Punj Lloyd Limited

Q4 & FY-'14 Earnings Conference Call Transcript
May 21, 2014

Disclaimer: This transcript has been edited to ensure language correctness and proper flow and also to amend any unintentional inaccurate mention with regard to the business. It is hence not be a verbatim representation of the call proceedings.

Moderator: Ladies and gentlemen, good day and welcome to the Punj Lloyd Q4 and 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 – Head, Investor Relations, thank you and over to you, sir.

Vinay Sood: Good Afternoon, everyone and welcome to Q4 & FY-'14 Earnings Conference Call. Joining us today on the call are members of our senior management team namely, Mr. Luv Chhabra– Director, Corporate Affairs; Mr. JP Chalasani -- Managing Director & Group CEO; Mr. P. N. Krishnan – Director, Finance, Mr. Dinesh Thairani -- Group President, Legal and Company Secretary; Mr. Pardeep Tandon -- CEO, B&I; Mr. Ravindra Kansal -- Group President, Strategic Initiatives; Mr. Atul Jain, CEO Pipeline and Tankages. I believe you have received the "Investor Communique and Results."

Just to recap – current order book stands at Rs.20,222 crore, consolidated revenue for FY-'14 stands at Rs.11,174 crore, and EBITDA at Rs.638 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 also 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: Our first question is from Amit Sinha of Macquarie.

Amit Sinha: The Company has recently bagged a number of orders in areas like Libya, Yemen, and Saudi Arabia. There seems to be political instability in the geographic areas of Libya and Yemen. There could arise a situation where the Company has deployed large number of assets and resources and are unable to move on those projects. What are the kind of risk management practices being followed and measures taken by the Company, with respect to this?

JP Chalasani: Out of the 3-4 orders that the Company has received in the month of April and May; two of them are the large orders of Libya and Yemen. The Company has been present in Libya even in the past. This is an add-on project. Currently, the Company is in the process of mobilizing its team and organizing the bank guarantees. The Company would ensure that it is able to cover its risk. We would ensure that the cash which we receive from our clients would always meet our expenses. This is being followed in Libya as well. This ensures that we don't put any capital at risk and the Company gets paid for whatever work it does. So, this way the Company will cover its risk. We will also look to ensure on time payment. The advance plus the other things together would ensure that we have a positive working capital.

Amit Sinha: Is the Company net cash neutral/cash positive on its existing projects, for example; the Company's existing project in Libya? How is the execution moving on that project?

JP Chalasani: The Company is net cash positive in Libya. Our aim was to start project-by-project. We have been working on 'Arada project' in this quarter and are now submitting our bill for the work that we have done and expect to get paid as promised. The payment would generate confidence and the Company would slowly start expanding into its other four projects. This is the approach of the Company. Therefore, currently we have done work in one project for which billing has been done and hopefully by June we expect to receive our payment. We will keep increasing the work momentum later in a similar way and then keep getting the money for the work. That has been our long-term approach in Libya. But after the disturbance which happened in the last 3-4 days, we are waiting and watching like others. In the new project that we have got, we have full payment security through an LC mechanism; therefore the risk of payment is much less in the latest project.

Amit Sinha: What exactly went wrong in the current quarter in terms of the projects which had a cost overrun? Is there anything extraordinary which has been booked above the EBITDA line? In terms of the entire portfolio of projects, is the Company done with the whole loss-making projects or there is still certain amount of problematic projects present which would be taking some time to get sorted out? If yes, then how much time do they expect to take?

JP Chalasani: I would like to clarify that we have not taken a loss on a project which we have booked now. For example, in our project 'SATORP' in Saudi Arabia, there are claims worth about $97 million being negotiated with them. While the negotiations are still on, they have given us a confirmation of $60 million in writing, and we know informally that internally they are talking about going up to $85 million. But in writing we have $60 million. So to be on a conservative side we revised from $97 million to $60 million, and considered this $37 million as a loss. As negotiations are yet to be settled with them, we have kept $37 million in the separate box to see to what extent we can stretch it and then it will come back probably in this quarter. With respect to our project in Indonesia, where the Company has a couple of power projects, there is one project where the client has given us €8 million which is supposed to be adjusted against the work which we had done. But suddenly in this quarter the client said that he would be considering €8 million as an advance. As the situation is yet to be resolved we have taken out this amount as well. Therefore, we have not permanently written off anything on this and have put it aside along with $37 million. Thirdly, we are also doing a project for Tata and Bumi joint venture which is in Indonesia 380 MW power plant. In that we require certain contractors and have to do some additional things based on the client's requirement. Today there is an additional cost of USD 8 million which we have still not settled with the clients. We do not have in writing or understanding with them that we are supposed to pay this additional cost. Till that agreement happens with the JV company Indonesia, we put this USD8 million, but we are considering that as an expense in our books on this. Therefore, nearly close to $50-$60 million is put aside and not written-off fully. We are confident that these three projects would get settled this quarter. We expect that they will come back either in full or partly back into the top line as well as bottom line in this quarter. All these three developments happened in this quarter and we wanted to be absolutely sure that till this issue is settled we would keep it outside the balance sheet, and they will come back the moment these issues are resolved, hopefully this quarter.

