"Thermax Limited Q2 FY20 Earnings Conference Call"

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Management:

Mr. M.S. Unnikrishnan – Managing Director and CEO
Mr. Rajendran Arunachalam – Executive VP & group CFO

Moderators:

Ms. Bhoomika Nair - IDFC Securities

Moderator: Ladies and gentlemen, good day and welcome to the Thermax Limited Q2 FY20 Earnings Conference Call hosted by IDFC Securities Limited. 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 pressing "*" then "0" on your touchtone phone. 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: Good morning, everyone. On behalf of IDFC Securities, I would like to welcome you to the Q2 FY20 Earnings Call of Thermax. We 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 now hand over the call to Mr. Unnikrishnan for his initial remarks post which we will open up the floor for Q&A. Over to you, sir!

M.S. Unnikrishnan: Thank you, Bhoomika and thanks to IDFC for hosting this call on behalf of Thermax. Also, a warm welcome to all my friends from the fraternity who have been continuously supporting us. Starting with the glimpse of the results, order booking is 28% up from 1,344 going all the way to 1,723. Of this, domestic portion is one which has really made it happen and gone up from 751 to 1,349. Certainly, we had the advantage of the FGD order from one of the power companies of the country. But even after discounting that in the domestic market, overall order booking has been better off in a very tough market. However, for the international business, our overall order intake has come down from 593 in the same quarter, last year to 374, a 37% drop, primarily because there are no project orders that we had been able to conclude; not that we have lost any orders. The same thing that India is witnessing is also being witnessed by most of the markets where we operate in terms of order conclusions being delayed. Order balance at this point of time for the company has come down from 6,411 to 5,334, a 17% drop. This was expected in a market like this. When we are able to execute orders at a faster rate, unless order intake substantially goes up, there would be an anticipated reduction in order balance.

Our revenues for the quarter from operations have increased by 11%, 1,463 has gone to 1,628 and at the EBITDA level we are better, going up from 123 to 134, a 9% growth in EBITDA. However, at the PBT level it is just about 2% more - 118 going to 120. So, at EBITDA level, there is a drop of 20 basis points in comparison to last year whereas at PBT level there is a 70 basis point, that is 0.7% drop in the PBT. Now couple of things - at the PAT level, you would have seen that there is a substantial drop in net profits for the company. But this is on account of the fact that we have decided to opt for the lower slab of taxation. You would have noted that Thermax's effective tax rate had been between 34% to 36% for the past many years, and we opted for the 22% slab; including surcharge and cess, it may go up to 25.17%. This would mean a net saving of approximately 10% in the future. So, the deferred tax assets lying in the balance sheet of both TBWES as well as Thermax Ltd. having an impact to the tune of around

70 crores had to be reversed - approximately 35 each for both the companies. This has brought down the PAT substantially. Apart from that, while transferring our boilers and heater business to TBWES through slump sale as a part of the agreement where we have shifted it as a 100% subsidiary, we have also taken charges related to the AR write-offs which were already provided for so there would have been some impact on that front. Plus, we also had to consider the depreciation of TBWES on the group balance sheet which was earlier a joint venture. So, that is amounting to around 36 crores per annum where we have been hit by 5 crores. It is only at the PBT level whereas at EBITDA level it is not applicable.

Further information is that we have been able to sell the assets of our Chinese subsidiary - both land and building, and we are also on the verge of closing all the accounts over there. And, as I mentioned to you in the last concall, we will continue to have skeletal operations to take care of the warranty obligations and there afterwards, the entire operations will be closed down in China. The feedback on Danstoker is that the operations have turned around in the current quarter; it is a breakeven plus at this point. However, there is a loss which will be reported on account of the severance paid to the CEO, as well as some other employees, who have left the company. Otherwise, operation wise it has turned around and we are expecting a marginally positive result by the year-end.

You would have noticed that in the details of the balance sheet, expenses would have gone up a little more than usual. This is mainly on account of the freight recovery being grossed up in the overall revenue, which in the past was reported as a net expense. That is approximately 16 crore. There could be some other items which are minor in nature which may have gone up or down. Otherwise, there is nothing to worry about with regard to our expenses. It is well under control and we have been able to manage it. TBWES is fully operational. The slump sale formalities are completed, and employees are being transferred into the new company. Going forward, there are certain worries in the market and anxieties related to order conclusions. It is not that orders are not getting concluded but larger projects are limited in number.

However, as I mentioned to you in the last concall related to refineries, the Barmer Refinery enquires are already in the market. We have already bided, and discussions have already started. So, conclusions would happen progressively, may not be in the current year unless luck prevails. Could be in Q4 in case they finalize in February-March 2020, else it may get shifted certainly to Q1. There are enquiries from other two refineries in the market and we are participating in the bid. There are enquiries in the Cement industry, but in the last two months, people are little wary of concluding. And I am sure all of them are waiting for a turnaround in sentiments before they can conclude. So that is the overall indication about the economy. We are preparing for possibly lower Indian economic growth of 6% or even sub 6%. All the related corrective actions have been taken within the company.

So that is all from my side. Now I will leave it to you to ask me specific questions. Thank you once again.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Ranjit Shivram from ICICI Securities. Please go ahead.

Ranjit Shivram: Sir, if you can elaborate from where are the domestic orders coming and if you can give us an outlook segment-wise like which are the segments where you see an uptick and where are the challenges lying for the next 2 to 3 quarters?

