“Thermax Limited
Q2 FY2019 Results Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Thermax Limited Q2 FY2019 Results Conference Call, hosted by Motilal Oswal 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 call, 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 Mr. Ankur Sharma from Motilal Oswal Securities. Thank you and over to you Sir!

Ankur Sharma: Yes, thanks, Aman. Good morning, ladies and gentlemen, and welcome to the Q2 2019 Post-Results Earnings Call of Thermax Limited. With us today from the management, we have Mr. M.S. Unnikrishnan, Managing Director and CEO; and Mr. Amitabha Mukhopadhyay, Executive VP and CFO. As always, we shall begin with the opening remarks from Mr. Unnikrishnan and then open the floor for a Q&A. Over to you, Sir!

M.S. Unnikrishnan: Thank you, Ankur. Let me welcome all our friends for our second quarter con call. Our internal conclusion is that this has been a good quarter, though not excellent. Starting with order intake for the quarter at the group level, we have ended with Rs. 1344 Crores, 4% lower than the last year same quarter at Rs. 1397 Crores, but almost at the expected levels that I had projected internally. And the order balance has gone up from Rs. 5261 Crores in the last year same time to Rs. 6411 Crores, which is 22% better than the previous year. On the revenue front , certainly, we have been able to execute all the orders, with commercial security. The total income has gone up to Rs. 1463 Crores from Rs. 1057 Crores, a 38% improvement. Very happy about that number.

The consolidated PBT for the quarter has gone up to Rs. 118 Crores versus last year's Rs. 95 Crores. However, at the profitability level, yes, we expected it to be lower, but it was even slightly lower than even our internal expectation. And I need to explain this reduction to you. The material cost has gone up at the group level by 1.4%. A part of that impact can be attributed to the orders taken in the last year, which were executed in the current quarter under challenging market conditions where people are desperate for orders. Not that we were not desperate that time, but it has increased lately. And the commodity price increase, which happened between the time of the order intake and today, though we have covered a good part of that, led to certain price increase that we had to concede to some of our suppliers despite having already given them the orders for some items. This explains a part of it. Otherwise, we lost margins both at the negotiation table and later during execution.

Similarly, we also noticed that on the middle line in the other expenses, there is certainly an increase. Last year it was Rs. 218 Crores and it has gone up to Rs. 327 Crores, so it was 21.1% in the last year same quarter going up to 22.8%. There are a couple of them which are one-time expenses, and some of them are related to the Mundra assembly going on, for a major order.

You would also notice that there is an increase of Rs. 42 Crores in one quarter alone in the manpower cost. That is Rs. 172 Crores of the last year going up to Rs. 214 Crores for the current quarter. Of this, around Rs. 18 Crores is for standalone, as there has a been a surge in manpower hiring to support the increased order book level, the increments that we have given had some impact and the additional provision made towards employee variable pay.

Another factor is the accounting practice followed at one of our subsidiaries, for the site executed by them. In India, the labour expense is either a part of the material cost or site expenses. But over here, it is coming into employee cost which is approximately Rs.19 plus Crores, so do not get carried away by the Thermax manpower cost having gone up. Without these our profitability could have been better, and we tried our level best. Even at the existing level, it is quite okay as per our understanding.

Then coming back to our YTD performance. The order book is lower by 10% for the first six months, at Rs. 2996 versus Rs. 3315 last year. The order balance as compared to June has remained constant, but the revenues have improved for the group by almost 28%. That is Rs. 2463 versus Rs. 1926. Where the margins for the quarter, has lowered by 1% at PBT level, here it is 1.1% cumulative impact of first quarter and second quarter put together. That is on the results of the company.

To give you a feedback about Dahej, which I have spoken about in the last quarter, we had some difficulty in improving the capacity utilization on account of the fact that there were some glitches. We have overcome that. We are almost at 60% capacity utilization with the orders coming in that are compatible. And we are certainly moving upwards with an expectation that we should reach a peak capacity at least in the Q4 of the current year.

On Sri City, I am happy to inform you that the trial production has started. In fact, the first couple of chillers have already come out of the production bay, while the entire automated manufacturing and robot welding area as well as the testing facility is performing well. So we will start the commercial billing from here. Billing has already happened in October. So you will have output coming from the Sri City factory from Q3 onwards.

Then coming to TBWES, we have already declared in the results that it has now become a 100% subsidiary of Thermax. Certainly, B&H (boilers and heaters) have a fairly large order book available, and with this facility coming in, it will help us to ensure that if at all there could have been some delay in execution, it will be a thing of the past. I am happy to inform you that the market has well accepted the first batch of boilers, which were produced in the Q4 of last year and Q1 and Q2 of the current year from our Indonesian facility. Though Q2 order intake for Indonesia was not very large, we have been able to book fairly good orders from that captive market in the last one month which is an improvement. We will be on track related to Indonesian manufacturing facility.

China continues to be a major difficulty. Things have only worsened there because we were expecting that the Chinese-manufactured chillers can be sold in certain markets. With the current trade war on where a duty of 25% is imposed on anything coming from China as the country of origin, our plans of manufacturing the orders from the entire American market is in difficulty.

We are taking a calculated decision going forward, which I cannot explain to you at this point in time. But at least by Q4, we will let you know as to what and how we will be proceeding with our Chinese investment. But let me assure you that the current asset value post the impairment is about Rs. 15 Crores over there. So, I do not think the shareholders should worry about it.

For Danstoker, despite my promise in the last quarter, the current quarter also has reported a minor loss, but not as major as the previous quarter. Order intake had been good in the current quarter. We have decided to stop our entire manufacturing at Boilerworks factory. And since the Polish factory has stabilized we are shifting the entire manufacturing from there to Poland, which should help us with the additional order intake coming from Danstoker Group to rise to a positive balance sheet by the end of the year. All other subsidiaries are doing well.

I remember having mentioned to all of you that cooling business had a challenging Q4 last year, and it improved in the last quarter. But the current quarter has not been so good for them including services. That is overall about Thermax.