Moderator: Our next question is from Nalin Shah of NVS Brokerage.

Nalin Shah: The Company has a lot of contingent liabilities with respect to Saudi Arabia and Indonesia? If you could also throw some light on what would be the potential liability that would be hanging on to the Company as on date? What is the potential write-off which can arise in future? Is there any kind of fund raising the Company is planning to recapitalize?

JP Chalasani: We had spoken last time on fund raising to reduce debt**.** Predominantly, we were talking about the four areas – one was about ONGC settlement and the second one about monetizing the assets like Barges and our Medanta stake sales. The last one is our claims management where there is huge amount of claims which we are working on getting back.

JP Chalasani: As far as ONGC is concerned, the new OEC has been formed under Mr. Shunglu. I think about a deadline of 8 to 12 weeks was given to them. But they took quite some time to understand the case as they considered it is a complicated case. They have started the proceedings now, and have had the first meeting just two weeks back. So now it has started moving, and hopefully this quarter or early next quarter we should get that settled. So this actually took a little longer than what we thought.

Nalin Shah: What is the quantum involved?

JP Chalasani: Our claim is large. But if you remember the last time, OEC had given us an order of nearly about Rs.1100 crore on this.

Nalin Shah: Do you expect that by 30th June you will have clarity or the result will come on this issue?

JP Chalasani: I would say that is our wish and that is what we are chasing them to do. At the moment we can wait and see. It is a high powered committee, consisting of all senior retired IAS officers, who want to go in a systematic way. This is the reason they have taken a long time to go through the papers and in understanding the whole thing. The first meeting was a long meeting which was to check their understanding from us and from ONGC. Therefore, now they are completely aware of the subject. In the next meeting they would be putting forward their arguments on what we are saying and what ONGC is saying. They have agreed that, they will try to do series of meetings on a continuous basis. As far as the barge sale is concerned we are now in the final stage. The draft agreements are being put in place. We are reasonably confident that it should happen in this quarter.

Nalin Shah: So what is the quantum and the percentage?

JP Chalasani: I would not be able to disclose the quantum of sale numbers as it is confidential. I would just say that it is a substantial number as it is one of the reasons we are considering that it will go a long way in reducing our debt. The Medanta stake sale process is taking a little longer than we actually thought, but are hopeful that it should happen in this quarter. On the fourth one which in fact is more significant is claims management, which is one area which we now are focusing significantly within the company. We now have the special claims management group in the company, looking after claims management.

Nalin Shah: The claims according to the books which have been given to the claims management team for claiming that money, what is the quantum involved?

JP Chalasani: According to the books it is much lower than what we have put in the claims with the client. The reason being there is no point in taking everything what we have put to the clients into the books unless you are sure about it because you work on this and subsequently they revise or reverse it. I would like to state, that ballpark number wise it is Rs.2,000 crore claims which we need to get resolved.

P N Krishnan: Contingent liability is largely on account of the corporate guarantees that have been issued on behalf of the subsidiaries by Punj Lloyd. There is one which is about liquidity damages charged by customers which are not accepted by the company that is about Rs.170 crore.

Nalin Shah: And how much is the amount on behalf of subsidiaries guarantees?

P N Krishnan: That is about Rs.3,000 crore, that is in the normal course of business.

Moderator: Our next question is from Jigar Valia of OHM Group

Jigar Walia: If you can give some color in terms of the margins which are there in various geographies, i.e when you bid for the projects and whatever the margins that you would have factored in normalized IRR? Just to get some perspective in terms of when you go about bidding for projects abroad, how would they differ from those in India?

JP Chalasani: It depends. If we are trying to bid in a place like Libya where the risk is very high, then we would bid for very high margins of like say 25-30% levels. This is because the risk and reward go together. If we are trying to bid in a very safe place then the margins are based on project-to-project and on the intelligence of competition at that point of time. The margins would be anywhere upwards of 12% normally, depending upon the competition it can go as high as 30-35%. So even in the same region for a particular project you might feel that this time the competition is going to be really large, this is an easy project for us to get, risk is less, and therefore you can even compromise on the margins because there is nothing else, just go and do this project and come out of it quickly. But I think that is how we do on a project-to-project basis analysis.