M.S. Unnikrishnan: One order I mentioned to you is from the power industry for flue-gas desulfurization system. That is for the environment segment. The main one after that is in the cement sector where we have received an order for waste heat recovery based power plant. And also, for a new line being opened by one of the southern cement companies, we have concluded an order and received an advance also. We have also received orders for air pollution control equipment in the cement industry. Flue-gas desulfurization is also catching up in the conventional industries where notices are being served by the Pollution Control Authority. We are also seeing orders coming from food processing. It is continuing unabated despite what you may be reading in the newspaper; there are a sufficient number of enquiries and orders both in the food sector and also in the dairy sector. We are also seeing opportunities, maybe temporary, in paper industry at the back of growing e-commerce. These are orders for conventional boilers. Apart from that, we have been able to introduce a new product which will be able to convert waste to energy in the paper industry. There we have been able to proliferate and conclude a couple of fairly large number of orders because all of them are under cost pressure. So, if they are able to utilize their waste as a fuel to produce steam for the process it will reduce their overall cost. That is an emerging business. There had been also some order movement in the sponge iron industry all of a sudden, surprisingly because steel industry, the parent industry is not doing too well. But then there had been orders related to upgrades from smaller capacity to the next level. We have also seen chemical industries, not the heavy chemical ones but the normal chemical industry conclude orders. These are mainly the agro based industries. We have fairly good enquiry inflow coming from the FMCG sector despite all the complaints that you may be hearing that the market in the rural sector is under stress. Enquiries are there and some of them are under negotiation also. And there is a visible revival in the alcohol and beverages sector also. Again all of them may be showing a topline reduction on the balance sheet in the last 2 quarters but are also simultaneously planning for expansion. So, these are the sets of industries which are currently doing quite okay. We also have the pharma industry giving enquiries with some conclusions, though not substantial in nature. So that is about overall positive sectors. The ones where I do not see any movement is the power sector. Nothing is expected and I continue to say that it may not move for quite sometime. And in the steel industry, there is no movement visible, nor am I expecting anything to happen. Fertilizer is also equally negative. However, I am hopeful about refineries. As I mentioned, about 3 of them on the anvil at various stages of movement. They are no more on the drawing board but at enquiry levels. Maybe 1 or 2 more may also happen as per what we hear from the Government of India. That is generally about the sectoral movement, Ranjit.

Ranjit Shivram: So, when we look at our order intake for the first half it is kind of flat. So, for the full year given these industries shall be doing well, will it still match the last year order intake, so that will give us some visibility on the growth?

M.S. Unnikrishnan: Well, I mentioned that the international market has not really helped us in the first half overall order intake. If that would also pick up, only then we will be able to meet up. But in any case, meeting up last year's number or closer to that looks possible at this juncture based on the enquires but order conclusion is something which I am little worried about. There are many of them; I mean good number of my customers who do not have any difficulties in generating money both through debt and equity. But they are not concluding orders or even if concluded, they do not want to sign the cheque or maybe even pay advances, saying that they will start the project a little later. That is the thing which will have to reverse in the market. It is more do with sentiments, at least for those sets of customers. It is just about their own confidence – whether they can afford to go ahead. See, one thing which many people do not recognize is that when you do not invest for possibly 1 or 2 years, you are giving out this space to somebody else in case the market turns around. And expecting that the Indian market will not turn around in at least 18 months is a wrong assumption. In my opinion, consumption will start picking up. Even in the auto industry, some have reported positive results in the month of October. I am sure all of us spoke about it saying that it may take a year plus for things to turn around. It is not a structural change where automobile industry is going to be perennially on a decline. I am sure it is going to turn around. So similarly, all other industries will improve, barring power and steel. These are the 2 sectors where I believe that the balance sheets are under stress and there is an NPA problem with the bankers so that the debt portion will be a difficulty and because of which it may take a much longer period of time. All other sectors, in my opinion, should turnaround and we will continue to see this kind of stress for couple of more quarters, post which some of them will start ordering progressively.

Ranjit Shivram: And sir, lastly a bookkeeping the order intake and order book break up in terms of energy, environment, chemical?

Rajendran Arunachalam: Yes, so you are looking for the order booking breakup across the segment for the quarter or on a year-to-date basis?

Ranjit Shivram: Both.

Rajendran Arunachalam: I will first give the numbers to you on a consolidated basis. So, the consolidated order booking for the quarter was 1,723 crores and the breakup of that into segments is - energy is 980, Enviro 634 and chemical is 109 crores.

Ranjit Shivram: Environment is how much sir?

Rajendran Arunachalam: Environment is 634 crores.

Aanjit Shivram: The FGD we have booked in the environment?

Rajendran Arunachalam: Environment; 471 crores is booked under the environment segment.

Ranjit Shivram: And similarly the order book?

Rajendran Arunachalam: Yes, this is the order book for which I give you the figures - 1,723 crores.

Ranjit Shivram: Sir, this is the order booking, order intake for the quarter?

Management: Order book means carry forward.

Rajendran Arunachalam: You need order carry forward?

Ranjit Shivram: Yes.

Rajendran Arunachalam: Order in our assumption is the booking. Order balance at the quarter end is 5,334 crores. The breakup of that between energy environment and chemical is 4,127, 1,135 and 72 crores respectively.

Moderator: Thank you. The next question is from the line of Renu Baid from IIFL. Please go ahead.