Coming to the outlook going forward, I need to admit that whatever was the positive sentiments prevailing in the domestic market related to capacity building in Q1 of the current year and Q3-Q4 of last year, seems to have slowed down. All of a sudden, private investment appears to be witnessing a slack in conclusion and handing over of advances to register an order. Similarly, the NBFC difficulty and the creditor's difficulty in the market may have problems going forward, at least for a short while till their liquidity improves in the market for the lifting of finished goods. So we are going to be very careful about how we will support the SME industry by supplying our equipment.

But I am very happy to inform you despite an improvement of 38% in the top line; our overall accounts receivables are well under control. On the contrary, I would say the days of sales; DSO has come down for the first time as far as I can remember in the recent past to a double-digit number of 90 to 93 days. We always prevailed in 108 to 110 days. So our mission is working very well in terms of cash flow management. That is about the overall performance of the company and looking forward to your questions and suggestions to take the company forward. Thank you once again.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Venkatesh Balasubramaniam from Citi Research. Please go ahead.

V. Balasubramaniam: Good afternoon Sir. The first question is, what is the kind of capex that you are expecting on an annual basis over the next two years? And how much of that would be the maintenance capex, and how much of that would be growth capex, if possible if you could share this?

M. S. Unnikrishnan: Yes, I will share it with you. We have already cleared Dahej Phase 2 for taking the current installed capacity of 12000 metric cube per annum to 22000, which is currently estimated to be costing nearly Rs. 50 Crores to Rs. 55 Crores. It is already sanctioned, expenses related to ordering is starting based on the learning from the Phase 1. Because we will need further capacity addition and some decisions that need to taken related to the existing chemical facility in Maharashtra. There are no major CapEx related to capacity building anticipated except smaller ones. We need to setup an assembly unit for the water business because it has started growing well. It would not require more than Rs. 20 to Rs. 30 crore investment if the land is available. Do we need to have an additional facility for heating at Sri City?. Presently it is under consideration only for Cooling. So barring that, there is nothing expected in terms of capacity building in the next, I would say, 24 months, I can predict very clearly, which could even extend up to 36 months. Beyond that, if Thermax has to achieve a double-digit growth averaging out to maybe 15% for the next three years, we will have to create additional capacity for the core businesses of the company, where we will take the call only in 18 months down the line. Then the maintenance CapEx as you asked would be ranging between Rs.30 Crores to Rs.45 Crores on an average. We have just started digitizing our operations. Very happy to inform you that we are one of the earliest Indian engineering companies to induct a Chief Digitalization Officer into the executive council of the company. So if there is anything needed related to future automation, though not requiring substantial investment, will come only as a maintenance capex . This will leave us with the option of disproportionately growing some of the better profitable businesses through inorganic route, an area that we are looking forward to, where we will crystallize the plan in the next two to three quarters. Is that okay with you?

V. Balasubramaniam: Yes. So to conclude, would it be reasonable to assume that on the maintenance capex, you will not spend more than Rs.30 Crores to Rs.45 Crores and growth capex might not be more than Rs.40 Crores, Rs.50 Crores? So the capex number should be somewhere closer to Rs.100 Crores, down from Rs.200 Crores in FY2018, approximately?

M. S. Unnikrishnan: You are right. Maybe a little over also, however we are very conservative in spending money.

V. Balasubramaniam: So on a related thing, the company is fairly well run and generates very good cash flows from operations. So whatever capex or acquisition needs are there, it can be very well be done from the cash flow from operations. So what is the need to hold so much cash in your balance sheet, which is I think the cash and investments are almost, like, almost Rs.1300 Crores or Rs.1400 Crores? Why does not the company take a call to return this money to shareholders? Because this Rs.1200 Crores or Rs.1300 Crores is almost half of your net worth. And if you return it, at least visually, your ROE should go up meaningfully. So why are we holding cash? Because I have been noticing there is a substantial buildup in current investments over the years. So why is the company holding cash?

M. S. Unnikrishnan: That is a wrong word to use, Venkat. When you are prudent, you cannot be saying that. See we are a volatile industry. So we do not even borrow working capital to run the organization. ROE maximization is not the prime motive of Thermax as a group. You must have been following Thermax for at least 1.5 decades where it is run as a professional company. You would have seen it that way. We are not expecting Thermax not to grow. Growth will be needing capital. Of course, we can borrow money from the market. All of you will come after us and I am sure will give us money. But we rather prefer for some more period to bring in stability for the organization. Look at the companies who went in for huge expansion and huge borrowings, both in the European Continent and American Continent in the past one decade. Some of the largest names in the capital goods companies today have disappeared or are on the verge of disappearing. And I do not think that is the fate of Thermax. It is the shareholders' money and, none of us is taking it away. But if it is going to be taken out to deprive the company's future by distributing wealth, at this point, that is not the way we look at it. We are not a quarter-over-quarter company. We are a fairly medium- to the long-term company. So your argument is welcome. But the decision is that we are not. We have a very clear-cut plan laid to double the turnover of this company using growth capital. And there afterwards, we will also take it to a global-level size, which needs a lot more money than what we currently have or what we are going to generate. So one option, as you mentioned, was to drain it off and then borrow it when needed. Yes, on optics, it looks very nice, but we are not an optic-oriented organization.

V. Balasubramaniam: Okay Sir. Thank you very much for the detailed answer.

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

Bhavin Vithlani: So my question is on the orders. Could you help us on the exports front and domestic front? Your commentary was a bit soft last quarter. So how are you looking at the waste heat recovery? Steel and cement was an opportunity that you spoke about. How are you progressing on that?