Jigar Walia: Where do you see the mix changing over the next 2-3 years in terms of order book between Middle East, South Asia, Asia Pacific?

JP Chalasani: Last year, our top lines did not grow as per expectations. This year the order book position has already started moving and we have booked close to about Rs 815 crore of orders till date. There are already close to about $3 billion of projects which are at different stages, and some of them are basically in South East Asia and India. In South East Asia the bidding is open, we are at L1 and we are in the process of negotiating. I think in the next one year, we expect growth majorly in two areas. One is the power vertical and second is pipeline and tankages vertical where we are seeing new opportunities coming up in Africa and from other countries in Middle East. In the Middle East we are also looking at the large infrastructure options and are already getting pre-qualified in bidding. Therefore, infrastructure, pipeline and tankages outside India are going to be a major growth area for us. Earlier we concentrated and depended outside India for orders. But, currently we assume that has changed, and we believe that there is going to be a huge amount of growth potential for us and would be able to book good orders in India. I think we are seeing that as a very positive thing for us in India with whatever the latest political developments.

Jigar Walia: The last two orders are considerably big in Yemen and Libya. You still feel that the share of India in the pie would increase or will it still be like one-third would be Middle East, and CIS?

JP Chalasani: It is going to be the Middle East and South East Asia if you look at a 6-month horizon. These are the two places which we are seeing in this quarter and next quarter. But we expect the second half of the year would see change in scenario and we would try and continue to get projects in the areas of pipeline and tankages in India and some of the African countries.

Jigar Valia: Earlier you have done projects in Yemen and Libya. It was mentioned earlier that you have put up your bill for Libya and tried to see how it works and then move forward. If you quantify the past project that you have done, what was the size of that project and how much have you received?

JP Chalasani: In the beginning, we got more than $100 million worth of projects and I believe by now we have done about $30 to $40 million in these projects. We wish to experiment the projects, one by one project and build up the base instead of spreading ourselves and undertake all five projects simultaneously. We are the few people who have presence and continue to work in Libya which is very positive for us. The project we have undertaken is completed to the extent of $5 to $6 million worth of work which we are billing to get payment. Further, in Libya we had one pipeline claim in oil and gas line. This quarter we have reached a settlement. We do not have the formal communication on this, although the minutes of the meeting mention an amount of around $70 million. Things are moving in Libya. We are moving gradually and this quarter the progress is evident in terms of settling $70 million of claims. Thereafter, we will undertake work in 'Arada project'. Presently we are working on providing bank guarantees and other things for the project, where we have the payment security which we have got for the first time in the contract. We are there on a long term basis but right now we are watching the situation and will act accordingly since we do not intend to put anything at risk and keep continuing to work. Currently at the beginning stages we are putting our team together and working on initial guarantees. The funding does not appear to be an issue since it has been funded by Saudi Development fund.

Jigar Walia: Doing project in a place like Yemen or Libya, where the margins are high, i.e the Company may price it at 25-30% because of the risk. What is the normalized debt-equity in these high risk areas? Would you follow a 30:70 approach or something like that?

JP Chalasani: This is a contract, therefore, it is not a development project, and we do not own this asset. Therefore, there is nothing like a debt-equity.

Jigar Walia: Most of the Company's debt consists of INR debt. While 75% of your business is overseas there would be very little of FX debt?

P N Krishnan: Largely, it is domestic debt except for the projects that we have in the Middle East, which were funded by the local banks. It would be roughly about 20% in terms of a weightage on the total debt.

Jigar Walia: Why is it so? Wouldn't you have SPVs for each of these projects and you are investing into the project?

JP Chalasani: I think you are getting confused between a project development versus a contracting.

JigarValia: Can the Company raise overseas debt for overseas projects, for the purpose of contracting?

JP Chalasani: What we raise is meant for working capital and for nothing else. This is because we are just a contractor, and are not putting any equity there. First of all, our aim should be to manage in such a manner that the cash flows from the contract are good enough, and we do not need working capital. Wherever it is required, we are taking working capital for the duration of the project.

P N Krishanan: In some of the projects we take the benefit of Packing Credit Facility (PCF), which gives us the same advantage in terms of a lower interest rate. We get the PCF facility from the banks especially for projects which are situated in South East Asia, which gives us a borrowing cost that is fairly attractive, without exposing on the liability side much to the exchange rate.

