"Thermax Limited Q1 FY-20 Earnings Conference Call"

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MODERATORS: **MS. BHOOMIKA NAIR – IDFC SECURITIES**

Moderator: Ladies and gentlemen good day and welcome to the Thermax Limited Q1 FY20 Earnings Conference Call hosted by IDFC Securities. As a reminder all participant lines will be in the listen-only mode and 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 entering '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Ms. Bhoomika Nair from IDFC Securities. Thank you and over to you ma'am.

Bhoomika Nair: Thanks Melissa. Good morning everyone. On behalf of IDFC Securities I would like to welcome you to Thermax's 1Q FY20 Earnings Call. I have the management today being represented by Mr. M.S. Unnikrishnan – Managing Director and CEO and Mr. Rajendran Arunachalam - Executive Vice-President and Group CFO. I will now hand over the call to Mr. Unnikrishnan for his opening remarks post which we will open up the floor for Q&A. Over to you Sir.

M.S. Unnikrishnan: Thanks a lot, Bhoomika and a warm welcome to all my friends once again for the Q1 earnings call. I already have feedback that most of you are okay with the results, though some things could have been better.

So, let me repeat the numbers another time. The first quarter order intake has been a disappointment at Rs.1,217 crore versus Rs.1,657 crore in the first quarter of last year. This is impacted primarily on account of the fact that there weren't any project orders of substantial nature either from the domestic market or from the international market that were concluded or registered in the quarter. Not that we have lost any major orders, it is also postponement and a lack of urgency at customers side, including in the international market, to conclude orders immediately. So, I'm hopeful that some order improvement may happen in the future. That's about the order intake. This, along with opening the year at a lower order carry forward has resulted in our order balance at the end of Q1 come down to Rs.5,250 crore versus last year's Rs.6,420 crore, an 18% drop. But the positive side is that we have been able to accelerate the sales by 33% from Rs.1,026 to Rs.1,361 crore, predominantly in the domestic market where the execution has been extremely good. So, 55% more than the last year in domestic sales, while marginally better in international at around 9% to 10% higher. That's a split between domestic and international numbers.

At the EBITDA level, we have been able to marginally improve whereas at the PBT level you'll find an 80 basis points reduction. The reason why the profit bridge has come down, at the PBT level whereas the EBITDA is retained is that the treasury has been lower in size as compared to the last year first quarter. There would have been an impact of maybe Rs. 7 crore in the treasury side and one of our businesses was negative in the current quarter but that's only one quarter. This is because the Cooling could not execute many of the orders after having shifted to Sri City but it will catch up in the second and third quarter. Plus, we have made some provisions for the China facility closure so that also would have had some negative impact at the PBT level. Otherwise operations have produced similar results as last year, some divisions, especially ones in the energy segment, have been marginally better off in comparison to previous year because you would find that for chemicals, both top-line and profits are flat and the environment segment is marginally lower, but they have not been able to impact. But energy has performed quite okay in the execution of the orders as far as the numbers are concerned.

Just to give you a split of how these orders have panned out; energy segment has come down to Rs. 815 crore only in order intake at the Thermax Group level. Environment segment order intake has gone up in comparison. On average we were doing between Rs.170 crore to Rs.200 crore per quarter for environment in the last 3 or 4 quarters. The current quarter, especially the air pollution control business has seen a substantially high level at Rs. 286 crores for the first quarter. Also the chemical order intake has improved. So, it is fundamentally the energy part which has created the slump in the order intake as I mentioned about no major projects being concluded.

For the other side of the story in terms of domestic and international, the overall domestic order intake had gone up whereas international is marginally lower. As I mentioned, no larger orders were concluded, even if concluded, they were not registered in the current quarter. And this number which I'm talking about of the order intake is exclusive of the FGD order of Rs. 471 crore which we have declared to the press and all of you three weeks back. It will be accounted only in the Q2 numbers of the company. That's about the numbers.

And beyond that, I'd like to report that we have taken a conscious decision to close down our operations in China which we had been talking about progressively. Many of you may ask me why aren't you taking a harder decision or what I am going to do with that? Please remember that 10 years back when we started it as a wholly owned subsidiary of Thermax, we were very hopeful that we should be able to come to a level of profitability though it may take time. For two consecutive years, we had a positive EBITDA, and in one year, we also had a positive PBT. But there afterwards, things started deteriorating over there, and there are multiple reasons for it. Then we thought we will retain it as a manufacturing unit and will execute export orders there but Chinese products were not accepted everywhere and on the top of that with the current trade difficulties with America there is a punitive duty on them. We have manufactured and exported orders from there to America but that is impossible now. And most importantly when we went to China, there was a cost arbitrage of almost 7% to 8% available by making in China. Today it is cheaper to make the same chillers in India. Chinese costs have gone up, not that Indian costs haven't gone up, but we have become more efficient in India. At Sri City we are able to make it much cheaper than what we were making in China. So, we have taken the conscious decision of closing down the manufacturing facility. We have invested a total of $14 million so far in the land, building and machinery and we will be disposing it and will keep you informed progressively once the transactions are completed. We will remain there in a very truncated fashion to support our customers because there are more than 250 or 300 Chinese customers who bought our equipment. They need to be provided service and Thermax will not walk away from that, so we will have to keep the service centres going on for some time and it should break even on its own. By that time, we should be able to hand it over to some agency over there to take care of our customers.