Renu Baid: Sir, my question is just to understand a bit more on the execution pattern. Can you just help us understand this strong growth in energy that we saw was driven by what type of projects and does Q2 also reflect meaningful execution from Dangote? Because during monsoons, the shipments for Dangote were supposed to happen, so if you can help us understand what drove the execution in the energy in this quarter to what extent it is sustainable?

M.S. Unnikrishnan - Yes, in the energy sector the carry forward orders were good and the Dangote project has certainly helped. Dangote consignment is totally dispatched. There is hardly anything remaining. And the good news is that the entire bunch of boilers which reached through the first ship got installed in exactly 21 hours which normally would have taken maybe 6 to 8 months to be constructed. So that is already executed. So, there is an improved cash flow in that area. Second, if you remember, we had an order from a steel major - BTG order of around Rs. 300 odd crore that is going on, that has helped us. Then we are also executing gas-based co-generation plants for a couple of public sector fertiliser companies. Then for a private cement player, there is one order which we are executing plus in Gujarat there is another large project of captive power plant that is a 130-megawatt BTG order. So these are the main large orders under execution. Now if you ask me these are all projects where either the balance sheet is strong enough or they already have funds allocated or may be term sheets signed. So, we do not expect major delays on account of cash or payment. We are really very prudent in picking those orders. Project delays other than that from the customer side for some reason could be there. So for the larger projects in the energy side, I have not seen any delay barring the auto ancillary sector, specifically the tyre sector. There are people who possibly placed bulk order for 3 or 4 projects but after completing one, they are telling us to wait for some time. There are no major order cancellations which we have witnessed so far - we are still keeping our fingers crossed. Thankfully most of the larger projects are under execution, so there should not be a problem on that front. So that is the execution cycle that I see. However, the hurry that normally some customers have , I mean they write to people like me asking to meet up with their CEO to ensure that we accelerate the project, are the kind of things that are missing at this point of time. I mean they do not mind a little delay here and there, they rather welcome it than pushing me to execute it faster. So that is on the execution cycle.

Renu Baid: So, the question here is given that the backlog as inflows have not kept up pace and we were broadly looking at flattish revenues this year, first half has been significantly stronger. So, should we be prepared for a flattish second half or second half could actually decline over first half given that energy has been, I think Dangote is clearly completely out of backlog now and nothing much left for the second half to be done there.

Management: I would say that there is still an opportunity for us to at least have no reduction in turnover in the Q3 and Q4. Thermax has the potential to book and bill a thousand plus crores which we did last year. I would have done 1,150 crores booking and billing in the second half of the year because we also have chemical business, cooling business, standard product businesses where if I get an order, short cycle orders, I can execute it. So what I do get in the entire of Q3 can be executed. How these are standard orders. Regarding project orders, even if they come in H2 say in the month of October-November, none of them can be revenue recognised. It cannot help me for a growth. However, the smaller orders which are short cycle in nature can help me to reach that kind of a number. Will there be so many orders coming in is the first question. Secondly, even if it comes, will they take deliveries. These are the issues which can only be experienced. We are geared up but it also depends on how the market will pick up. I mean, all of you are aware of the sentiments prevailing. Yes, there are companies still calling us and finalizing orders but will it be at the same rate as last year is a question to be answered only by experience.

Renu Baid: Rajendran sir, can you help us with the exact Dangote revenue in the second quarter, it will slightly help us in terms of looking at the numbers?

Rajendran Arunachalam: Yes, I will have let you know that later. I do not have that immediately with me..

Renu Baid: Because if I remember at the end of first quarter we mention nearly 50% of the order was still in the backlog. So will it mean that nearly 45% is entirely out and done away in 2Q alone which is where I had the question.

Management: Not Q2 alone, because the shipment was done only in the month of the third quarter that is October. But is some portion which has happened in last year as well.

Moderator: Thank you. The next question is from the line of Sandeep Tulsian from JM Financial. Please go ahead.

Sandeep Tulsian: Sir, just wanted to check on the FGD order pipeline - we had shared some numbers in the previous call that second lot was under ordering and third lot you expected the ordering to beginning by 4Q or maybe 1Q of next year. If you could just comment on that which are the orders that you are targeting, what is the average pricing the order that we have booked where will be the margins?

Management: Sandeep, the ones where we were L1 beyond this one is now going for retendering, so that will be in the lot 4. What information I have is that lot 4 will be concluded, lot 5 enquiry will be released and concluded, in the next 18 month period. So, I expect lot 4 to ideally get over in December but not later than January because they have to report back to NGT due to the prevailing pollution scenario in Delhi. This is also another issue which is being spoken about. So we are a bidder for lot 4 where Kalgam is one project where 4 numbers 210 megawatt and 3 numbers 500 megawatt, totally 2,340 megawatt is included in one order. In Farakka Super Thermal Power station, there will be 3x200, 2x500 and 1x500, total 2,100. Singrauli Super Thermal Power station is 5x200, 2x500. Feroze Gandhi Unchahar is one project of 1,050 megawatt and Rihand. So there are 5 projects to be ordered in lot 4. Each lot is fairly large. I mean they are very risky sizes, not the small ones, of 2x500 each like the recent order we bagged. We will be bidding, but we will certainly be careful about the pricing. In the last one, the way pricing has been done, I can say that it is a positive order. But in terms of the project execution, I am anticipating that since they do not have too many projects going on, this may move around but we will be certainly particular about the cash flows in that project. So, we will be targeting these 5 projects which are going to be ordered out in Lot 4. Let's see how my competitors are going to quote the prices. If you remember in the first lot, we did not even bid for 2 reasons. We were not at all okay with the payment terms, with a 30% retention and the prices were abysmally low. Whereas the next lot onwards, we started seeing improvement in pricing and some of the small people moving out. We also need to be cognizant of the fact that one order of NLC has gone to Chinese player. Now, if that were to be opened up and the way the Chinese are in difficulty right now, then people like us will not go down in the price level to pick orders. So that is also to be understood. Then in lot 5, there are 7 orders to be coming in, the smallest one being of 250 megawatt and the largest for Talcher Super Thermal Power for 3,000 megawatts. So, that I think will go into the next year for ordering out. That's about the entire FGD market related to the power sector. I have not considered the state power plants in this. Many of them do have notices from the pollution authorities but I do not think any of them have the financial power or is seriously considering to install it at this point in time.