M. S. Unnikrishnan: Yes. I think more than the numbers, you were asking about what is underlying in the numbers. Usually, I would have asked Amitabha to give the numbers to you. Our domestic order booking has gone up from Rs. 697 Crores to Rs. 751 Crores, an 8% improvement. Whereas for international, it has come down from Rs. 700 Crores of last year same quarter to Rs. 593 Crores. Why I said that I want to explain to you is that last year, in FY2018, quarter-over-quarter, our international order booking was almost equal to the domestic order booking; not because international was great alone, but also because the domestic business had not grown to that extent. So we had a specific quarter where I declared that we have almost become an international company because our international booking was more than 50%. But it has taken a major dip four quarters back where international component of the order intake had come down to 20%. Now I am very happy to say that, even at the Rs. 1344 Crores order book level, it has gone to almost 44% so, if I can retain that kind of level for a few years, where 60% to come from domestic market and 40% or upwards from international. So, there is an improvement in international order intake for the quarter. Then you asked a specific question about waste heat recovery. Yes, there had been a delay in the conclusion of order, but we have been able to conclude in the cement waste heat recovery area. We have also incurred order losses in waste heat recovery, for cement waste heat recovery to a Chinese organisation, who have set up their company in India because there is a reemergence being seen of Chinese companies in India who had vacated India earlier. But thankfully, the rupee devaluation by the prevailing 10% to 13%, may not make them as competitive as the way they expect it to be. So there is traction in waste heat recovery in the market, and it will continue to be so.

Bhavin Vithlani: Could you also help us breaking the order in terms of how is the B&H boiler, the smaller boiler business, the chillers and the boilers and heaters division, and how should we look at the growth within that? So what my observation is the larger projects are absent, but your base business is growing fairly strong this quarter. Correct me if my reading is wrong.

M. S. Unnikrishnan: For the quarter, it has not grown. It has stabilized and remained at the same level, anywhere from Rs.400 Crores to Rs.600 Crores both domestic and international put together. We also had a decent intake of orders from projects. For example, we had, one order for the single largest capacity of bagasse fired boiler in the world on a grate from Colombia. It is a 250-ton capacity boiler worth around $12-plus million. We had orders coming from Southeast Asian market for a medium-sized captive power plant using biomass as a fuel. So there were project orders in the current quarter. We had a couple of orders coming from various EPC companies who are in the oil and gas sector for mostly heaters and waste heat recovery system. So both projects and products have done well. If the projects do not do well, my order intake will be in three digits. The moment you see a four digit and that too almost Rs. 1350 Crores, it means that projects also have done well. Now to answer the question on enquiry pipeline for both, I would say it is not strong, but good. But looking at the overall market sentiment, there is a slowdown in conclusion of orders at this point of time even from the standard domestic market. International market, it is not so bad right now. It was bad maybe three quarters back, but today, it is looks promising.

Bhavin Vithlani: Last question is on chemicals. When do we see the stabilization? And once, you mentioned fourth quarter is when you will see full utilization. How should we look at the margins once you see full utilization from fourth quarter?

M. S. Unnikrishnan: Chemical has two verticals. One is the Resins, dependent on the Dahej Facility which is commissioned and progressing, which is almost equivalent to 50% of the business at this point of time. Second one is the performance chemicals, which is coming from our Jhagadia factory, again in Gujarat. There, there is a capacity constraint. It is where root chemicals are procured and then there is a trade secret of blending it, and service plus chemical is given. So I will treat both of them separately. For Resins, I expect that once we complete the current phase with full production coming in, you should be at a PBT of 15% and upwards. Last year, of course, in the same quarter, we had a chunky profitable, order, which totally changed the cross-section. It would have shown you a 27% to 28% profitability for the last year's first as well as second quarter. In the current year, it has come back to around 15% for the overall chemicals business. You should look forward to 15% plus profitability in chemicals, including performance chemicals and the other one. Coming to the growth potential, we do not see anything negative in the chemical business related to the offtake from the factory. And yes, of course, for specialty chemicals, which is more profitable than the numbers I shared it is not one order. It is like IT companies getting an order for five years. You get entrenched into a company; then there is replacement chemical required every year, so you keep getting the orders. We are focusing on such orders than the one-off sale of standard chemical, which is like a commodity, making 8% to 10%. So these are the ones who can give you a profitability upwards of 20%. So an average of specialty and normal Resins put together is upwards of 15%. Does that answer your question?

Bhavin Vithlani: Yes, it had answered. Thank you so much for taking my questions.

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

Kirthi K Jain: Sir, in our press release and also in our opening statement, we had highlighted that order flow seems to be on a slower pace. So with regard to that, what would be our revised guidance in terms of the order flow which we are envisaging for the current year? And also, given the steel price, everything high, which had impacted our gross margin, have you taken the expected impact of the steel price increase in our current quarter numbers, sir? That is the second question I have.

M. S. Unnikrishnan: The first one is very clear that I would not have cautioned all of you if there is no visibility of slackness. I need to elaborate further. See, we have gone on a domestic order dependence to build Rs. 6411 Crores carry-forward orders right now. Amitabha, if I am to take a carry-forward split between domestic and international, what would be the number like?

A. Mukhopadhyay: Carry-forward domestic is Rs. 3916 Crores and internationally, Rs. 2495 Crores.

M. S. Unnikrishnan: So you can make out the domestic dependence on the order carry forward. Now with the on-going semi-final elections and the finals expected in a few quarters to come, infra-oriented projects will be declared. But on the ground, funding would happen for them. The inauguration will happen, no matter what the foundation is. But will that create additional demand for multiple commodities and overall sentiments in terms of signing the cheque to go ahead with the project? Because I have seen multiple elections – three election years in the country and a set of people who are from the consumer FMCG- sector, non-government-related or maybe non-policy-related ones, may continue to do so if their capacity utilisation has reached the peak. But others will normally wait. So that is the reason for caution. In the international market, one of the markets I am a little doubtful about is that of Middle East. Though the oil prices have significantly gone up and, of course, also come down in maybe the last week, it remains higher than 70. It is an investment grade for the entire Middle East owing to their oil production extraction cost being low; rather the lowest in the world. But given the political instability with the recent happenings, which I don't want to comment on beyond a level, the largest investor still got to be Saudi Arabia. And following Saudi Arabia, should be Kuwait and Oman. Kuwait and Oman may continue, but Saudi Arabian investments are in suspicion. I need to watch one of the international markets that normally supports me for equipment and the boiler heater equivalent and see how it pans out. What I am quite comfortable with is the Southeast Asian market. I am equally comfortable with the African market at this point in time, though last year, there was a little of negativity from the African market. At least there is some positive investment movement that we are witnessing in a few African countries. So that is my overall take on the order booking. Next thing you asked me was about the margin, whether we have accounted for it. Be assured of the fact that all visible and predictable cost increases for the completion of orders in hand are already accounted for. We do account that way. Very few would stand unaccounted for when you execute the orders, example a Rs. 1,340 Crore order which I picked up in the last quarter, all the costs, non-costs were already accounted for in the estimation itself. As we execute these orders, if there is any further increase in the costs, beyond what is available in the contingencies of the project costing sheet, it may take a hit going forward. But unlike the last year order being executed in the current year where there had been a significant increase in the commodity prices, I do not think any one of us are expecting the commodities to be rising at the same level or acceleration that happened in the last year. I am possibly looking forward to stability or at best, in some sectors, towards next year, though sometimes there could be a reduction. The capacities are getting built in various places. It is my take right now.

