"Ahluwalia Contracts India Limited Q1 FY15 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Q1 FY 2015 Results Conference Call of Ahluwalia Contracts India Limited, hosted by Emkay Global Financial Services. We have with us today Mr. Shobhit Uppal, Deputy Managing Director, and Mr. S. K. Sachdeva, Executive Director (F&A) of Ahluwalia Contracts India 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 "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nitin Arora, Research Analyst of Emkay Global. Thank you and over to you Mr. Arora.

Nitin Arora: Thanks Karuna. Good evening everyone. I would like to welcome the management of Ahluwalia Contracts, Mr. Shobhit Uppal and Mr. Sachdeva to give us this opportunity for organizing this conference call and without taking much of the time I would like to hand over the call to Mr. Uppal for his opening remarks followed by the question and answers round after that. It is over to you Sir!

Shobhit Uppal: Thanks Nitin. Good evening everybody. This is Shobhit Uppal. Thank you and all of you for joining in. Ahluwalia Contracts as all of you would be knowing within the EPC segment in the building construction industry. We closed FY 2014 with a turnover of top line of 960 Crores and we have planned for a growth of about 20% year-on-year for the next three years for the total operating income for the first quarter FY 2015 is to the tune of about 239 Crores. Mr. Sachdeva would take up through the financial things.

S. K. Sachdeva: The Company's total operating income for the first quarter is Rs.239 Crores as compared to Rs.221 Crores in Q1 FY 2014. EBITDA operating profit is Rs.32.79 Crores as compared to Rs.12.65 Crores in the corresponding QI of last year.

Profit after tax is at Rs.16.89 Crores as compared to Rs.0.85 Crores in Q1 FY 2014. The EPS for the Q1 is at Rs.2.69 as compared to Rs.14% the last corresponding period for Q1 FY2014. On quarterly basis, the topline has grown by about 8.47% year spread and EPS has grown by 1825.22% and 1821.43%.

This is the turnaround performance in the financial year ending 2014 as well as for the first quarter of 2014-2015. Despite this quarter being at 8.7% for 7% growth in turnover we reaffirm that company would be able to achieve better growth on an annualized basis as demonstrated in the past and same would be done continuously reviewing and consolidating the business in line with growth of Indian economy. The total unexecuted order book of this company right now stands at 3200 Crores under execution which are expected to be executed over the next 30 months. Over to Mr. Shobhit Uppal!

Shobhit Uppal: After being in the red for consecutive years, we turned the corner and posted the profit in FY 2014 and as Mr. Sachdeva we are bullish of our prospects over the next three years. In the last six months, we have won orders worth of about 1500 Crores and these are primarily orders in the government sector or in the public sector. We over the last three years we went into the consolidation mode over the last two years and started shying away from the private sector because there has been a liquidity issue with almost all private developers.

That is why our focus going forward is going to be more on the government sector. Our order book ratio between public and private sector at the moment stands at 50:50 and going forward we plan to take it about 60% in favor of the public/government factor.

This is where we stand at the moment. We are ready to take questions from all of you.

Moderator: Thank you very much Sir. Ladies and gentlemen we will now begin with the question and answer session. We have first question from the line of Shlok Dave from Seraphic Capital. Please go ahead.

Shlok Dave: Thanks for the opportunity. Sir if I just go through the line items that you have shown there has been some significant drop in certain line items which you would expect not to happen because that drops have been on an absolute basis. You talked about subcontracting cost, labor cost, what has happened that things have fallen costs have fallen on an absolute basis? Second Sir compared to last cycle and this cycle how do you think the nature of work in your order book going forward which will be coming from the government side as you said, how will that change and overall economics of these projects should we expect something significantly different? My third question is that if you look at the operating leverage in your business as of now as you said you are coming from a very low base of profitability and now you have just turned the corner so going forward what else can we expect from the operating leverage side given that you are planning for 20% growth over the next three years? Thank you.

S. K. Sachdeva: As about the line items of the profit and loss account you have mentioned there have been certainly certain cost reduction in these items just as the operating expenses as well as the employee expenses subcontracting also, but if you see the direct cost that includes the cost of raw material consumed, purchases, operating expenses, labour and subcontracting. These have reduced only from 81.24% to 77.05%. So there is no considerable change or it cannot be because the direct costs remain more or less the same. As regards the growth of 20% which we are already facing, it is based on the order book pattern, which we have received till date and 1500 Crores have been received during the financial year of till date and we are expecting 2000 Crores in this year and keeping two years and two and half years visibility in hand we are hopeful that we will be able to achieve 20% growth on an annualized basis for the next three years. Even then we will reach 1700 Crores which has been achieved in past also, so what we are gaining that is not baseless that is based on the fact.