Sandeep Tulsian: So basically lot 4 can be anywhere in the range of say 5,000 crores to 6,000 crores upwards or …

Management: That is the kind of size that will get ordered out, you are right. So in that we will participate, but we will be very clear about how many will I want to execute in case we get one more order from a private industry. See, remember even now in most the NTPC, DVC, NFC project, there is a 17.5% retention. So, if you take a 1,000 crores order, you will have 175 crores stuck for maybe 3 or 4 years period. There could also be a delay of a few months in releasing the cheque after the material reaches. So, in such a situation, we will have to take into consideration the cash flow while bidding. For adding to the topline and to show that there is a growth of Thermax, we will certainly not go ahead. We will do serious ones where we do believe we can do the job. That is way we plan to execute.

Renu Baid: Sir, my second question is pertaining to the international order intake where we have seen a very sharp slowdown. And also we closed the China plant, so there may be some cost savings arising out of that. So, on an overall company wide basis how do you expect the trend in the international revenues as well as margins?

Management: See, in the current year we have been lucky because most of the Dangote portion has gone and there had been some other projects also like Cement project in the Middle East, which we completed and commissioned the plant in record time. There is one more project in the Philippines that we completed. So, we have cleared many of the projects which were in our hand. There are enquiries under negotiation in South East Asia and Africa and enquiry in Middle East also. One thing is to be noted - what we have read in the newspapers of India is also the truth in South East Asia where nobody is concluding orders so quickly. We have almost reached conclusion levels in 2 or 3 orders. But it all depends on when we will receive the NTP or advance and LC because we are very particular about the terms of payment to ensure that cash flows are supported. If that were to happen then things can improve in the second half. But I am not seeing any large enquiries in the international market either. The size of the project orders are ranging between 10-15 and I do not have an enquiry more than may be a $40 million at this point of time on the buying platform. There are inquiries of may be $60 million-$70 million but those are not at buying level. It is at the discussion level and I cannot say if it will translate into an order in the current year. So, that is about those areas. Similarly, in Danstoker, I told you that we have stopped taking project orders over there totally. So, there could be a drop in the overall order intake. This is something which we necessarily decided not do. We have been able to turn around the operations in the current quarter other than the provision for severance pays. But that is not a big hit for the size of the company that we are.

Fundamentally our big numbers for the international business will come from the project business which we normally receive from South East Asia, once in a while from South America; the Middle East and Africa are the other areas where we undertake projects. In all these places, there are enquiries which are at different levels of discussion and buying platforms. I am expecting that at least some of them should get concluded in the current quarter. But this does not give you the financial number as to whether I will match up with last year's order intake number. And I am expecting I will have a drop in the overall percentage of international contribution in the current year and next year. But it will not be substantial. We have already completed our registration in Indonesia for doing EPC. We are also on the verge of concluding it in Thailand. And we are having project operations extended to South East Asia where earlier we were executing from India. This is going to qualify us to participate in many more bids as a local company over there. But that will not help the balance sheet in the current year or in the next year, maybe it can happen in the second half of next year. That is the reality.

Moderator: Thank you. The next question is from the line of Bhavin Vithlani from SBI Mutual Fund. Please go ahead.

Bhavin Vithlani: Just dwelling on to Renu's question. So, you have done 2,000 crores in the first half and last year you did 3,500 crores of revenue. Just to get clarification you are hoping that you will be able to match the 3,500 crores of revenue that you did in the second half, is that correct?

M.S. Unnikrishnan: Last year second half numbers. Well, it may not be the same number. As I mentioned to Renu also, book and bill is main factor in this case. Last year we have done a booking and billing of 1,150 crores in the second half, which means that there were no orders in existence, but fresh orders were taken and executed in businesses like chemical, standard products in cooling, heating, air pollution control and service etc. If I am able to catch up with a similar kind of a number in the second half where booking is yet to be done then coming closer to the 3.5 thousand could be a possibility, I cannot say if it will be the same number. But upwards of 3,000 should certainly happen, I mean near to 3,000 is what I am currently anticipating. We have to be cognizant of the market realities rather than being over ambitious. See capacities are there Bhavin, I mean, if I would get a short cycle order by end of Q3, even if in December. Imagine that if I were to get a water treatment standard skid mounted order, I will push it through in the month of February itself; even January orders can be executed in the same year for this product. If I would get a chemical order in January, I will certainly push it in the month of February and March. So those are the areas to worry, not really worry, but whether that will happen in reality. I mean, will the market want it or not is something which we will have to experience going forward rather than committing that this number can happen. See ours is not that kind of industry where we can predict that it will happen. So, we will have to wait and watch.