Kirthi K Jain: Sir, next question. We are telling that Dahej has ramped up to 60%, but when we see the turnover, the commercial turnover has not gone up. So is it due to the rundown of the Maharashtra facility, we are seeing this ramping up at Dahej?

M. S. Unnikrishnan: Yes, as and when it rises, I did make a mention earlier that I will also run the other one down. But it will run for sometime based on the orders available, to fill the gap. For example, in the current year, I am expecting the demand to be between 16,000 and 17,000 metric cube capacities. So, even if I reach up to say, a peak capacity of 10,000 also, I will still be short of 4,000 to 5,000. And when I commission Phase 2 and stabilize it next year, I will not have to worry about the Maharashtra capacity at all.

Kirthi K Jain: These are the questions from my side Sir. Thank you Sir.

Moderator: Thank you. We have the next question from Venugopal Garre from Bernstein.

Venugopal Garre: Hi Unny, my first question is on the margin side - I just want to understand two things here. One is that since we have an export business, which is fairly large, as well as an international business, would there also be some element of benefit coming in from rupee depreciation on the margin? The second thing on the margin side is, now that we are sort of doing a line-by-line addition of TBWES, given that is a slightly higher EBITDA margin entity, is it really small from an absolute EBITDA perspective in this quarter?

M. S. Unnikrishnan: Venu, when the rupee devaluation happened, unfortunately in such times, Thermax would not stand to be a beneficiary because the way we conduct it is that Amitabha and the team takes a forward coverage on a weekly basis. Though we have had some small amount of very large orders left open, in anticipation of the conformity of the final payment, otherwise, I would have booked it and not known when even the lifting would happen. But happy to say that we have got a standby LCs for the last payment. So, when he covered it, there was some improvement that we would have seen but that is only a percentage. Otherwise as a practice, Thermax always, on a weekly basis, does the forward closure. On the contrary, the mark-to-market for all these people, will make me do a negative over there, which of course I will recover on the top line. But it is an MTM loss for me rather than a gain for the company. I want to be honest with you. Many companies have mastered the art of having part covered, and part not covered but we believe that we have better engineers than currency management people. So, we prefer a confirmed margin than a speculative additional profit, on principle.

Venugopal Garre: Got it. Also the other part about TBWES - what will be the sort of contribution, because this is the first quarter where you are doing line-by-line addition, right?

M. S. Unnikrishnan: It is at a Rs. 20 Crores top line only. That is the final part of the last order remaining. And I do not think from next quarter, anything will remain. The facility utilisation certainly will happen, as I mentioned about the boiler and heater business, which is the main beneficiary of this, and is bereft of capacity was going for outsourcing, has now a facility available.

Venugopal Garre: Got it. Sir, my second question is in this water assembly related expenditure that you spoke about – capex, you are seeing some improved traction. I just wanted to understand what exactly this is primarily going to cater to, given that you only operate in certain parts of the water business.

M. S. Unnikrishnan: Yes. See, in the water business, Thermax is only into two segments. One is commercial and the small MSME segment, where we make skid mounted water treatment plants and wastewater treatment plants, which is a very profitable business. Even when the water business was witnessing difficult times for three years showing markings in red, this one was generating profit. That was Rs. 50 Crores, Rs. 80 Crores, Rs. 100 Crores, Rs. 130 Crores and now raring to cross Rs. 200 Crores size as a profitable business. And the second one is the industrial projects, the regular Thermax water and wastewater business and recycle business. And in that, we have got zero liquid discharge; those are technology-oriented, industrial B2B business. Talking about the first one, we present a standard package plan, which normally gets sold. These standard ones are less than 30 lakhs in size, which my distributors, channel partners buy and sell. And about 30 lakhs is something, where the orders are directly taken through the channel partner, but it is assembled in an assembly unit prevailing in Pune. Now the logistics cost of the entire thing is currently consuming near to a double-digit percentage, which involves transporting the entire thing to Pune, assembling and sending it back to maybe Chennai or to Kolkata or to maybe a Northern market. So progressively, we want to have localised assembly facilities and a localised value chain created, for there is nothing complicated in the water, barring some of the core components which in any case are imported or will need to be fabricated or manufactured based on our own engineering. We do not do any manufacturing, we only have an assembly line. So, we need to create these assembly plans. And we have already decided that since the traction is visible for this growing business, where one does not have to worry about how many additional wastewater treatments, water treatment plants etc. are going to be needed, we need many assembly lines. We want to start with the capex for it. But it is not a major capex-oriented assembly unit. You need a building, shed, some very minimal equipment for the assembly, preferably have workmen who may not be on the payrolls. This is similar to a model that some of the automobile companies have perfected, where your outsourced and assembly contractors will come and manage the quality and the finance over there. This is what we have in our mind.

Venugopal Garre: Sure. Thanks a lot.

Moderator: Thank you. The next question is from the line of Ravi Swaminathan from Spark Capital. Please go ahead.