Jigar Walia: Overall weighted average cost of debt would be upwards of 11-12%?

P N Krishnan: It is about 11.5%.

JigarValia: Apart from the cash flow that you would receive from these settlements in terms of payments from ONGC and asset monetization, are there no other plan in terms of any other separate fund raising?

P N Krishnan: We keep getting cash from the projects which we are executing. There is no separate exercise to raise any additional debt as presently due to RBI restrictions these kind of opportunities are not significantly available. Also, ECB cannot be availed for repayment of Indian domestic debts.

Moderator: Our next question is from Tanuj Makhija of Ambit Capital.

TanujMakhija: It was mentioned earlier that the order inflow would pick up from India in the second half of FY15. Could you give us some insights with respect to this?

JP Chalasani: We believe that the Infrastructure sector would witness major order inflows. Infrastructure sector includes roads, power and the railway system which is the MRTS or the metros. The other sector we are positive about is the Energy sector. I believe that it is one of the key areas which we are going to work on. So we are expecting that the order inflow would pick up from the Energy sector and Infrastructure sector in India by the second half of FY15.

TanujMakhija: Would this CAPEX be driven by government or by private companies?

JP Chalasani: The Company believes that the ‘policy level freeze’ which was present earlier would decrease to some extent. This will lead to the participation of the private sector in Infrastructure sector to grow significantly. As a private sector Company we had a significant presence in this sector. But in the last 2 to 3 years most of the projects have got stalled. We believe that this is going to change and there would be significant private sector participation in the sector. In some areas i.e mainly in the Energy sector, the Government owned Companies investment would significantly increase. Even Private sector would contribute significantly in the Energy sector.

TanujMakhija: With respect to growth in Energy sector, could you elaborate whether the growth would be upstream or downstream?

JP Chalasani: We expect both the sectors to grow. Before the elections were held, there were talks that the new Government was giving importance to energy sufficiency. There were talks about fuel shortage which is one of the major issues that needs to be addressed. Therefore, I believe that while working on coal they are going to work on the gas sector as well. It is going to be a push for the upstream as well as for LNG. Therefore this leads to the facilities for the upstream and most importantly the pipeline and tankages business would have significant bearing. The other process related industries would also improve. That is one segment. The other Infrastructure obviously all of us know, power itself in my opinion is going to grow significantly.

TanujMakhija: Can you provide some insights on your payment cycle in India? Has it improved or further deteriorated in the last 3 months? Going ahead how do you see it?

P. N. Krishnan: Receivable-wise we have come down. The working capital cycle has reduced as it has come down to 152 days in FY 14 as compared to 157 days in the previous year. We believe that a lot needs to be done and we are working on it and also working with respect to claims management.

JP Chalasani: We also have a positive assumption that many of the private sector clients would now improve their position much faster.

TanujMakhija: Is this change seen for the entire industry or is the improvement only at Punj Lloyd company level?

JP Chalasani: There is a general overall outlook that this industry is going to grow in a big way. I think everybody has an opportunity on this. There was a bit of a slowdown in the last few quarters with respect to new order bookings. We did an inward-focused approach in the Company. In the last one quarter we have revised our organizational structure. We are no more on the regional basis but on a business unit basis and this new organization started functioning from 1st April 2014. Currently the 'process' is made separate, irrespective of where the business is, whichever country it is present. Power is separate and infrastructure is a separate one. Now we have business units on this. We have worked more on internal processes and controls to make it more efficient. We believe that whenever the opportunity arises we would be able to seize it in full manner. We also believe that opportunity is there for everybody. We happen to be in a place where the sectors like Infrastructure, Oil and Gas are expected to grow.

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

PriteshChheda: What are the projects currently in place on the hydrocarbons side in India? Post this major event which of the projects do you think can actually materialize?

JP Chalasani: I am not very sure at this stage. But, I feel that this sector is likely to grow. We are in talks with Reliance Industries for the CBM area in respect of the pipeline. We assume that the pricing issue on CBM will get resolved quickly and they will move ahead faster on the pipeline. I have quoted one example. We have seen them figuring the process of pipeline finalization. Earlier, everybody thought that it was taking its own sweet time before they actually wanted to build the pipeline. Now they are hurrying up to build up the pipeline because they know that CBM embargo would affect the price of CBM, whether PSE and the gas allocation policy apply or not. These things expect to get resolved. It is more of a directional guidance at this stage rather than committing what kind of projects are likely to happen.

PriteshChheda: Is it fair to believe that currently there are no projects on the exploration side? On the refinery side, barring Reliance, there are no projects which have come in due to policy changes? On the transmission side nothing has happened even though there is always a need?