Bhavin Vithlani: That is the reason I was asking because in the last meeting you mentioned you are looking at flat revenues for whole of the year.

M.S. Unnikrishnan: Correct.

Bhavin Vithlani: So, now you are little more optimistic that you can actually show some growth even that you have shown growth in the first half.

M.S. Unnikrishnan: Well, ambitions and aspirations are of growth but as I mentioned, in reality, I may be flat on that as I am not very hopeful that the same enthusiasm may prevail in the market. Remember, I currently have 5,300 crores worth of orders in hand and if the execution can be flawless from the customer side, I can execute much more than that, I mean not orders worth 5,000 crores but certainly about 3.5 thousand. Thermax and all the divisions put together can easily execute that much order. Will all of them move at the same speed is something which can be experienced, and you know our style, I am not the kind of person who will push further sales because I want to show a growth. Orders are on hand, but AR will go up, no we do not do all of that. So, in case if the cash flow cycle is not going to help me which is under stress frankly for the industry. For Thermax, luckily, we have been able to bring down our DSO from 104 to 90, am I correct Rajendran? In the current quarter? I would like to be safe at this point in time rather than meeting up with the market requirement of showing growth. That is why I would be cautious and would rather prefer a flat turnover or even a slightly lower turnover. Because, I mean accounting is done for the balance sheet purposes but business is continual. So, on that front whether I do revenue in Q4 or may be Q1 does not make **a** difference for my company. See, there is a stress on some of the industries. For example, while I am executing orders for PSUs, but the cash flows are not matching my expectations, I will naturally slow down the progress of work. We have a treasury available, but I cannot be a funder beyond a level for the projects, Bhavin that is the reason for it. So, when you ask me specific numbers on arithmetic, everything is possible in arithmetic, but certainly there are other factors which are related to the balance sheet strength of the company. That is why I am a little wary about it. I would rather have flat growth than having a 500 crores more AR from now. Because nobody in the industry will bother about 90 going to 140-160 but Thermax will. Because then I will get into a realm of borrowing money from the bank to run the operation, that is not the way we operate you are aware of that, right.

Bhavin Vithlani: The second is on the taxation, if you can give some clarity given that you have said that next year is the year where you have the timelines, any clarity on that will be helpful.

M.S. Unnikrishnan: See, it is a board level decision on what needs to be done. So, we will have to just wait for the right information at the right time.

Moderator: Thank you. The next question is from the line of Abhishek Puri from Axis Capital. Please go ahead.

Abhishek Puri: Just wanted to understand on the margin front energy business is seeing over the last 3 years the margins have been going down we are just at about 6%-6.2% in the first half of the current year which is probably amongst the lowest ever in the last 3-4 years. What is depressing these margins and when can we see some bit of recovery? I think first quarter you mentioned is some provision related to 8 crores provision related to the China subsidiary.

M.S. Unnikrishnan: In the current quarter also, we have provided some amount of money for the balance closure and with that, I think China will be totally over. Other than that. let me tell you, margin improvement in the current market condition is possible only in limited number of businesses. In the product business of the company, we can improve even today because repeat customers are there and are used to our prices. In project orders, in the energy business right now where tendered out orders are coming in or maybe even negotiated ones - all my competitors are in a much more negative condition than what I am. So, for them to pick an order at breakeven plus at this point of time to keep the factories on, is a reality. So, improvement of margins beyond a level may not happen barring the product business. But it may not remain like this as we mentioned about, yes in the current quarter, the energy business has come down to maybe 6.5 something, am I correct, Rajendran? Energy margins are 6.17?

Rajendran Arunachalam: 6.2, yes.

M.S. Unnikrishnan: Whereas, last year it is 7.2, so it will go back to those kinds of numbers. It will not be lower than this. What happens, once in a while when you provide for something or take hit in a project business, quarter-over-quarter numbers get affected, but I would go by year-to-year number. So, I do not think there will be a reduction in overall profitability in energy business on a last year versus current year.

Abhishek Puri: And what will be the China closure final settlement numbers which will be there, I mean like in the last quarter you have mentioned 8 crores is there any amount for the current year quarter?

M.S. Unnikrishnan: It will a similar kind of number that we have provided for and the current one to complete the entire closure.

Abhishek Puri: And secondly, in the chemical …

M.S. Unnikrishnan: So, as I mentioned Abhishek, the factory, the building and everything are sold off and there are some tax liabilities on all of that, which has also been taken care of. So, as far as we are concerned, it is only related to the salary to be paid for those 6 employees who will remain there for some time to ensure that the rest of the closure activities are completed like any claim which is unknown to us which may come from a customer or something otherwise. Else there is nothing remaining over there. That is the reality.

Abhishek Puri: And on the chemicals business also, I think we have seen very high volatility in the last couple of quarters. Again, I understand we should not look at it from a quarterly basis but is this 17%-18% kind of margins sustainable?

M.S. Unnikrishnan: 17 is a sustainable margin. See, it again depends on the resin business where there is a mix of standard commodity resin versus speciality. Now speciality resin manufacturing is always better in the automatic plant in Dahej. Dahej is improving right now and I am expecting it to be maintained. That kind of numbers can be maintained, certainly, yes.