Ravi Swaminathan: Hi Sir. I just wanted to know what the market size was in the domestic market and the energy segment in the first half of this year vis-à-vis last year first half? And the kind of growth that one could have seen in the inquiry pipeline at least. Has there been any growth at all?

M. S. Unnikrishnan: I have to divide this into two divisions. One is the standard size for heating energy products, both heating and cooling. I need to say that there had been an improvement in the market size by around 7% to 8%. These are all estimates based on the inputs from the market. We currently have the Salesforce totally implemented. So, there is an accuracy available in terms of the data fed into that. Any data not having come into that, I will give a 10% to 15% correction factor to it. My market share has been retained and, in some verticals, it has gone up also.

Ravi Swaminathan: Okay. And the regular CPP market?

M. S. Unnikrishnan: No, the regular captive power plant market is quite silent right now. It is only the waste recovery oriented for the cement plant, which is continuing. In fact, I have enquiries but no orders getting concluded for the captive power, which I thought should come in, but all the industries are a little silent right now.

Ravi Swaminathan: Okay. Say, in terms of megawatt terms, would it be roughly around say, 600 megawatt to 700 megawatt per annum? Is my assessment right in terms of size?

M. S. Unnikrishnan: See, if I were to look at the current year in megawatt, maybe first quarter, we already had one order of a BTG, which should have been, may be 160-megawatt. If you multiply that by four, you will get the number. But if I look at it for the captive power, right now, the orders which should have got concluded, whether we receive it or our competitors, it is only in the cement waste heat, which goes up to Rs. 7 Crores to Rs. 8 Crores per megawatt. I would say almost touching an 80-megawatt would have got concluded in the first half of the current year. And in the sponge iron sector, in the eastern part of India, there were 14 to 15 conclusions; some of which happened when there is a captive power plant, some of which when there is a separate boiler and turbine required. That would also amount to an equal number. Then there would have been one or two one-off order conclusions in the country. Put together, we would have concluded maybe a 250 megawatt to 300 megawatt in the country, currently in the first half. Second half, the number would be almost the same, if there is a large order to be reported. That is my real take for the current year.

Ravi Swaminathan: Got it. And from a competition perspective, I mean, say, other listed companies who basically are the known ones, I mean, have they been more aggressive in terms of pricing compared to last year or past few years? Or is it like the pricing environment have been highly stable, say, compared to though they could be tough but it would have been stable over the past two, three years. Your perspective on that would be great, sir.

M. S. Unnikrishnan: See, the listed company, I think, would now be a little more careful about quoting, that is my understanding. Because in the last two conclusions that we have had, all of us have been competing for the orders (all three plus one Chinese player). In that, there is a decency prevailing in the pricing by atleast the Indian players now. I would say that indecency which prevailed for almost a year and half is getting corrected. But since there aren't too many finalisations, I cannot say what the pattern is going to be. How are the Chinese entering well entrenched zones in India with their own operations? With the EPC portion and manufacturing coming from China, they have started quoting some not-so-conducive prices. But of course, in the market, not everybody will go along with them. Fortunately for them, they have a group company also making cement plants. See if that were to be combined with the cement plant, along with the wastage recovery, then all three Indians will be out of that game. But thankfully, we have not come to such a level so far. But again, as the market picks up, what happened is, Ravi, all of us were expecting that the cement investments are going to now really rise, because everybody is ready with their plant. I think one by one; some people are coming in also with the fresh orders. But it is just going to take some time before we see the traction in the fresh cement capacity investment. They will have to invest. I am aware of the fact that there will be investment happening. But signatures are not forthcoming at least in the last one quarter, and we will have to wait and watch on that area.

Ravi Swaminathan: At least over a 24 to 36-month period, can it pan out?

M. S. Unnikrishnan: No choice for India. We will have to do that. See RERA has now settled fairly well. Barring the inventory available or unsold inventory available in the four metro cities, along with Hyderabad and Bangalore, you will see affordable housing really catching up. Even the biggies of the construction world have started moving into one-bedroom and two-bedroom user demand zones, which in turn will increase the cement demand. And the projects already concluded by the Minister of India right now is already in traction and will continue to be. Rural roads, which were announced in the last budget by the Finance minister, are already taking shape, though I never expected them to really happen at the ground level. Non-national highway sectors have almost increased by 100% in the last two quarters and most of them are cemented roads even in rural areas now. So, cement demand is going to pick up. Irrespective of the outcome of the elections, I would say going ahead, there will be cement demand improvement in the country. You talk to anybody who is running an organisation. All of them are looking forward to investing money. So, cushion of 24 to 36 months is positive.

Ravi Swaminathan: Okay. And my last question is with respect to the chemical segment. So basically, rupee depreciation, can help you in two ways. So, one is that, say, a few quarters ago, you had mentioned that there used be a lot of imports which used to be there in the chemical space, which is where the pricing used to be aggressive. So is it getting plugged? And a lot of your specialty chemicals goes in terms of exports to the USA and other countries. Are you seeing better demand because of better price competitiveness for you here? And can you see better margins in this, going forward?

M. S. Unnikrishnan: Whenever there is rupee devaluation, my ability to be passing on that on a one-on-one basis, 100% to the market, is limited. The contracts have to get over for the current year. Next year when they get it, I will be able to pass on a good part. It again depends upon how the competition behaves, that is why there is a lag factor in that one. The lead factor related to the recovery on the fresh orders are all my pots in the developed world, where dollar denomination deals are on, I will certainly get a benefit. I would want to utilise it not for margin improvement since I already have capacity available. I would rather want to have order obtained at decent margins. In this market, already it is a decent margin for the company making an overall PBT, though at a currently languishing 8 but has the ability to go to 9s and 10s. I would rather have a business which has got a 15% assured profit, take a higher slice of the turnover of the company at that 15% to improve my margin, than go for sticking on to my margins to marginally improve this rate. So that is a kind of instruction to the business. They are going with that only, right now.

Ravi Swaminathan: Okay. And imports, which used to be aggressively priced, are they getting blocked, and giving way to Resin space?