On TBWES, the transactions are being concluded in terms of slump sale and operations; they have started manufacturing in the Shirwal plant, and progressively all the employees of the Boilers and Heaters Group will move to TBWES . So, it will be a seamless movement between Thermax and TBWES. That being a material subsidiary, one of our independent directors, Mr. Nawshir Mirza will be chairing the audit committee of the company. We have decided to keep the same name for some more time because we have been allowed to use the Babcock & Wilcox name. In India, Thermax is a much stronger name than B&W, but in the international market there may be possibility to have a brand equity attrition for the company. So, we have decided to keep the name for the time being. We may change it in the future. There is also a deferred tax credit worth around Rs.16.2 crore which should have hit the balance sheet. Am I correct Rajendran? Would you want to explain that to everybody?

Rajendran Arunachalam: Yeah. There is a proposed amendment in the Union Budget which is currently in the stages of approval. The turnover which will attract lower income tax rate has been increased up to 400 crores compared to earlier 250 crores. So, deferred tax asset in our balance sheet, more specifically in our TBWES balance sheet for the accumulated losses that was present will be impacted because of this income tax rate change and hence an impact of Rs. 16 crore is expected in the event that the budget is passed. So, we have disclosed it as an item in our results.

M.S. Unnikrishnan: Certainly you may want to know what's happening in the market. A lot of negativity is prevailing in the market spectrum with some of the industry leaders suspecting if we are headed for a meltdown or a slowdown. Certainly, there is a negative sentiment prevailing all through the country which we have seen in terms of the order conclusions in the last quarter. Personally, we thought that with the government continuing, a change could happen immediately, but it is not happening. But it's not that there are gloomy days; don't get unduly carried away. Sectorially, there will be investment happening in the country though the capacity utilization has come down and may continue to remain negative for some more time. But I am confident about the fact that in the medium to long-term, we need to have more capacities created because this is only a temporary slowdown in my opinion barring one or two industries which may have some difficulties. Why I am being very specific is that nobody is currently talking about refinery enquiries which we used to talk about for the past maybe 2 years. One of them was already on the verge of being ordered to EPC companies, the discussions have been completed by engineering consultant and I'm sure they will place orders to EPC bidders in the next maybe few months. So, as I predicted earlier, you will see at least one refinery ordering where we will also participate for our equipment. The second and third refineries have gone to an international consultant unlike all PSUs. Technik has taken the first order and there are enquiries already in the market, which we have also received. So, they may happen in H2 or maybe Q1 of next year. So, there are three refineries which are very clearly visible at this point of time. FGD ordering as I mentioned, we already got one. We also have another opportunity where we are L1 but there the budget is much lower than the L1 price that we have bid. So, will they go for a re-bid or call us for negotiation and conclude the order is yet to be seen. Similarly, in cement, greenfield capacities may be limited though there were one or two of them almost on the verge of ordering. They may also take a break of couple of quarters before finalizing. But the enquiries related to waste heat recovery power generation has got a payback, so all the cement companies in India are considering it at this point of time. So, one needs to look forward to the sectors where there will be some movement happening for medium projects and after that anywhere in the world. That's the only solution for people like us for the next maybe few quarters. I would even go to the extent of telling 18 months to maybe 2-year period of time. We got to be very agile and present in every enquiry and be cost-competitive to pick the orders. We will keep updating you about the movement but don't have that doomsday kind of a belief based on some of the newspaper reports. I am not sounding optimistic, I want to be realistic. That's about it. Thanks a lot again and I leave it open for you to ask me questions.

Moderator: Thank you. Ladies and gentleman, we will now begin the question and answer session. We have the first question from the line of Abhishek Puri from Axis Capital.

Abhishek Puri: Two things, one your order book has depleted in the energy segment after this stupendous performance in the last two quarters. Is there a chance that you can really grow in terms of revenues in the next three quarters for the full year? That is one. And secondly if you can just talk about your new factories that have started and can we see the sunk cost been covered in those factories and why the margins are still lower? They have started to inch up but why are they still quite low vis-à-vis the historical last 4 or 5 years average?