Shlok Dave: Sir how do you think nature of work will change going forward in terms of margins compared to previous cycle and what you are doing currently. Can we expect going back to over 10% EBITDA margins consistently?

S. K. Sachdeva: In past we have by mistake accepted certain firm contracts, in which we have incurred losses also, but henceforth what we are doing we are mining for the good margin contracts with escalation contracts.

Shobhit Uppal: This trend in the industry has been so far to award fixed price contracts, but going forward we are not accepting any fixed price contract that is why as I mentioned earlier we are taking more government contract because now escalation clauses are built in government contract even with the private contracts when we are tendering we are putting in an escalation clause. OLR fixed price contracts have been most of them 95% of our contracts, fixed price contracts have been completed and by March FY 2015 we will close out whatever are remaining, the balance 5% also and we plan that a year from now say FY 2016 onwards we would touch the EBITDA levels that we had once touched. That is about 10 to 10 plus.

Shlok Dave: Thank you very much Sir.

Moderator: Thank you. We have next question from the line of Nitin Arora from Emkay Global Financial Services. Please go ahead.

Nitin Arora: Actually there were two questions from two fund managers. They were not able to join the call. So I am just asking on their behalf. Sir basically the thought here is that now we are again seeing a bidding coming back in the building segment where your competitors like Simplex and Nagarjuna is again getting a little active and what they say is that the competition is less in building segment, so the margins will improve going ahead. Sir just wanted to get a sense that how much variation you have seen over the last six months in terms of the building segment competitive intensity in terms of the L1 and the L2 and the L3s because what your competitors are saying that margins going to really surprise over the next one or two years?

Shobhit Uppal: What we are seeing over the past one year is that competition has increased in our segment that is the building segment that has happened because a lot of our competitors are going through strike and they are unable to bid or match the credentials or the prequalifying credentials which the various government departments are asking for. Now the trend is of composite contracts wherein the various government departments like DDA, CPWD, NVCC, they are coming out with contracts which are not only core and shell, but which involve all services also, so it is more or less like a turnkey job where very few companies are able to meet the prequalifying criteria or post-qualifying criteria, but we have been seeing over the last one year is that lot of these jobs there have been primarily three companies who have been prequalified to bid, which is Ahluwalia Contracts, Larsen & Toubro, and Shapoorji Pallonji and then depending on the geography you can at some places have Simplex, you can at some places as Nagarjuna, but all in all there would not be more than five or six plus who are bidding now consistently. In the days gone by say two three years ago there used to be more than 10 or 12 bidders, so obviously now the margins are looking up, the pricing that we are getting is higher plus as I mentioned earlier we have a built-in escalation clause, so the volatility of the construction materials, prices as well as that of the labor is we are insulated from that, so that is why as I said we are projecting growth in terms of EBITDA in excess of about 10%.

Nitin Arora: Just one follow-up question more from their side is that we have already bagged in order inflow of about 15 billion is this year-to-date, rather in this financial year. So what is the guidance of the management over the next two years and any visibility in terms of the newer order intake over the next two months?

Shobhit Uppal: As Mr. Sachdeva said we hope that we would get orders worth 500 Crores more in this financial year that is in the next seven months and already bids are out on some of these orders, and then as I said we aim for a 20% year-on-year growth, we aim to take it back, take the company back, take the topline back to the level that it had achieved which is about 1700 Crores. At the moment, I do not see any problem in getting orders. We from our side actually our plans or our growth plans on the conservative side.

Nitin Arora: I will come back with more questions in the queue.

Moderator: Thank you. We have next question from the line of Chetan Vadia from JHP Securities. Please go ahead.

Chetan Vadia: Good afternoon to you. First question on the debt side what is the consolidated debt right now in the cost of debt?

S. K. Sachdeva: The total debt in our book is 220 Crores. The bifurcation is 130 Crores in working capital and 40 Crores as term loan and the average cost is around 13.5%.

Chetan Vadia: Average cost is around 13.5% and what is the schedule of repayment?

S. K. Sachdeva: Schedule of repayment is five years for the term loan portion out of which one year is left and that has been paid off, four years remaining term is there.

Chetan Vadia: Sir my next question is on the new government and their policy as such. Are you seeing some activity on the ground level with respect to various ministries in sense of any acceleration in avoiding of the contracts?