M. S. Unnikrishnan: Yes, it is in the Resin. Styrene is the main item to be imported. And that is a cartel which is so large. We are all pygmies in terms of our requirements, in terms of volumes. So there, we will have to suffer the cost, whatever is pushed down. Petroleum crude is going up and the rupee is devaluing. It is a double hit. The adversities that you would have faced in the last two quarters are on account of the crude petroleum going up all the way to 80s, which means the Styrene price increases and the rupee devaluates. So, for the same quantum of Styrene to be imported, the cost increase is considerably high, which the market would not absorb overnight. But thank god, it has started to come down now. I hope it stabilises, at least for India's sake, closer to maybe 60s would be at least good for the country's sake and my divisional base also. But this will be utilised by us going forward. And I am sure we would stabilise it in terms of the profitability.

Ravi Swaminathan: Got it Sir. I will go back in the queue. Thanks.

Moderator: Thank you. The next question is from Abhishek Puri of Deutsche Bank. Please go ahead.

Abhishek Puri: Congrats on the good set of results. Sir, on the environment business, specifically for the last couple of quarters, you are seeing good traction on revenues. What is driving that and is it sustainable? That is one. And secondly on the margins front again, sorry to harp on that once again, have you built in the Sri City costs that will be coming in and TBW costs that will be coming in fully into your P&L when you are saying that margins will improve in the second half?

M. S. Unnikrishnan: Yes. Starting with the environment business, the water order intake has substantially improved in the last two quarters for the standard plants. And we are selective in taking the orders for the projects, because the project orders are the ones which put us into trouble apart from the municipalities that closed down. So, their margin stability will improve going forward also. But it may not reach the energy margins at least for some time. I do not think the water can go to that level. The air pollution control business of the company, witnessed some good orders in the market with a couple of competitors who are quoting very low prices, including the second largest player after Thermax in the market. They are probably realizing that top line without bottom line does not mean anything. Otherwise, there would have been some challenges. Currently, it is us versus many small players. So, in the organised sector, larger companies are really wanting to have air pollution control done rather than having a certification from the authorities with a plan which may be okay but not of the high-quality and the automated ones that we provide. As it increases we should be able to improve our margins. But one area where I need to admit that we could have had a top line going forward is the air pollution control at the sulphur oxide SOx plants in NTPC which we kept outside. If the market were to stabilise there, we will enter, because if we would have taken any orders it would have made us lose money in the future. But currently, I think in the next year, year and a half, there will be plants getting commissioned. And I am sure the government is going to understand that underrated plants will have difficulty. So there, we will have a possibility of re-entry. That is about the current and the future for the air pollution and water where margins will improve.

Top line improvement by a huge jump, the way energy could manage, will depend upon us getting chunkier orders for NTPC, which we are currently are not. Then coming to you asking about Sri City, the factory is already ready for the cooling business. But there again, like the way we are running chemical, we will be running our cooling facility, in Pune along with Sri City for fairly longer period. Though, earlier our intention was to have China and Sri City run together. Now we would possibly make it Pune and Sri City, and eventually Sri City alone. So as Sri City reaches full capacity utilisation, we will then take a call on what to do with the Pune facility for cooling. But the costing for Sri City, as per our calculation, is going to hit the balance sheet as a depreciation for the company from this quarter onwards. Amitabha will do the capitalisation, for Q3 onwards. Is that okay, Abhishek?

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

Sandeep Tulsiyan: Very good afternoon. Sir, the first question is on the margin outlook that you mentioned some inputs on the projects taken at low margins in the last one to one and a half years, but at the same time, you have also pre-booked certain costs pertaining to Dangote assembly at Mundra. So how should one look at margins going forward? Will they continue to remain under pressure? Will there be a marginal improvement? Directionally, if you could guide us on that?

M. S. Unnikrishnan: Barring any surprises invisible to us going forward, maintaining this margin will be practical. I am talking on an annual basis, though there could be a possibility of a particular quarter going up or down, based on some mix. For improving back to the double-digit that we are used to, we are working on various belt-tightening and other areas where trimming can be done. These areas that I am talking about are mainly on the global level because the areas we usually control is in India but not much belt-tightening has been done globally and maybe it has to be applied to the international operations. With that, there can be an improvement. We really need to see if we can go back to what our dream numbers are from currently at what we are, maybe at 8% PBT. You are talking about maybe 200 basis point improvement to be happening in the six-month period across a full balance sheet where the growth is going to be also relatively large. It will be a tough challenge, but we never give up. So, let us fight out. Let us see where we are. I am sure all of you would also have had that worry in your mind related to an order book now at a fairly large size visibility going up to may be a one-year quarter equivalent. Now that worry is not there in our minds. As of now, there is nothing which should go wrong in that front.

Sandeep Tulsiyan: Secondly sir, you mentioned that based on current capacity utilization levels and the new capacities that are coming up, you forecast at least a 15% growth over the next three-year horizon. So how much of that would be through these new capacities, and at what pace do we expect the base business from the existing capacities to grow? New as in that Dahej plant, Sri City and Indonesia plants.

M. S. Unnikrishnan: And you could have listed up the acquired plant. All of them are there. So, put together, we are certainly geared for the percentage that you have asked me. Of course, I will need a lot more filler of manpower, some amount of IT expenses for it because we do not want only human orientation and all that is possible to manage. Your question is can you have a 15% or more growth in the next three-year period? Yes, it can be done with very limited balancing capex, no problems at all. But will I get that many orders? If the demand is there, why wouldn't we? Certainly, we are there to take orders. See, if you would have asked me the same question maybe a quarter back, my answer would have been, which you had have heard, is that everything is positive. At this point in time, there is nothing negative except the short-term few quarters related to the election effect. Otherwise, globally, there is a stability of a different nature barring some political instability in one or two countries. I am looking forward to the trade war as an opportunity for overall Thermax rather than a threat. There will be threat of course, because the companies managing out of China who may be bereft of orders from say, America and in some case a part of Europe, how they will react to the markets where they are currently operating. Thankfully, Thermax operated very strongly in Southeast Asia, Africa and elsewhere whenever I got orders. Other than the Indian competition, the formidable competition was always from Chinese. And we have been able to overcome. Our currency depreciation had been much more than the Chinese currency depreciation. So, there is still an advantage available, over and above our technical credentials. And for example, in some other South American orders, they do not even want to touch Chinese unless they are coming with the funding. So, these are the positive indicators at this point of time. So, if inquiries are there, orders are there, things could happen. But even today, I am quite dependent, whatever said and done on India as 65% to 70% of my revenues will come from here. With that kind of a number, imagine that if there is political instability in our country, the way it is prevailing in some of the smaller nearby countries. If that would happen, which I am sure none of you want, then larger projects will not happen. The small will continue. That will fetch me the regular orders, but not the biggies which I want.