Abhishek Puri: And just as a follow up on the last one in the order booking, I mean obviously our order booking is 0.8 times expected revenues for the current year. Last time we had this number, I think it was difficult to grow revenues in the next year. Would you see this concern for the business going forward and in terms of the order inflow also have you considered any more FGD order to be coming in? I understand you are bidding for it but in your assumptions one, you have already won how about …

M.S. Unnikrishnan: I would target for one more in the current year of similar nature and another one in the first half of the next year. That is a kind of target we have at this point in time. Note that we cannot pick many more, but I would rather have the customer concentration and the sectoral concentration for projects of this kind to be limited. Though, one can raise maybe couple of 1,000 crores by bidding very aggressively that will show very high order intake. But, if I take more than this, then I will not be able to take a single order from a PSU for anything else, even for my chemical business. There are some sectoral concentration factors for which we internally have a discipline managed because things can go wrong. It is not the best sector to collect your money.

Abhishek Puri: If I ask one more in terms of the order intake for the current quarter, if I remove the FGD order, the base orders are pretty flattish versus the last year and the current quarter and previous quarter as well. So, you gave a good overview of all the sectors that are doing well and not doing well. How would you think the base orders would perform from an overall year perspective? Are we looking at flattish number in terms of base orders or are we looking at some growth there or decline there?

M.S. Unnikrishnan: Certainly not growth in that area barring movement in one odd sector. See, decline may happen only in limited areas, for example auto, auto ancillary and light engineering which also contributes a lot of orders for our standard baby products, sum of which is not a small number. What I sell through my channel in a year is 400 crores to 500 crores, half of them come from MSME sectors only. And that sector is not in the best of the condition, so because of that I would imagine that even if I am able to maintain the same base numbers for the next 2 quarters, I should be happy. And the topping should happen with maybe one FGD and couple of projects orders both from India and outside.

Moderator: Thank you. We take the next question from the line of Varun Ginodia from Ambit Capital. Please go ahead.

Darshan: Sir, this is Darshan, here. Sir, in previous concall we have been talking about moving our subsidiary from Denmark to Poland and which would result in cost saving. So, sir can you please help us what would basically drive this cost savings and how much would this cost savings be?

M.S. Unnikrishnan: We have already started moving it, in fact, we closed down one factory in Denmark, the Boilerworks factory. The entire manufacturing related to that factory is already in Poland. Over and above that, we have also started manufacturing what we were making in Herning factory of Danstoker in Denmark. It is going on very well; I need to say it is positive. However, there are limitations to shift the entire manufacturing because there are Danish and other customers in Scandinavian countries who would prefer it to be made in Denmark and are willing to pay a minor premium for it. So, the shifting has already happened, and the cost reduction is substantial in terms of the cost of labour. In Denmark, the cost of labour is 2.5 times more than the cost of good quality welders in Poland. So, every work that we are shifting on to Poland is bringing down the overall cost by at least maybe a 5% to 6% which would certainly make us competitive and we will also go back to profitability over there.

Darshan: And sir what was the China factory closure provision that was done in current quarter? I know you have answered that, but the number was not audible, sir.

Management: So, the incremental provision in this quarter was about a crore of rupees, the YTD provision is about 8 crores.

Moderator: Thank you. The next question is from the line of Krishna Kumar from Sundaram Mutual Fund. Please go ahead.

Kirthi: Kirthi here from Sundaram Mutual Fund. Sir, first is on the execution of the large orders one in FY18. Have we competed those orders what I mean is the Dangote order, the 2 fertilizer orders and also the Sharjah Cement work orders which we had won and JSW Dolvi. How is the completion stage and where we are in those orders? And secondly, how is the product project mix in the energy which you are expected in FY20 and how that mix will evolve in FY21? So, these are the 2 questions first I have.

M.S. Unnikrishnan: Of the orders that you mentioned Sharjah Cement is commissioned and handed over and is working well. The first fertiliser order has also been commissioned and we also received a second order. Then you asked about JSW, the execution is going on. There had been some minor stress in the execution of the project but now we have recovered on that front. Cash flow issues were there, but that is sorted out and it is moving on. Dangote supplies are complete; shipping is done from our side, only a minimal electronic item which would be fitted on to the boilers is remaining. Then the other orders in the energy area which are currently being executed are - three plants for the PSU fertiliser company I mentioned earlier in the Punjab state, another one in Gujarat for a fairly large 130 megawatt BTG order. These are the ones under execution. The next portion that you have asked is about, I mean, am I expecting any similar kind of orders? Kirthi you asked that question?

Kirthi: Yes, product project, product project mix like whether the mix will change to more granular orders thereby the profitability will improve. That is what my purpose was to ask that question?

M.S. Unnikrishnan: Thermax has mastered the art of equalizing the profit in products and project frankly speaking. Whenever we had a good margin available, we retained it, even for lower margin projects. But anyway, coming back to the question, certainly it is going to be on the products side or maybe smaller projects rather than mega projects in the next 2 years. FGD projects will continue, those are big value items. But I do not see like a Reliance 1,700 crores order or like we have earlier executed a 1,000 crores project for Meenakshi. Those kinds of projects are not in the visibility right now, anywhere in the world. Though there are enquiries maybe a couple of 100 crores at discussion platform not at the conclusion platform, right now. So, I would say small ticket size projects and products rather than very large projects for some time.

Kirthi: Sir, in FY19 one of the reasons of the margins where the steel price had a very sharp increase which we had in FY19. Going into FY20 we have seen the steel prices coming down by at Rs. 10,000 per tonnes. Do we see and also like some of the old inventory would have got consumed by now? So, do we see the benefits in H2 and FY21 the benefits of the softer steel prices?