Shobhit Uppal: Yes as can be seen in the last six months we won contracts worth 1500 Crores and activity we are actually seeing from slightly before this government office also even with the last regime but now there is more it is picking up pace and we feel that is why I mentioned earlier I do not think picking of order will be a problem but we from our side are being conservative because we want to work in the four metros plus we want to work in state capital. We do not want to go to areas where labor unions are a problem or political problems are there or unrest is there. Does that answer your question?

Chetan Vadia: It does. That is from my side thank you Sir.

Moderator: Thank you. We have next question from the line of Ankit Sancheti from Kotak. Please go ahead.

Ankit Sancheti: Couple of things. First in the initial remarks you mentioned that 95% of our old orders, which has some issues have been completed only 5% to 7% is remaining can you share with us, are you expecting losses in those orders and if yes what is the quantum of those losses?

S. K. Sachdeva: Those estimated and contingent losses have already been provided during this financial year ending 2014. So there would not be any corresponding loss in this current year's balance sheet in profit loss account.

Ankit Sancheti: Second thing is on receivable side are any receivables stuck at any end whether it is a private or public. I can understand it will come, it might come with delay but at the private end any receivables you think that as a challenge in terms of recoverability?

S. K. Sachdeva: The largest chunk is with Emaar MGF it is the chronic receivable in our book that is for 47 Crores for which arbitration process is going on. We are hopeful to recover this money within next two years.

Ankit Sancheti: Have you provided for it?

S. K. Sachdeva: We have not provided for it because for a key management considers to get good money.

Ankit Sancheti: Any other apart from Emaar MGF, which is under dispute or under litigation?

S. K. Sachdeva: There is another dispute with this Talkatora Stadium we have the CBI enquiry was there that enquiry has been over. Court has passed order and we are hopeful that money would be recovered within this quarter.

Ankit Sancheti: How much is that amount?

S. K. Sachdeva: It is around 20 Crores.

Ankit Sancheti: 20 Crores and you will get it with interest or you are just getting the principle?

Shobhit Uppal: For interest we have again to go for arbitration. Right now we are talking about the principle amount only.

S. K. Sachdeva: Another thing you mentioned in the opening remarks that in the government order you used to get escalations but in private it was typically a fixed contract. Now you are bidding for private orders with an escalation clause built in?

S. K. Sachdeva: We are insisting for the inbuilt escalation clause as well as we are insisting that will not provide any performance guarantee.

Ankit Sancheti: I am just wondering why as a builder or as a contractor body why should someone accept these terms and conditions obviously it is good from your perspective I do not deny but then escalation the project cost also has some challenge at the builder end or the guy who…?

S. K. Sachdeva: Those contractors are also insisting for the same terms and conditions right now because everybody have burnt their fingers.

Ankit Sancheti: So you are saying as a builder someone does not have a choice but to agree to these terms and conditions is that right. Is that what you are saying?

Shobhit Uppal: Going forward what is going to be the key is delivery now builders also as you would have read now builders lot of large builders are also in soup. They are being penalized by the various government departments, competitions, Commission of India so on and so forth. Delivery is going to be key. The government is also going to come down very hard. So now the tender conditions are going to be far more equitable.

Ankit Sancheti: Because the challenge is what I understand is earlier also there was an escalation clause so far as government orders were concerned but whenever the price rise in either a steel or cement was too sharp what feedback we used to get from other competitors of yours like Nagarjuna. We are still used to say that we are able to cover 60% to 70% of the cost but we cannot cover 100% of the cost because of the kind of index or the kind of reference from which the escalation is taken into account. So they used to say that if labour is available at 60% to 70% higher cost the inbuilt clause is that you have to meet CPI, WPI inflation which does not account for that 60% to 70% rise. So I am just trying to understand though there is a clause of escalation whether it actually covers 100% of things or it covers 40% to 50% and then we have to work out for that remaining 40% to 50%.

Shobhit Uppal: This can vary actually though the clause in majority of the contracts the clause is on the wholesale price index but now what is happening in CPWD contracts and MMDC contracts is that they are also coming out with the separate index for cement and steel prices. So with the result that the escalations is far more in tune or is sync with the actual prices as far as these two volatile materials are concerned and if you average out the escalations which is calculated based on the WPI for all the other items more or less over a period of say two to two and a half or three years for which a contract the lifecycle of a contract is there it averages out. Going forward it is not going to be 60% or 70%, it can be 90% or it can be slightly more than 100 also. I think now the clauses which have been followed are far more equitable. Secondly a lot of us took a hit on escalation as far as the private contracts were concerned because the major delays one has seen in private contracts because all the developers are facing liquidity crunch. Two to two and a half years is the standard time period but no project has got completed in less than five years so the timelines have almost doubled and in this doubled time line we have all these contracts have been escalation free contracts. Now even the developers are now hearing around to the fact that we will have to pay escalation. Secondly as far as Ahluwalia Contract is concerned we have a policy now even where we are bidding for private contracts we have been very clear upfront we are saying we are going to give you no bank guarantees because what has happened in last two, three, four years or this bank guarantee thing has been used as a sword, which has been hung over our head by the developers. Some clients it is a pleasant surprise that 20% to 25% of the clients are agreeing to this clause. Going forward we feel that maybe this number will go up nearly 50% within a year because there is a genuine paucity of good contractors who can deliver in time and as I mentioned earlier delivery is going to be key here.