Sandeep Tulsiyan: Okay. Got it. Sir, lastly, a little bit in your net working capital side. We have seen a sharp jump in the other current assets and other noncurrent assets basically comprising of unbilled revenue. Is it a more pertaining to the accounting, some change in accounting standard IndAS 115 or is there something one-off over there which you would like to explain?

M. S. Unnikrishnan: Sandeep, the largest order that is being executed is Dangote, where in normal circumstances one would have revenue recognised and also shipped it to the destination. Here, we are doing a port assembly. So, the physical movement out of our custody of the item is the one where the buildup is happening. But be assured of the fact that it is funded by the customer. So that way, nothing to worry on that account. Accounting standard corrections were already run by Amitabha and team well in advance. So that is already accounted for. This is more of a port assembly happening and will continue to increase till the time the ship starts coming and taking it away from here.

Sandeep Tulsiyan: Alright Sir. Thank you so much, Sir. That is, it from my side.

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

Renu Baid: Yes, hi. Good afternoon Sir. A couple of things from my side. First, on the execution side. Can help us understand what portion of Dangote has already been booked in our books in the first half? And by the end of the year, should we be done with 70% or more?

M. S. Unnikrishnan: 27% is recognised of the main order from them so far.

A. Mukhopadhyay: Yes, so far.

M. S. Unnikrishnan: See, it will spill over to the next year also because the physical movement will be a logistic management to be done by them. So, what will happen in Q3 and Q4, as I mentioned about, we are ready for the first hydraulic test of the in Q3 by December end. So, this is reaching a crucial stage of physical dispatch. I can give you one more information, something which is monitored by our team in Nigeria. The site is ready now, where the kind of civil work they have been able to manage is unbelievable. The entire civil work for the foundation, including a jetty to receive heavy consignments got ready in less than 12-month period. And we have the photos and the details available of the refinery's largest vessel manufactured in Korea in a ship. So that means material movement has begun. And they are already opening LCs, making payments and taking deliveries. And even another Indian company who had an order not so big like ours has also got paid 90% and their material is also under inspection and dispatch. So, it is very crucial for us. We are looking at it on a weekly basis as to how it is going to be moving. So, we expect that we will have in excess of 60% revenue recognition done in any case in the current year, we are ready for even more. But we will be very prudent related to the cash inflow for that one.

Renu Baid: Sure. And sir, one bookkeeping question for Amitabha, sir. On the other income side, are there any exceptional items or just pure treasury-related gains that you have seen in the current quarter, stand-alone and consolidated both?

A. Mukhopadhyay: No, it is a regular item. There is no exceptional item in this quarter.

Renu Baid: Right. And on the margins front, you did highlight the headwinds that we have had from previously secured low-margin orders and inflationary pressures. But should one assume that at least the orders which have come in the last three to four quarters, especially in the domestic market and once these low-margin orders out of the backlog are executed, margins should be inching back to 10% levels towards the end of the year or next year? Or do you think there could be practical headwinds to margins from here on as well?

M. S. Unnikrishnan: If you look at it historically, it is a declining commodity price market, so I do not think we are near to that. But sometimes, you get exclusive projects; there are also items where we do not have far too many competitions, or we get international orders, where only larger companies are prequalified to bid, not the smaller ones. Those are the kind of orders which should help you increase the margin. That is the way it is to be understood. So see, Renu, frankly speaking, current orders, including some which are ongoing - for example, for an order which we have taken from a steel capacity expansion in the state of Maharashtra, once again the Chinese is the competition because that company has bought 73% of this steel plant from China. Technically we were able to overcome Chinese, but commercially, they will not allow us to overcome beyond a level. In that order, to make a profit equivalent to a double-digit will not be practical. So, to offset that, we should have other service orders or high-margin orders coming from resins, chemicals or operation maintenance. So the balancing is which would take us to a real double-digit. We are not too far away from there if the market behaves the same way. If the market is going to take a plunge in the next maybe two or three quarters in order intake, then what will happen is all the competitors who are weaker on the knees, will start trembling. Just go back, maybe a year or maybe six quarters back; average order intake of Thermax used to be say Rs. 530 Crores, Rs. 850 Crores, Rs. 900 Crores, or maybe Rs. 1000 Crores for one quarter. From there, in the past four quarters including the current one, all are in four digits as I mentioned about. That means if I am getting orders, others are also getting orders. Sometimes, I become a little more aggressive to take a higher market share. But if there is at least sufficient or I would say, enough for the fixed expense coverage for the competition, then the margin improvements can be possible, for us. So that is the uncertainty currently prevailing in the market.

Renu Baid: Sure. And, sir, lastly, you did mention that we have a clear detailed plan to double our turnover in the next few years. So can you share with us what exactly are we targeting apart from initiatives as you have mentioned the Indonesian market and the South Asian market is growing. Some more granularity possible within segments or broad businesses, how are we looking the broad numbers to pan out as we look to double our turnover in the next four years?