M.S. Unnikrishnan: First and foremost, by executing very well you will be depleting faster, so ability to perform and grow for the rest of the year will be limited. But remember if there are orders having short cycle and that's where we are going to focus a lot more - the standard package boilers, absorption chillers, chemicals, air pollution control and skid-mounted water treatment plants put together which normally gives us anywhere upto Rs.400 crore to Rs.600 crore and sometimes going all the way to 700 crores. The average time for execution of this varies between a month to maybe 5 to 6 months. So, we are only at the end of the fourth month, and we have started the fifth month of the current year. So, it depends upon the order contribution and that's where the pulse of the market is not as negative as people are speaking—I am talking about small investments—yeah there is liquidity difficulty for various SMEs but there are decent ones also in terms of the balance sheet. The way I am looking at it Abhishek is that the larger investments which are done, maybe a steel plant worth couple of billion dollars or a new cement plant worth maybe a billion dollar or power plants which are billions of dollars, fertilizers if at all anybody were to be coming forward. So billion dollars size projects are normally decided by maybe 15-20 human beings in the Indian country. I don't have to name them, you will know them. It's known to everybody. They may not be very optimistic but there are thousand others in the country who normally put up a 100 crores to maybe a 500 crores to 1000 crores size of projects. The focus is on them, so if they were to conclude orders, if they have a faith that Indian market can consume, there are orders in the sectors like food, food processing despite all the negativity prevailing. Indians are eating a lot more and lifestyle is changing. We are consuming alcohol; distilleries are coming in, drugs and Pharma are in demand as we are getting sick. So, if you really look at the ground-level realities there will be medium-size investments we are certainly going to be there in each of the enquiries and pick those orders. If that is practical then it is possible to have a marginal growth in the year. But yeah, it will taper off across the year and maybe next year. I need to be picking orders. So, that is where I mentioned about FGD as a sector where we were shying away earlier as we have been able to get not so good terms but it has improved in comparison to the original ones where we refused to quote, and we have been also able to contain our cost and get one order. Second and third could also be possible moving forward so that's a sector with the chunky large-size orders. I mentioned that cement and refinery, put together should help me out is what I'm looking forward to. And for any order of maybe 50 crores and above, we will be present in all the markets where we operate and we will have to be competitive to take the orders and make margins there afterwards. So, coming back to the question you asked —will I go back to the original days of double digit margins? Well we are trying our level best but it has not become practical to touch a double-digit, though in one quarter we would have reached. But otherwise it may become a bit difficult. If the market is looking negative my competition is much weaker than me in terms of the financial stability of their organization, so they will be the people to buckle first. So, our average price in the market can come down, so that's the reality. Does that answer your question Abhishek?

Abhishek Puri: Yes and just on that factory part. We have started three new factories in the last year and how is the turnaround passes there and whether we will be able to cover the sunk off there?

M.S. Unnikrishnan: Sunk costs will be covered. Will it happen in the original payback period or will it get prolonged is a question, so I will go one by one. The first one to have been commissioned was our factory in Indonesia; I'm happy to say that we are receiving orders. Our order intake has been fairly good. It is up to what we expected it to be. At this point of time, I'm carrying forward 90 crores orders in Indonesia and we have been able to establish our name which is what we were little worried about earlier. As an Indian company going over there, will the market accept us and will they give a score? It is happening over there. With that we had predicted on our payback period, the company was supposed to breakeven in the fifth year, or sixth year and we are very confident because it could quite be likely that I may end up breaking even in the current year itself at least with EBITDA positive. So, the signs are very positive in that area and that market is not going down either - Indonesia, Malaysia, Thailand, Philippines all of them are growing. Albeit they may not be growing at 6% and 7%, maybe an average of 4% to 5% and the investments are happening, so that is a positive sign.

Coming to second one that we commissioned, the Dahej Chemical factory, we had major challenges related to stabilizing the plant and after stability of course we have been very careful in loading. The daily performance of that particular factory is being monitored at the corporate office. We have reached up to 700 metric cube per month production capacity as against 1000 installed capacity. At 620 onwards it's a breakeven and above—I am keeping the depreciation separately and talking about the operating breakeven—so we have already crossed that level and chemical is a consumer built business. It's not a capital income business and it is not only for India. In fact, it's an EOU, export-oriented unit and I am expecting that with the China America trade problem, the maximum benefits will come to my chemical business. China has been the major supplier to North America and with punitive duties already coming into vogue; there is likelihood that at least one business of mine that can get positive impact from the trade war between China and America. The third one is related to absorption chiller; here in any case it will do well because of the fact that after closing the China facility the only facility from which I'm going to manufacture chillers is the Sri City one. That is one business where the order intake has been almost 18%-19% more than the previous year. So, that is cooling business; world is getting warmer, so you need more cooling, so that should be better. We have been very calculative by investing in only selected areas and all three of them are going well. Albeit, breakeven for a couple of quarters could be here and there, that is the answer Abhishek for that.

Moderator: We have the next question from the line of Aditya Bhatia from Investec.

Aditya Bhatia: My first question is on FGD; it would be great if you could share some details on FGD ordering. What is the quantum of orders that are already being finalized in the industry, how many of them are likely to get awarded in the foreseeable future? How has been the pricing and how do you rate the contractor?