M.S. Unnikrishnan: Not to that extent, see what happens is, in our kind of orders every time you negotiate an order with the customer and conclude it, the customer is equally aware of the price reduction in commodities including steel. And they would always have an internal capability to approximately estimate the new price. So, our ability to retain that reduction totally with us is nil, totally nil. However, some minor improvements are possible here and there and one cannot afford to stock that much steel. I mean, barring very few items, it is against an order. It is only for the very ordinary standard products that we will buy and stock which will be comprise most of the total purchase of the company. It will amount to at the best maybe a 5% to 10% of the total value. If you look at Thermax's total inventory you will find it around 400 odd crores at this point of time for a turnover of 6,000 plus crores. It is a minuscule value and that too most of them are under processing for projects only.

Moderator: Thank you. The next question is from the line of Aditya Monge from Kotak Securities. Please go ahead.

Aditya Monge: The question that I had was again on margins. So, wanted to focus on the international subsidiaries that you are working, FY19 saw some of these reporting meaningful losses. I just thought if it would be possible for you to be sharing numbers for the first half and if you see any improvement happening in those subsidiaries from a PBT perspective?

M.S. Unnikrishnan: The largest operating subsidiary for the company is Danstoker group in Denmark. They had reported a negative in operations in Q1. Second quarter I told you operations are breakeven plus, however, there is a charge that we have taken for severance pay for employees over there. So, it is showing negative, but operations are positive, breakeven. I am expecting the year end will wipe off the negatives of Q1 and Q2 and we will marginally be positive. So, that is about Danstoker group. China is reporting losses for quite some time. So, there no more transactions happening. It is only a very small amount related to the operation that may be incurred, mainly the salaries and expenses of the people, that is not substantial in any kind. So, that will come down. Indonesia is the third subsidiary where we opened up the operations in the year 2017-2018. That is budgeted to breakeven in the fifth year if you remember that is what I committed. I am hopeful that in the last quarter of the current year, we may be closer to breakeven for a quarter. The losses have come down. Rajendran do you remember or have the number with you? Yes, Indonesia number? Last year, for the first half, it was minus 8.2 and the current year it is minus 3.6. These are the loss-making subsidiaries for the company and all others are subsidiaries, Thermax Europe Limited**,** Thermax Inc**.** America and all others are making profits and will continue to make profits.

Aditya Monge: So, just to clarify when you say Danstoker you include Boilerworks to say that incrementally there will not be any losses?

M.S. Unnikrishnan: Danstoker, when I say that means all 3 of them put together that is Danstoker, Boilerworks and Poland.

Moderator: Thank you, we move to the next question. The next question is from the line of Vinod C from Dolat Capital. Please go ahead.

Vinod C: I just wanted to ask you about water. Water is talked about a lot nowadays and especially with the JJM. So, do you see this vertical becoming important for you especially to compensate for the slowness in power and metals?

M.S. Unnikrishnan: Vinod in fact, the Board asked me the same question, why cannot you push this up? See, we are in industrial water and partially in the commercial sector at this point in time, and both are under stress. In the water business, there are two areas which are doing well. The drinking water and the municipal sewage treatment are the largest businesses over here. Thermax is absent in both of them. We were there but we decided to move out of that. It would have also helped the company to grow and maybe make a decent profit. But the blemish in those orders is something which has forced us to move out some number of years back. And we booked a lot of losses because of the fact that we were not willing to go along with the way the system is operating in that area.

Vinod C: No, I understand in the past you have said that you do not like to work with municipal corporations where receivables are a very big problem. But now I think under JJM if you, these are going to be multilateral funded, does that change the game for you?

M.S. Unnikrishnan: Not exactly because we are trying for some technology play over there. I cannot comment on that right now because funding may come from multilateral agencies, but there are powers who are part of the decision making in the entire process. So, we are trying for joint bidding if at all, and it is practical to do that way. But otherwise, we will keep away from that. I know, it is the same question was asked to me as in the depressed market condition - why can't we focus on this particular area. But we are not very keen. We are willing to give a prequalification to others and supply major components and design to them. And another side is if there are Effluent Treatment Plants coming in as a CETP we will be willing to bid because that will be SPV. It will not be a government owned company. So, we will be bidding for it. So, these are the only things evolving at this point in time.

Vinod C: What is the, also mean for your chemical business especially on the water treatment side which your resins and chemicals?

M.S. Unnikrishnan: I did not get you. What is the …

Vinod C: No, what could be the opportunity also mean for your chemicals business?

M.S. Unnikrishnan: Chemical has a good opportunity. Certainly, at this moment, the Dahej plant has stabilised and we are able to accelerate the order intake. We are especially focusing now on speciality chemicals and not the volume business. To get an order in speciality chemicals, you need to have sampling done because speciality means an application that somebody has identified and they have to try it out. So, you make a table model and then pilot it and ship a test container and then it is a commercial order. So, normal gestation period for a speciality chemical can be as long as may be one year, the earliest could be 6 months. But the recovery is extremely good and that is the only area where you can get maybe upwards a 20% margin is possible. So, that is what we are focussing on. Otherwise what will happen is that our entire Dahej capacity will be consumed for commodity resins where we will make maybe a 5% to 6% margin. So, that is not what we are interested in. So, the current capacity would progressively grow as I mentioned where resin alone can go to maybe 500 crores and plus other chemicals. Because imagine if I were to get a 17% average margin and if that were to be growing even moderately at 15%, it will substantially contribute to the bottom line of the company.