JP Chalasani: We are working on transmission, packages and there are some LNG terminals happening. We believe if we are to have a GDP growth then it is important that the Energy sector grows. Many things are expected to get expedited. We were in touch with RIL for the CBM pipeline, and we are bidding on this LNG terminal at Ennore. We expect the entire Pipeline to speed up. We believe that new opportunities might come but it is not going to happen overnight. Like the present quarter, the next quarter would also be more of a preparation for everybody as most of the opportunities are expected to arise in the second half of FY15.We are not expecting anything to happen except which is in the pipeline this quarter. In the next quarter the new opportunities would be based on the new government.

Pritesh Chheda: What is present in the pipeline is transmission and LNG terminals and those projects?

JP Chalasani: In India, currently, we are involved in 7-8 projects. Whether the projects are of pipeline or tankage, we are participating in the bidding process.

Moderator: Our next question is from Ronald Siyoni of Sharekhan.

Ronald Siyoni: During the quarter, USD37 million have been written-off from the revenue and from the cost?

JP Chalasani: I do not want to use the word of ‘write-off' though. We have kept aside $37 million as discussions are on with them. I think the amount is $97 million and the internal recommendation is $85 million. However, we have got the figure of $60million in writing. Discussions are happening at the highest level in this Company with both the joint venture partners. We hope to reach the numbers we have targeted for. But to be on the conservative side, we say $60 million. We have kept aside $37 million out of this. I am sure that the major part of it will come back in this quarter itself.

Ronald Siyoni: So even if we add back during this quarter also this $37 million then also the execution seems very low compared to like Q4 being a good quarter and average about Rs.3,000 Cr odd crore you do during Q4?

JP Chalasani: As of now, we have announced some projects which we have won and with the first project coming into execution we hope to see the top line growth.

Ronald Siyoni: In contractor charges, you might have added €12 million and USD8 million for JV Indonesia. Apart from that, is there any FOREX loss during the quarter?

P N Krishnan: There was a translation gain of Rs.21 crore

Moderator: Our next question is from Jinal Fofalia of AlfAccurate Advisors.

JinalFofalia: What is the margin of present order book?

JP Chalasani: 12% on the EBITDA level.

JinalFofalia: What would be the core area which the management would be focusing more for the next 2 years?

JP Chalasani: The management focus has been on organizational efficiency improvement on which we concentrated during the quarter by reorganizing ourselves on SBU basis, streamlining of systems and processes and improving claims. In the next 2 years, we expect to increase our order book position which will result in improving our margins in the new projects. Hopefully the results would be visible by the end of the second year. We have made a beginning as an International development company and have won a road asset and couple of solar projects. We would also like to expand on asset creation after we significantly stabilize our operations.

Moderator: Our next question is from Manali Shah of CRISIL.

Manali Shah: What is the total order inflow for the entire FY14and in Q4FY14?

JP Chalasani: Current year, we have booked about USD815 million that is between April and May. In Q4 it would not be a large amount; it may be some variation on orders, etc.

Moderator: Our next question is from Rahul Goenka of Noesis Ventures.

Rahul Goenka: How confident are you in getting the Iraq pipeline project where the company is planning for both oil and gas twin pipeline which is considered a big project and the TAPI project?

Atul Jain: These projects are still in the planning stage and we are chasing both these projects. They are the large projects, and have not come to the bidding stage.

Rahul Goenka: Every quarter the unbilled revenue is increasing; it is almost Rs.7,000crore. Why is it increasing?

JP Chalasani: We have two types of contracts. In one type of contract, work is done on a monthly basis and accordingly we bill and receive the payment. In another type of contract, the billing is done on a milestone basis. We have a number of milestone based contracts. In these types of contracts, the billing cannot be done until the milestone is achieved and this has led a Q-o-Q increase in unbilled revenue for the quarter.

Moderator Sir, there are no further questions. Would you like to add any closing comments?

JP Chalasani: As mentioned earlier, the Company did have a slowdown in the order booking earlier and this has helped the Company to look inwards, reorganize itself and improve its efficiencies in various ways. We expect the order book to improve in the next quarter. Going forward, we see significant growth potential in India as well as in outside India. The company would also concentrate on the 'claim management' area which would help it to reduce its debt in the next couple of quarters. Having said that, if anyone has any further queries we will be more than willing to answer that; our IR Group is always available to answer that.

Moderator Thank you very much sir. Ladies and gentlemen, on behalf of Punj Lloyd that concludes this conference. Thank you for joining us, and you may now disconnect your lines.