M.S. Unnikrishnan: The first batch of FGDs in the country got commissioned quite some time back which was done by BHEL for the northeastern region for two numbers of 250 MW on a nomination basis because that's their project. They have executed it and that is where the country tasted this concept. But that time there were no norms in vogue because the northeastern coal has got very high sulphur. Then came in a couple of FGD orders where a part of the original tender, including some of the Uttar Pradesh Power plants, were ordered out to Doosan if I'm not wrong. Then many of us reached out to the Government telling that this is not the way, we have the new norm created and there should be some control from the Central Government as to what technology should be adopted for the country, so they have decided to go for bulk tendering. That is where you saw Lot 1, Lot 2 and Lot 3 being created which had three companies participating namely, NTPC, Damodar Valley Corporation and Neyveli Lignite Corporation. So, Lot 1 enquiry came out. Unfortunately, in the terms of payment of NTPC, the lead company to make all the bids, they kept 30% retention in their tender and despite multiple representations made, they stuck on to the tender and we didn't participate in that one. So, some orders got cleared on that front. To my reckoning the people who picked the orders in that first lot is ISGEC, GE picked up one order, BHEL, Larsen & Toubro and Mitsubishi were the companies who picked up orders. Thankfully many Chinese quoted but I don't think they were considered in the final bidding. In that endeavor, the valuation to my reckoning is near to maybe 6,000 to 7,000 crore of orders in Lot 1. The Lot 2 came in where they agreed to revise the terms of payment to 17.5% retention. Though we would have preferred a 15% or maybe a 10%. So a company like us also started bidding for it and in that one decision was made that no company will get more than three orders and that's the way it is spread. So, if a person is L1 in more than three, the L2 will get the order. In the second lot Thermax became L1; in one of them, there was a reverse bidding. Since there were four participants, i.e. more than three participants there was a e-bidding so in that Thermax got the first order. We already have received the order and letter of award has come, so the clock has started ticking, and commercialities are going on. There is one more tender where we are L1 where mandatorily we should have been given the order. But that it is much above their budget though we are the L1; two others are much higher than us also. But the discussions are on and customer is considering if they should retender or negotiate with us and place the order. If that doesn't happen, if they go for a retendering, no more ordering will happen in the current year. There are three such orders placed comprising Thermax's order, two others also who are L1 but much above the budget, they may go for retendering for all three of them put together and put it into Lot #3 and the size for Lot 3 then would be equivalent to around 8000 to 10,000 crores. This could happen in Q4 or maybe Q1 of next year. Is that okay Aditya?

Aditya Bhatia: Yes, for Lot 2 what would be the last choice?

M.S. Unnikrishnan: I may not have the number. Normally I have all the numbers; it is the one number which is not there with me because I don't know how many of them really got ordered. To my reckoning it could be in the range of around 4000-5000 MW into maybe 70, around 2500-3000 crores approximately. On pricing you asked the question, it is far superior in the second tender because only decent companies are participating and many people who were L1 in the first batch of tendering have now become H1, so that's an indication that maybe they haven't priced it properly and people like us, in any case, have been outpriced. Currently it is decent enough pricing let me say. Everybody has understood that executing an FGD is not an easy task, so everybody has got decent enough prices. So, all those who would get the orders in Lot 2 at least should make profits. How much I can't declare.

Aditya Bhatia: In terms of gross margins we have been seeing some bit of pressure in the last few quarters, is it largely on account of industry-level pricing and desperation by some of our competitors which is bringing down pricing?

M.S. Unnikrishnan: Certainly that is one of the reasons even in areas where we have 60% to 65% of orders coming as repeat orders from customers. In earlier days, there was a preference for you; they will give you a premium. Today the desperation of the market is going to a level where other players would cut the prices to such a level that customers will say that we also need to be fair, so you take the order at the same price quoted by others. So, we have seen the prices dropping but then in the last two quarters and I think moving onwards for few more quarters, the suppliers are also under terrific pressure and reduction of cost is practical. The feeder industry to all of us is steel industry because 70% to 80% of what we are buying is made of steel only. There was a time when though things weren't too good, steel companies availed the minimum import price or what government gave them; all of us supported them because they were in red. So, they were very pricey, if you look at steel price in India in the past maybe 3-4 years time after the slump started picking up. I am talking about specialised steel that the people like us buy. I cannot comment on the automobile grade because I don't know about the prices. I'm talking about boiler grade tubes, plates everything which was rising on an average 10% to 15% per annum and had become unbearable till last year. Now only in the last maybe two quarters it started sliding down and I'm hoping it will continue because they don't have too much of orders also happening right now. So, all of them have come down to earth level, so I'm sure that moving forward also it will stabilize. So, once they come down, the suppliers will bring down the prices and we should be able to marginally improve the profitability. Again, I can't say about the behaviors of my competitors. Anyone of them may want to accept the contract for cash flow support by bearing a financial crunch.

Aditya Bhatia: In that context we are not really anticipating a meaningful improvement in gross margins over the next few quarters or years?

M.S. Unnikrishnan: I won't say a year because we are developing a variety of products as innovation is only way to improve margins. The conventional commercial play is getting over as the market is under distress. You're going to have only intellectual play, where we are better off than our competition. So, there are workouts of that kind happening and new product introductions which we would do. Though we are an expensive company for most of the products that we supply, however we're able to maintain the market leadership. It's only by innovation. So, there are also innovations happening, some of which may improve the margins. I can't say that for the company level, it is at product level. There will be improvements in that area also.

Moderator: We have the next question from the line of Apurv Bahadur from Jefferies.

Apurv Bahadur: Just wanted to understand on this emission control equipment site, not power, so basically industries like cement and steel and where we are saying that internationally there is growing clamor and probably this could result in higher standards in India as well. So, what type of opportunity size do we see over there and what's the technology and so just some sense on that?