Ankit Sancheti: One thing you have mentioned that you are looking for a 20% topline increase in FY'15 is that right?

Shobhit Uppal: Yes.

Ankit Sancheti: You are expecting roughly 500 Crores worth of more orders in the remaining seven to eight months?

Shobhit Uppal: That is our target yes.

Ankit Sancheti: I was wondering on the margin side, how do you see margins for FY 2015 and how sustainable are these margins. Have you shared any outlook on that? I have no idea Sir.

S. K. Sachdeva: At EBITDA level we are looking at 10% and we have already achieved this margin during this quarter also. We are sustainable because now the loss making projects are almost complete.

Ankit Sancheti: Any of your existing order book or the previous order where work will start or all are moving order in your order book?

Shobhit Uppal: They are moving but they are moving slowly. As I said that some of our clients have they have liquidity issues so that at the ground those issues continue to be a challenge, which we feel that may be it will take another six months for this position to improve. No projects have stuck but they are moving slowly.

Ankit Sancheti: What will be those slow moving projects it will be say 500 Crores or 3000 Crores order book or 200 Crores or even lower than that or higher than that if you can share?

Shobhit Uppal: It would be to the tune of about 700 Crores.

Ankit Sancheti: These will be I presume all private jobs?

Shobhit Uppal: Yes.

Ankit Sancheti: In case of government jobs what is the receivable cycle so after you raise the bill on completion or whatever part completion of the work done in the month what is the timeline of receivables three months, two months, one month?

Shobhit Uppal: The timeline as per contracts the standard clause is that we have to offer a bill once a month and they have to pay within 30 days. So if you look at a cycle we have to get a payment every 30 days. But you can say that the cycle is anywhere between 45 and 60 days.

Ankit Sancheti: In case of private is it three months cycle billing and then it will get?

Shobhit Uppal: Again the standard clause is the monthly payment but in the private it is now stretching to about three months.

Ankit Sancheti: Three months repayments are the payment cycle and private roughly 45 in public in the government orders?

Shobhit Uppal: Yes.

Ankit Sancheti: In terms of this new order inflows, in terms of the organization strength how geared up in terms of management bandwidth given the current bandwidth how many projects can you handle at a given point of time, a number of sites which you can handle 50, 60, 70, 80 whatever, if you can throw some light on that?

Shobhit Uppal: Roughly broadly speaking anywhere between 70 and 90 sites the organization can handle. We had touched the topline of about 1700 Crores in FY 2011 and then we scaled it down over the last two years to about 951,000 Crores. So the management bandwidth exist to at present bandwidth is that both in terms of our staff and also in terms of the equipment and other resources that we have to scale up back to the level that we had retained three years ago so that is what our target is for the next three years.

Ankit Sancheti: Typically if you get let us assume you get a 500 Crores order or I am just looking you got some 336 Crores order from Police Headquarters at Patna in Bihar. Of this order will you typically in any order do you execute on your own or you subcontract it and if you subcontract what are the terms and condition or why subcontract why not do it on your own?

Shobhit Uppal: We do not subcontract. Ahluwalia Contracts does all their work themselves. The only subcontracting which is done is in highly specialized work such as elevators, escalators or baggage handling systems for building management systems other than that we have in our capabilities to execute or we complete job.

Ankit Sancheti: Sir, most of the execution is done in house say is that right.

Shobhit Uppal: Yes.

Ankit Sancheti: I think that is from my side. Thanks a lot.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand over the floor back to Mr. Nitin Arora of Emkay Global for his closing comments. Over to you Sir!

Nitin Arora: Once again, I would like to thank everyone for joining us on the call and thank you for the management of Ahluwalia Contracts for giving us this opportunity to host the earnings conference call for them. Thank you so much Sir for this.

Shobhit Uppal: Thank you Nitin. Thank you everybody. Thanks so much. Bye.

Moderator: Thank you Sir. On behalf of Emkay Global Financial Services Limited that concludes today's conference. Thank you for joining us and you may now disconnect your lines.