M. S. Unnikrishnan: First and foremost, a geographical expansion for the project business which we restricted earlier to only fraternal markets. As I mentioned earlier about South America, where we have started spreading our tentacles. We are opening our offices in South America and getting prequalified. But of course, there are challenges over there because; in that market you need funds to come along with your EPC or maybe the equipment. So, we will not go for it, but selectively be over there. Second, we are opening our own office in Kenya, where we have started targeting some of that market and picking orders. Southeast Asia is a big move for localising the project operations. Amitabha, Amruta & team had recently gone there, and in the recently concluded board meeting, taken the concurrence to have the hubs created in Thailand and Indonesia for project businesses, two separate ones. And now we will have to complete the registration of the company and that formality is completed. Then local partner for some of work to be done, not by Thermax forming a JV or as a company, but for project to project SPV creation and identification. Then the second item - we have concluded that there are certain industries where we are already present, where we are only doing the current products of the company, which are the adjacent products. I am not currently talking about it unless we crystallise the entire thing and the team start recording and picking orders. They are both in EPC group moving away from power EPC into general EPC, okay? And in boiler heater, unfortunately, it is only boilers and heaters but what they manufactured predominantly is heat exchangers. So, moving into those terrains and these are all the activities already started. So that is for the project business growth. And we have been predominantly domestic in nature for the air pollution control, but we are now looking at other markets - India is leading followed by Southeast Asia or maybe Africa equivalent markets. But even those markets have started implementing, owing to the climate change, the air pollution control equipment of the type that we can manufacture. For example, when we went to Indonesia in the beginning, we thought a primitive multi-cyclone is what the market is taking for air pollution control. We tried introducing electrostatic precipitator, the very modern product. Nobody bought from us. But today, it has almost become mandatory in Indonesia that for an enquiry coming, they should also be going for an electrostatic precipitator. That business will also move in globally. So, these are the geographical expansion and product basket expansion not to the unknown terrain but known terrain with products which are not currently done there. We want to have a better growth to the following business of the company, which are profitable. Chemicals - We will look at both green and inorganic route for expansion because there is a profitable business. We know what to do in that business. We have identified the performance chemicals, which one to grow in India, and how to grow globally for resin, which can fetch us a continued 15%. That is an area that we want to be growing faster.

Water, I already indicated to you that we have now got a niche after having undergone major difficulty of losses for three years and picking up as the margins improved. There the investments are not too much. It is our ability to ensure that we take the right order and execute correctly. We are growing. Our subsidiary, Thermax Onsite Energy Solutions, is going to cross a triple-digit turnover, which started seven years back, and is currently delivering almost equivalent to maybe 12% to 13% profits and EBITDA level, much better. And the green steam is being given. We are expanding the territorial limitation for them. We are moving into Southeast Asia with that product, and even Africa. But there with selective multinationals, where we will own the asset and run it and we are going to expand it beyond steam into water and wastewater treatment also, where we will charge them with our plan on a per meter cube basis. So that also we will have to know. It is not a normal growth and even growth further. So, there are very clear-cut ideas related to the smaller businesses growing faster with capital allocation and the larger business, which does not really need money but is more in terms of our own ability to take global risk and going ahead. But see, we studied what is our prime criteria for expanding geographical territories for the project businesses. It's the risk mitigation of the country. And second is in terms of our ability to execute and meet the margins that we are making in India plus. It's the same way as in India. We have got a Risk Council incidentally chaired by Amitabha and when business sits on that, they do the analysis and they have already identified the countries and geographies where we are going to go and what are the safety nets to be built to ensure that we are able to execute orders safely and come out of that. With all that accumulation, we are able to see the numbers which I spoke to you. One item that I missed is cooling, where we have only absorption cooling right now. We have just started process cooling. So cooling also will have more than proportionate growth; cooling market is not growing for the absorption cooling. But the general cooling market is really growing. So that is another item that is identified. So, these are the initiatives planned. And thankfully, we have good capacity available. We have got financial muscle power available because somebody asked me earlier, as to why you are not returning the money. It will all need our money that we have and what we are going to generate. Even for working capital requirements, you will need to have a balance sheet strength. So, money on the balance sheet will give you a better rating. But I do not know if many a times when people talk, do they understand that I have a Rs. 4,500 Crores worth of a bank guarantee limit to be given today. And if I am rated -- Amitabha we are AAA+?

A. Mukhopadhyay: AA+.

M. S. Unnikrishnan: AA+. They will get at competitive rates. So money on the balance sheet and working capital management of this strength is what is going to grow the project businesses the way we want it to grow. Because this lower rate of commission for a bank guarantee can make a lot of difference in projects for advance, for the warranty, guarantees put together, the BG per order will be almost 30% in the global market. Yes, that is it.

Renu Baid: Sure, sir, that is pretty helpful. And then one more question. For Thermax, the inflows in order backlog detail segment-wise was shared for Thermax global, can we have those details for the standalone India business also?

M. S. Unnikrishnan: Yes, of course.

A. Mukhopadhyay: Standalone.

Renu Baid: Yes, standalone.

A. Mukhopadhyay: I think we were giving standalone when you used to ask for only consolidated number, anyway. Energy segment, Rs. 870 Crores, I am talking about orders intake. Environment segment, Rs. 204 Crores; Chemical segment, Rs. 106 Crores. Total, Rs. 1180 Crores. And orders carried forward, order balance: Rs. 5223 Crores for Energy; Rs. 620 Crores for Environment; and Rs. 42 Crores for Chemicals; total, Rs. 5886 Crores.

Renu Baid: And the share of exports in both inflows as well as backlog?

A. Mukhopadhyay: Okay. Exports in inflow Rs. 466 Crores. Exports in backlog Rs. 2190 Crores.

Renu Baid: Thank you so much Sir and all the best.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, that was the last question. I would like to hand the conference over to the management for the closing comments. Thank you and over to you.

M. S. Unnikrishnan: Thanks a lot, Ankur, and Motilal Oswal for hosting this conference call for us. And let me thank each one of you, who continue to motive and encourage us to perform. If the market were to look up, I am sure we will also look up better than what we are currently, but in any case, with the visibility having improved, we have a lot of work to do in our backyard to ensure that the profitability can be improved. We will work towards that, and we will come back to you after one quarter. Thanks a lot once again.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Motilal Oswal Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.