Vinod C: So, do you or your strategic planning team have a breakup in terms of what opportunity because we have one Rs.3.5 trillion macro number but how can it be broken down into across the value chain in terms of the opportunity, I think nobody is clear government is still probably at a drawing board I guess. You guys have a sense of how big that opportunity can be?

M.S. Unnikrishnan: There are 2 types of chemicals that we are currently manufacturing. One is the resin which is used for a specific application of water treatment. And the other has two commodity resins - cation resins and anion resin. Anion resins can be modified to speciality resin but predominantly it is a commodity. The global market is approximately closer to billion Dollars right now and the fastest growing market for those applications are Europe and America, the developed world where people will want to use these kinds of resins for multiple processes. Now very few Asian companies have been able to succeed barring maybe Mitsubishi. Now we are one company who entered in that area and I have been able to progressively move up from a single digit share in our entire resin sale coming from speciality to almost 20%, right now. If I am able to reach up to 40% to 50% of my total production going to speciality application, then you are talking about good profitable sustainable chemical business. That is our intention. Now coming to that billion Dollar size of the market. In that market, the commodity portion is growing at 3% and speciality depends upon an individual's efforts because for every order, we will be putting in an effort to prove to the customer that by using this resin his cost will come down or productivity will improve. So, that is something where I cannot quote a number. That is as far is resin is concerned. Performance chemicals go into power plants and fertilizer plants where you find cooling towers. So, cooling water chemicals is manufactured by us and we have also entered into construction chemical. For construction chemical alone, the Indian market size maybe a Rs. 6,000 crores and for performance chemicals in India, it could be around say 3,000 crores in size. We are a marginal player, but both of these will be needing services to be added to the chemical supply. That is where the market is turning. So, you will need to train people also which is going on. So, it is a little longer journey but a very steady journey. It is not the kind of chemical company that you have heard about - having a huge plant and producing say millions of tonnes of chemicals and going in containers and maybe as shipment and making money. No, ours is an engineering chemical, let us say that.

Moderator: Thank you. The next question is from the line of Punit Gulati from HSBC. Please go ahead.

Punit Gulati: Sir, quick question here. On the cash flows, you said that PSU cash flows are still weak. So, despite what the government has been talking over the last couple of months. Is the trend still very much there in terms of delayed payments by PSUs?

M.S. Unnikrishnan: Yes, certainly. First and foremost, in the PSU tender, there is always retention. Even if you supply a foundation bolt to start the project where you will start the construction work, minimum 10% of that money will be held till the project is over. And when will the project get over is a decision involving n number of people, not one human being unlike in private industry. So, you have retention for a longer period of time. In FGD for example, I mentioned to you that in the beginning, when the first lot came out, the retention was 30%. So, we refused to go for it, then after n number of representations, they brought it down to 17.5%. Even that 17.5%, when cumulated for larger projects, is a fairly large part of our money. Then apart from that unlike in private customers where sometimes we are able to get letter of credits, the government or PSU will not give letter of credit. Once we supply the material, there is a process and procedure for inspecting it, proving that you have supplied the same material – which put together takes a long time for authorisation of the payment. So, normally in a PSU getting cash after you despatch the material is 90 days on a safer side. Prior to that you would have already invested money to manufacture it, or you would have paid predominant part of it and that is where the cash flow issues arise.

Punit Gulati: But there is no undue delay from what the norm has been?

M.S. Unnikrishnan: I will give you some number outside, Thermax. I am told in our own group of people who do EPC or similar kind of projects that currently the pending retention for A category companies in India is 175,000 crores to be received. There was a ruling given by the government that 80% of that amount can be released against the bank guarantee. Even in that, see not every company is healthy like us for even a bank guarantee. Many construction companies or maybe engineering construction companies in India have to put margin money today. Banks have started asking Thermax also for margin money I believe. Because of the banking stress, they are also worried. So, it is emanating you are creating retention and the slowness of payment by the commercial terms. The same PSU, when they have to import an item from China or any country, they will give a letter of credit. So, he is safe; he can get the money. That is the reality. That is why we have been normally limiting our entire business with the PSUs and the government.

Moderator: Thank you. We will take the last question from the line of Varun Ginodia from Ambit Capital. Please go ahead.

Darshan: This is Darshan, here. Sir, so what is the reason for fall in other income sir this quarter?

M.S. Unnikrishnan: First and foremost, treasury size has come down, number one, and the interest rates have also come down. We only invest our money into very safe investment instruments. And there the rates have also come down. Put together it has had a hit of nearly 15 crores YTD first half.

Darshan: And the depreciation has increased to the tune of 9 crores, you said right because of conversion of the JV into the subsidiary. Is that correct?

Management: Yes.

Moderator: Thank you very much. That was the last question. I would now like to hand the conference back to Ms. Bhoomika Nair for closing comments.

Bhoomika Nair: On behalf of IDFC Securities, I would like to thank all the participants for being on the call and the management for giving us an opportunity to host the call. Thank you very much, sir and wish you all the best.

M.S. Unnikrishnan: Thank you. Thanks to each one of you for the kind of questions that you ask and all of us, at least my colleagues and I take back a lot more positive thinking in some areas where we need to focus immediately from the concall. So, thanks a lot for active participation and looking forward to your continued support. Times are tough, but my understanding is that there are ways to navigate the company. I am sure we will continue to do wise and prudent things for the company. Thank you.

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