M.S. Unnikrishnan: Certainly yes. The law is applicable to everybody who is burning any carbonous item which also has sulphur in it. So, the norms related to SOx and NOx are getting implemented in all the industries across the country. But they are targeting the larger emitters, so other than the power plants, the cement industry is the one who is implementing and luckily they have not asked for extra time from NGT the way the power plants have done. So, in that area we already have a solution that is not imported. For power plants, we are giving a Marsulex technology of America whereas this is our own home-grown technology. We have supplied in the past in very small numbers, and now we are receiving enquiries progressively depending upon how each state is implementing the central law. 3-4 states are absolutely clear that they will not allow cement plants to run without desulphurization equipment, irrespective of whether you get imported coal or domestic coal. It's already started and we are getting orders also. But the size of these order can vary between maybe a crore to maybe 3-4 crores. In fact I have mentioned to you that my enquiry pipeline for that is fairly good at this point of time and order intake has also improved. Environment orders have gone up in the air pollution control business in the current quarter as compared to the previous year. Similarly DeNOx laws are also going to be applicable for many industries. So, there products are under creation within the country, trials are also going on. But you can also modify the equipment design without a pollution control equipment to meet up with the norm. That is another challenge that one may face. We may have to modify our burners for example, use low NOx burners which are available. That will be very expensive. Many companies have preferred to buy a low NOx burning system rather than going for a pollution control equipment because the pollution control equipment will also consume maintenance cost and service cost whereas they would incur a little higher cost in putting a system in the boiler itself. Once that is adopted, our per order value can increase which will mean indirectly pollution control will increase the energy segment valuation also. That is the reality. Implementation is happening in the country, some states have become very strict; others will have to become progressively. The industries to do that first and foremost, as I mentioned, will be cement plants and captive power plants across the country depending upon the technology that they go for. If they opt for a CFBC technology they can capture the Sulphur Dioxide in the boiler itself, technology is already provided by people like us whereas if they go for a pulverized coal technology or maybe a Chinese technology certainly they will have to go for an FGD. So, there are specifically 100 to 135, 150 MW range batteries of boilers working in the entire aluminum industry in the country and then zinc, copper and other non-ferrous metallurgy industries have captive power plants which are 100 to 150 MW size, FGD is industrial in nature where the market size in the country would be around 3000 to 4000 crores which will be ordered out in the next few years. So, there's a good market emerging and we are good players in that market. Not that I don't have competition but we are the leading player in that area. Is that okay Apurv?

Apurv Bahadur: Sir very helpful, just if you could help me with which are the states which are getting strict with this implementation, some sense on that?

M.S. Unnikrishnan: First is Gujarat, they normally lead in everything, other states which have started implementing are Maharashtra, Karnataka, I think Tamil Nadu is also another one. In fact, there are some states where it will be implemented even though people like us may not get the order because they only want the Pollution Control Certificate whereas I need to give a certificate from my company that we are matching up with the norms. So, I think at least 15 to 16 major states barring one or two will start implementing in the next 12 months.

Moderator: We have the next question from the line of Inderjeet Bhatia from Macquarie.

Inderjeet Bhatia: On these three new plants that you have commissioned, is entire fixed cost already in the P&L, depreciation interest cost or it is more left and how much of that would be which will come through over the next three quarters?

M.S. Unnikrishnan: All three are already accounted in the balance sheet depreciation and no interest because of the fact that it is an accrual of ours from the balance sheet, we haven't taken any debt for it. You may find a little more addition in the coming year because in the chemical factory we have already cleared Phase-2 for increasing the capacity at Dahej from 12,000 metric cube per annum to 22,000 metric cube per annum, so that is ordered out, it may be commissioned sometime in the current year, maybe in the Q3 or Q4. So that additional value which is around 50-60 crores worth of an expansion that will get added, it is very small sum for the size of the company.

Inderjeet Bhatia: My second question is on the energy side; are there any large chunky orders which are being executed right now which would get completed or booked in the next remaining part of the year?

M.S. Unnikrishnan: The largest order that we had carried forward was from an African refinery with 160 million, maybe around 1000 crore. We have already revenue recognized good part of that, and the remaining overhang would happen in the current year itself. Good part of the consignment is ready because these are fully assembled boilers and needs a special ship to carry it, so once the rainy season is over, the balance will also move. Second large order would have been from a steel major worth around Rs. 300 crores and is at the last leg of execution. Most of it is completed; construction is going on over there. There is no major order under construction right now, apart from these.

Inderjeet Bhatia: I'm just wondering that if you look at last four quarters we have been issuing 30% to 50% kind of growth on the energy side yet if you look at the PBIT margins they have remained again mid-single digits to high single digits number. Is there no operating leverage benefit that which is coming through on that side?

M.S. Unnikrishnan: Project companies do not have operating leverage like a consumer product company barring the salaries which will get spread across. Otherwise, it's a bill to print or maybe in a very specific engineered products. Engineered product companies do not have substantial kind of a margin recovery possible when you want an improvement in the topline. So, for every order, you will do the costing, negotiate and take the order; whereas, the operating leverage kicks in when you have got a standard price list like in case of an automobile - all cars sold in the country with same model will have almost the same price or maybe the shaving kit that you buy or blade that you buy from Gillette every day where you don't even negotiate. So, there when you produce more from the same factory you get a much higher margin. In engineered products, bespoke manufacturing, one doesn't have that.

