.

Rajesh Agarwal Will you be able to claim receivables with interest?

Atul Punj We do subsequently but right now the idea is to get cash in the bank, so we can stop paying this crazy interest rate, that itself will make a huge difference to our bottom line overnight, so the focus is to just make sure that we liquidate as much of the outstanding and collect the retention payments. The retention payments and outstanding probably would be around Rs 3,000 crore, so it reduces half our debt if we can collect this entire amount.

PN Krishnan Just to add on what Mr. Punj had mentioned, it is not that the whole of the receivables is sitting on a long-term basis, it is only a part of them that sitting over there, majority is also the normal working capital cycle which is already factored in our budgets.

Rajesh Agarwal There is Rs 7,400 crore inventory with WIP and the client receivables of Rs 2,000 crore, in total it is Rs 9,200 crore, the normal working capital cycle was 25% to 30% which has gone to 60% indirectly either the billing is getting late or client receivable is getting late, there is a major problem somewhere?

PN Krishnan In some cases the contracts are designed where payments are based on achieving the milestones.

Rajesh Agarwal But the inventory WIP keeps on increasing, quarter to quarter?

Atul Punj That is why the focus is to bring that down.

Rajesh Agarwal Is it possible by March, this fiscal year?

Atul Punj We are hoping. I'm spending almost 100% of my time just doing this.

Moderator Our next question is from Naveen Jain of JM Financials Institutional Securities.

Naveen Jain My question is actually a continuation of what you were just discussing on working capital, work-in-progress figure that we see on our balance sheet which is about Rs 7,200 crore, it is an unbilled revenue, essentially in terms of revenue recognition it has crossed the threshold but in terms of billing to the client it has not, is that the right understanding?

PN Krishnan Correct.

Naveen Jain If I look at this figure for the past several quarters it has been rising fairly sharply, so are these like very long gestation projects which are somehow not reaching the billing milestones whereas the revenue booking is happening, what exactly is happening here, if you can just help us understand a little bit about this?

PN Krishnan In the first place if we look at our net working capital level as of FY13 it was 157 days from where it has come down to 149 days – which is a marginal reduction but again as Chairman has mentioned our focus is now in terms of bringing this down further.

Naveen Jain So the reduction that has happened is essentially led by some reduction in the debtor's level and some increase in the current liabilities, so I just wanted to understand more about this inventory, the work-in-progress part?

PN Krishnan Some of the claims take their own time in respect of release of the payment.

Atul Punj Just to elaborate on this, what happens is in some of these large projects there are these components, one is, the actual contract value then there is something called as variation order, which are the changes that the client has requested or the engineer has requested and the third is the claims. Now typically the variation order should not be a matter of dispute, it is a matter of instruction by the client where he has asked us to do some different thing against which we raise the bill. Now what is happening with lot of clients is, they tend to club the claims and the variation orders together, now the claims are always some things which are subject to debate and could be subject to disagreement which in some cases goes to arbitration, some cases get settled, so it is a mixed bag, so the problem which we have in this business is the clients are trying to combine the variation orders as though they are doing us a favor on variation orders along with the claims which is the disputed item and that is what drives this thing into a longer and longer window that is one of the problems that we are facing right now which we are trying to resolve by interactions with the client management very aggressively.

Naveen Jain The second question was on $ 60 million kind of monetization that we have done, has the cash flow already happened, $ 60 million has already come in first half?

PN Krishnan Yes and it has gone to reduce some part of the debt also.

Moderator Our next question is from Mahesh Bendre of Quantum Securities.

Mahesh Bendre In the first half of this financial year our sales have gone up by 8% and margins have also held on well given the environment but majority of our operating profit is going away for servicing the debt, what is the outlook as things stand now do you think a substantial decline in the interest cost is possible probably the next year?

Atul Punj All I can say is that we are definitely looking at this very seriously, it is a major focus as we have mentioned we are looking at asset offloading, we are looking at outstanding recovery from clients, these are two majors thrusts that we have.

Mahesh Bendre Is there any possibility or probability that the cost will come down significantly in the next year?

Atul Punj I do not think we have any choice but to bring it down to whatever extent we can. It depends on the events as they unfold but we have no choice as an organization but to bring it down because right now we are only working for banks and that has to change.

Moderator Our next question is from Amit Sinha of Macquarie Capital.

Amit Sinha You mentioned about the subsidiary loss which impacted the consolidated results, can you repeat that again?

PN Krishnan It is not the subsidiary loss, it has been a subsidiary profit compared to the previous quarter where there was a subsidiary loss, so the previous quarter we have shown a part of that.

Amit Sinha The Saudi Arabian subsidiary made how much profit?

PN Krishnan About $10 million in the first half.

Amit Sinha What is our working capital at this point of time in terms of days? And has that come down compared to the last quarter? If yes, then primarily because of what?

PN Krishnan Working capital in terms of days is149 days. And it has come down from 157 to 149. It has come down primarily on account of better collection and also higher billing, so whole lot of factors.

Moderator Next question is from Ronald Siyoni from Sharekhan.

Ronald Siyoni How much forex gain has been booked during this quarter? And how much subsidiary profit has been booked?

PN Krishnan The forex gain booked during the quarter is about Rs. 257 crore and $10 Million of subsidiary profit has been booked in the first half.

Ronald Siyoni Expenses have risen quite a bit, if I do not account for the operating income then the EBITDA margins are just 1.4%, so is it that the expenses side has a hit in terms of foreign currency but we have not shown any extraordinary item because this time there is no higher expenses in other expenditure, this time it is only on raw material and contractor charges?

PN Krishnan On the revenue side we are required to reflect the forex gain separately though it is part of the operating income but on the expense side it is built in as part of our operating expense.

Ronald Siyoni If I include that about 10% margin would be there?

PN Krishnan Yes it continues to be about 10% as compared to the previous quarter.

Moderator That was the last question I now hand the floor back to the management for closing comments.

Luv Chhabra Ladies and gentlemen thank you very much. As we said earlier that our outlook continues to be one of cautious optimism and we certainly look forward to collecting some significant portion of our outstanding over the next 5 to 6 months of this fiscal year and we are confident that this picture of our total debt would undergo a change by the end of this financial year. So thank you and we should certainly be in touch.

Moderator Thank you members of the management. Ladies and gentlemen on behalf of Punj Lloyd that concludes this conference. Thank you for joining us and you may now disconnect your lines.