Inderjeet Bhatia: Let me rephrase the question; typically in a project order as you move closer to the kind of completion that is when start to recognize if there are any margins that we have managed to capture during execution because of efficient execution or typically companies go more I would say conservative cost accounting in the initial part of the project executions and the margins typically get released towards the latter half. So, is that not happening or you have not been able to get typically you have been saying that you take a project at the certain margin and then try to squeeze out on another 100-200 basis point because of efficient execution?

M. S. Unnikrishnan: What you told is true. In a good project, you will release maximum margin towards the large part of the execution that we also follow; initially, one doesn't do that otherwise you will overbook the profit in the beginning and it will be bereft of profits in the end. We have a very conservative policy on that front. But in the last few years since the market was not too conducive, one had tougher competition and many times one had to conclude orders at very low margins and whatever margins that you see are also a lot more improvement done while executing. The next question is, can you improve it further? In a rising market when the demand is good you will work for margins whereas when you are in a depleting market you don't work for growth, but you will work for ensuring that your factory's fixed expenses are taken care of because in the engineering industry to get good people is not an easy task including good workmen. So to keep them busy and engaged you need to have orders in hand. So, all this is because if you see, from 2011 onwards, the capital goods industry in India has been under terrific pressure. You know the companies, all of you follow them also. We are one of those companies who stood by in the market without having any negativity of any substantial nature, except letting you down once in a while in a quarter, but otherwise generally performing well by ensuring that our factories are at breakeven plus capacity atleast if not full. So, each time, though you may want to get a higher margin, the customer has a choice available and the desperate competition decides the price, not the customer.

Moderator: We have the next question from the line of Aditya Mongia from Kotak Securities.

Aditya Mongia: I had a few questions; first one was again on margins. It was suggested that there were a few bad domestic orders that were bringing down profitability in the second half of last year and this is a standalone business. Have there been a sustained impact of those bad orders in the margin this quarter also?

M. S. Unnikrishnan: Those orders are under executions still. Incidentally, two of them were EPC orders which I mentioned above. Supplies are going on, and they will be completed by Q3 of the current year, a major portion will be over in Q2. But, whatever had been the major overruns are already considered and we have accounted for that. We were aware of the fact that overruns will happen. The second item in which we had some difficulty last year if you remember the two quarters; we had consistent negative performance from our Danish subsidiary. Very happy to say that this is the first quarter where we turned around and they have had profits recorded, and they will continue to improve their performance across the year. We have shut down one of the two manufacturing units over there and we shifted that to Poland; where there is cost arbitrage substantially available between Denmark and Poland. These were the two reasons if you remember in the previous con-calls which I had mentioned about in Q4 and Q3. So, one of them has improved, another one is already accounted for, so the impact I thought on the negative side will not be there going forward.

Aditya Mongia: Is the Chinese subsidiary still leading to some kind of losses being taken in and fiber side if you could also give me the kind of cost provisions taken in this quarter on that account?

M. S. Unnikrishnan: For China, we have decided to shut down the manufacturing and only the servicing portion will continue. I think I had mentioned, if not then let me repeat it ; I think I told in the opening itself about the China facility closure, why we have decided to do that and I also did mention that 14 million was the total investment done, most of which got impaired across various quarters and in the current quarter we have got Rs.8 crore in total which would have been provided in the current quarter balance sheet.

Aditya Mongia: The next question I was more on opportunities outside India so we talked about the large EPC order on the cement side that you got in Middle East and that being the first order of its kind for you in that region. When you think about such kind of opportunity which other geographies or businesses come to mind wherein one can get a wagon and then grow the business internationally?

M. S. Unnikrishnan: South East Asia is a market where there are captive power plants being considered, ordered out and quoted for in countries such as Thailand, Philippines and Indonesia and from isolated parts in Vietnam; and we are present in all the markets. I mentioned earlier that we have registered our EPC company in Thailand and are on the verge of registering that in Indonesia also and we are creating an edifice over there to execute as a local company because for EPC orders of that kind - larger project orders, not everybody will be happy giving it to an Indian company who is based in India. So, we have to be locally present over there because they may want local guarantees, local construction to be undertaken. That's one market where we are looking forward to getting orders for larger boilers and also EPC for captive power plants. Then is the African continent where it is isolated with no regular orders. There is one large group which you are aware of that we are associated with. Those guys are investing in, for example, post the order for the refinery, the same group has given the order for their sugar factory which is coming up (two of them). We got the orders for the boilers of fairly large size but LCs are yet to be established. In Africa, there are cement plants coming in various locations, in a year may be one of them will happen. Then as I mentioned, when sugar factories get established then captive power plants are required and same is the case for larger consumer product company so we already have our office in Egypt, the second one is in Nairobi, and we have got people placed over there. So, we are prospecting enquiries, and following up for conversions. From South America too sporadically there are enquiries for very large capacity boilers, in Columbia, in Mexico, in Brazil, three countries where we have supplied and there are enquiries once in a while coming from there also. The only challenge in South America versus other places are the funding possibilities. Local companies may not have the funding capability, so they have to depend upon the European Banking System to support them. So, one has to be very careful about accepting orders from there because you may get an order but may not get money. So, we are very particular about that. These are the three markets that we are looking for medium to large sized projects.

Aditya Mongia: Last question which I had was on FGD now we have been talking about FGD orders coming from NTPC and other central agencies. Any movement that is happening beyond this subset of customers let's say states and private sectors starting to order for you?

M. S. Unnikrishnan: In private sector, there is hardly anybody who can leverage the balance sheet to get any money for setting it up though the government has already passed a rule that for the capital cost amortisation and running cost converted into paisa of per unit basis, CERC has empowered PPAs to be amended upwards. That should empower them to go ahead, but they don't have balance sheets which can be leveraged further to take loans to execute it. Progressively when they improve their balance sheets, I'm sure they will go for it. State Electricity Boards is a big story. I don't know how they are going to do it because frankly speaking, they are the biggest polluters because the capacity is dependent upon domestic coal and are also not well run. Ideally, they should go for it but despite the Udaan signature,I don't think any out of them are today making any positive contribution barring one or two states. No electricity board has a positive balance sheet, so I don't think in the immediate future, one should expect them to go. Will you be able to execute it in time with the cash flow needed by the management is something I don't know. I will restrain from commenting. Whenever private companies go for FGD, we will be one of the strong contenders.

Aditya Mongia: A data point what is the quantum of order that you otherwise expect to get from FGD in the one which is still not decided?

M. S. Unnikrishnan: It will be too speculative because it's not small numbers. If you get an order, it can be 400-500 crores to maybe 1000 crores. If you lose, not everything is lost, so to say that what I will get is a tendered-out one; it's not a negotiated one. So, depending upon what price you put in the tender you become L1 then only you will get an order. So, it's better not to be speculative on that. Participate and try to be competitive.

Moderator: We have the next question from the line of Priya Mehta from Anand Rathi.

Priya Mehta: I would want to ask on a macro perspective we are hearing a lot of commentary on the private CAPEX deteriorating and we see some green shoots in some industry so could you elaborate more on where do we see such green shoots and what will be the timeline where we see the recovery of the CAPEX and how the broad industry prospects?

M. S. Unnikrishnan: I had made some comment earlier that expecting a total CAPEX revival in the entire country may not be a conducive or maybe a realistic expectation going forward. What happened between 2003 to 2008 for the world and India extended to 2011 may never happen again for a very very long period. During that period of time, everybody invested in everything and you were looking at what your neighbour was doing and you were investing and creating capacity without recognising whether you will be able to market that capacity that you created. Banks who were funding were in trouble because ultimately in any investment, 70% to 75% of the money is from the banks. Only 20%-25% or 30% maximum will be from the investor. So, that kind of investment cycle if one is talking about it will never happen, should not happen also in the country. That is why I would go selective and sector-wise. Now if I were to look at cement as a sector, it can only be local business because it costs you $55 to make a ton of cement and if one were to get it from China which has got surplus capacity, it could cost you another may be $200. It's a very low-density item which means it is always going to be a local business. Even for construction, we have to catch up in the country from the current problems that they are having and more roads have to be constructed along with houses to be built for the poor people; also because whether rich or poor cement is needed to make a home. So, cement consumption certainly will go up in the country, so I could look forward to the capacity utilization in that particular industry and then go after them to get my orders for captive power, waste heat recovery, air pollution control. Each cement plant of current 10,000 TPD or may a 3 million tonnes per annum can have an opportunity for me ranging between maybe Rs. 200 to 500 crores. I'm sure it is going to happen in India. How many of them will happen is what I can't predict; whereas on steel, I may not be as confident as it can come from anywhere. There one has to look at little more of macro global, so that is what I spoke about; now the banks and the investments will have to be very careful. If we create a capacity domestically can it be distributed? That is why you are seeing the larger investments happen very selectively. In power similarly, you will have to generate it domestically. Though we have a difficulty with coal based power plants in N number of ways, we don't have any other fuel available and solar and wind put together, cannot be running India, growing India. So, we will have thermal happening, may not happen in the next 2 years because all the current players are in difficulty. So, that's why I spoke about, you shouldn't expect a cycle recovery, selective sector recovery can be expected based on the capacity utilisation. Coming to the macro level, unfortunately, for us, we have also created extra capacity in many areas and as consumption acceleration has come down slightly in the last 2 to 3 quarters; there is a scare, and the big guys from the country have already started talking about it. Some of the major leaders from the industry have started getting worried and making public comments about a deceleration in the Indian economy. No, there is no deceleration of the Indian economy; temporarily, there is a consumption reduction. Since you asked the macro question, this is my answer to it. Capacity creation in the country is based on gross capital formation. There are three items in that - there is government investment; there is private investment and then household investment. The government investment for the past 8 to 10 years has been constant with a variation of 0.5% to 1% only. Second is the private capital investment; it has not come down to the level that you guys are worried about, it has come down from 7% to 5.5% or 6%. It has never been a big number in the country and the biggest investor in the country is the household investment, they have got a secondary impact which is one that has come down by almost 5.5% meaning 550 basis points between 2010 and 2019 and why that has happened is what you should be asking. It is on account of the fact there is rural distress in the country despite all the WPA numbers that we hear about, regarding consumer price. You calculate what you paid earlier for a vegetable or maybe your household purchases; vis-à-vis how much it has really gone up and compare that with the inflation that government is declaring. The money in the hand of the consumer may have come down or even gone up, but the cost has gone up, so it is only for survival and not for durable purchase, automobile purchase and multiple things. That is why all this has happened. In my reading, I don't go along with the general perception given by everybody. If we are able to put the money in the hands of the consumer more where he has surplus money available for household investments which will be the white goods, the durables and multiple things of that kind, he will construct home then again it will catch up. There is a huge innate, but unsatiated demand in the country and this is what we need to be doing for economic revival. I think the government will catch up on this but will take a longer period that's why I mentioned that nothing would improve substantially for a period of 2 years. But in the 2 years, the investments are going to happen; growth won't be visible beyond a level. So, that's the reality. Priya is that ok?

Priya Mehta: Recently we have seen development for Green Energy Corridor and we have talked about it so what do you have to speak about it, what do you see about it?

M. S. Unnikrishnan: It will happen in the country but the pace at which they are expecting the Green Corridor; I presume you are talking about the electric vehicle plus source of energy being green. Am I correct?

Priya Mehta: Yes.

M. S. Unnikrishnan: Source of energy being green will continue to increase through the Green Energy Industry. I'm talking about the equipment manufacturers; the developers are also not in the best of the condition right now for putting up more capacity at a faster pace. I don't need to name companies; the balance sheets of them are already known to all of you. For the banking systems also, it is difficult to fund further. The electricity is produced from green energy sources, but that is sold to the electricity boards and who are not in a position to make payment on time because of which there is a little of mismatch between the recovery versus reaching up to the banking level; that is the issue number one. Second is on the electric mobility within the country. I'm sorry to say that on one side we wanted Bharat VI to be introduced in 2020, we improved all the refineries and told all the automobile companies that you better come with your Bharat VI compliant engines and they have struggled and invested. I don't know how many billion dollars have been invested domestically and internationally and once we are ready then they say that we will stop making all diesel vehicles in the country, at some point of time. I don't think it is going to be practical because the banks have to get their money back from all those who have taken loans for all of this and globally also in the most developed countries; I'm talking about larger countries, not some countries where the population is 1 lakh people, I'm talking about countries having population above maybe I would say 20-30 million. Nobody is expecting electrical mobility to penetrate beyond 20%-25% in the best of the countries by 2030. We are making some statements; it's an aspiration but do we have anything to back it up. Is that okay with you, Priya?

Priya Mehta: Yeah.

Moderator: Ladies and gentlemen due to time constraints we will take one last question from the line of Mohit Pandey from Citigroup.

Mohit Pandey: Possible to share the backlog breakup, I think you had shared that initially but I missed it, in terms of energy environment chemical?

M. S. Unnikrishnan: Oh yes. Rajendran will give all the numbers. You want the carry forward?

Mohit Pandey: Yeah that's right.

M. S. Unnikrishnan: Chemical carry forward will not have a major remaining because of the book and bill every month. We can get the orders and supply also. Rajendran will give you the numbers.

Rajendran Arunachalam: Mohit, what were the numbers you were wanting?

Mohit Pandey: The carry forward backlog as of Q1 end for energy and environment?

Rajendran Arunachalam: The carry forward for the energy segment is about Rs. 4500 crores, for environment segment is about Rs.679 crores and for the chemical segment is about Rs.71 crores, a total of about 5250 crores.

Mohit Pandey: Secondly chemical sales is definitely a short cycle, so overall what proportion of the backlog is currently short cycle which I think you classify as that gets executed in 1 to 6 months?

Rajendran Arunachalam: This is only particularly for the chemical segment that you are asking Mohit?

Mohit Pandey: Overall Thermax Group?

Rajendran Arunachalam: We would have certain book and bill orders as what we would call it and on the best estimate, I think it would be about 15% to 20% of our annual turnover and that's the one which we would be looking to bridge if the order book is lower or the order carry forward is lower.

Mohit Pandey: Possible to share any guidance for the FY20 revenue, full year revenue?

M. S. Unnikrishnan: Mohit fortunately or unfortunately we never given guidance for the year because we are in a speculative volatile industry so predictabilities are not there. Though we dialogue with all of you and give you what is known to us and from there all of you create your storylines and maybe the number lines.

Moderator: Thank you. I would now like to hand the floor back to Ms. Bhoomika Nair for closing comments.

Bhoomika Nair: Thank you very much sir, for giving us detailed responses to all the queries as always and giving us a good macro overview. Thank you so much for giving us an opportunity to host the call and also all the participants for being on the call. Thank you very much Sir.

M. S. Unnikrishnan: Thank you, thanks to every participant for being very inquisitive and asking questions, which will also make us think. I need to admit that every time I complete a con-call with all of you, I also think differently than the way I thought when I started the call because you ask very incisive questions. Many of our improvement areas are based on indirect suggestions coming through questions from all of you. Looking forward to your continued support and we will continue dialoguing with you. Thanks a lot once again.

Moderator: Thank you sir and thank you Ms. Nair. Ladies and gentlemen on behalf of IDFC Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.