Crompton Greaves Limited Q2 FY16 Results Conference Call

October 29, 2015

Moderator: Good day, Ladies and Gentlemen. I am Harpit Kapoor, the moderator of this call. Thank you for standing by and welcome to Q2 FY16 Results Discussion Conference Call. For the duration of presentation all participant lines will be in listen-only mode. We will have a Q&A section post presentation. So without any delay I would like to now hand over the call to Mr. Laurent Demortier. Thank you and over to you sir.

Laurent Demortier: Good Evening, Ladies and Gentlemen and Thank You for joining us for the Second Quarter Earnings September 2015 Investor Conference Call for Crompton Greaves.

Order intake for this quarter was strong; orders excluding Consumer for Q2 reached Rs.2,886 crores or 15% growth versus Q2 last year; Power Systems reached Rs.2,350 crores or growth of 22% versus Q2 Industrial Rs.536 crores which is slightly de-growth of 8% for the same period last year; Automation reached Rs.441 crores, growth of 40% versus last year.

If you look by region, the International business order reached Rs.1,721 crores which is a 22% increase compared to Q2 last year and India business excluding Consumer reached Rs.1,166 crores or 6% growth compared to the same period against last year.

In India, I think it is worth to note the Power Products BU grew by 15% as a result of large orders received from PGCIL. On the revenue level, consolidated revenue recorded was Rs.3,216 crores, which was slightly down by 6% compared to the same period last year. The growth coming exclusively from our International Power Systems business while both Automation and Industrial was stable. Consumer recorded 8.2% increase compared to the same period last year. On EBIT side, consolidated EBITDA reached Rs.157 crores and consolidated PAT reached Rs.52 crores.

Backlog at the end of September reached record of Rs.8,428 crores, which is 7% higher than the backlog that we registered at the end of Q1. This represent more than 10-months of global operations.

Now, explaining the results for this quarter, I think overall the International Power Systems business activity has been impacted by ongoing discussion on the divestiture on this activity. We have registered -16% growth in order compared to Q2 last year. As communicated last quarter, we are in discussions with potential buyer for the overall International Power Systems activity. The buyer has completely detail due diligence in all our activities in the past few months. We are expecting now to receive a definitive offer on the investor within the timeframe that we have indicated last quarter.

Regarding the Consumer business, I do remind you that this business is in the process to be demerged on CG. Consumer performed well this quarter. Q2 is usually a low season for this business and despite that the Consumer grew by 8.2% compared to Q2 last year and reached 9.7% EBITDA. The performance is worth to note that is due to first increase of our Lighting business more than 16.9% driven by a new LED offering and also Fans business which grew by 5% for the period.

Industrial business is witnessing somewhat we call stable market condition. However, in this quarter, that for the first time since long we have seen significant growth in both the large motor and the small motor in India, of 13.4% compared to last year.

On the Exports for the Industrial business, it is worth to note this has been communicated this quarter that we have signed for the first time a world-wide supply agreement with the largest cement company, Lafarge, where the contract stipulate that all the plants in the world will be served of Indian operations in Bhopal.

Automation last but not least I think this business grew by 40% during Q2 mainly driven by significant orders in the smart grid area in the European market.

As presenting during last quarter, following the demerger of the Consumer business we have been embarking into a major alignment of our businesses We have launched a product of the amortization of our non-productive assets as well as the disposal of our non-strategic businesses. The first results of those disposals have been announced in October. So they are not included in the Q2 results; however, the one will be fully realized in the Q3 results.

I just want to summarize those announcements for the benefits of all:

First, we have sold the second large parcel of land in Kanjur, India. We have sold approximately 13 acres of land at the price of Rs.496 crores. The sale is fully completed and the payment received.

Second, we have sold our PT Canada operations; it is a Power Transformer factory that was located in Winnipeg, Manitoba. We have sold this business to PTI Holdings Corporation for a net of price value of CAD 20 million. Here also the sales have been completed.

Further, we have terminated our Electrical Distribution Franchises in Jalgaon. This was the business that was under huge size and we have been stopping those activities on August 12. I think the results of Q2 only include partial activity there and it will be removed in the following quarter.

Fourth, we have sold our Medium Voltage business in India. We have the joint venture with Lucy Switchgear. We sold that for a net of value of €5.5 million. Here also the sale is completed and the payment received.

Fifth, we just want to reiterate the fact that we are on plan with demerger of our Consumer business. Just to update you on the process for this demerger, the plan is on track and progressing according to our schedule. Since 1st October 2015 which is the effective date for the demerger. The business is now managed totally separately. As per the Scheme of Demerger, Crompton Greaves will manage this newly formed Consumer company under trust until listing of the share.

So this summarizes the key strategic actions that we have been putting to realign the company and the results for Q2. So, at this stage I will stop and we will open the floor for Questions.

Moderator: Thank you sir. With this we will open the floor for Q&A Interaction Session. The first question of the day coming from Charanjeet Singh from B&K. Please go ahead.

Charanjeet Singh: On the Domestic Power Systems division, if you could please highlight what has been the reason for continuing de-growth and when do we see things improving in this segment?

Madhav Acharya: Charanjeet, if you look at versus Q1, in Q1 we have done Rs.390 crores of sales, Q2 we have done Rs.688 crores of sales which is almost as equal to that of the last year. So I would not really look at it as de-growth. There are timing issues as you know in this business. But important thing was as we had told earlier in the Q1 call there were certain shipments that got delayed and hence we could not completely book the revenues. So that has kind of got covered here. I will give to Laurent to talk more.

Laurent Demortier: There is another event that have been in Power business, as you know, we had the strike in Nasik that basically impacted our business for June-mid-October. The strike now everything has been stopped in mid-August. So, this has also had an impact on the result compared to last year. If you put that into factor you will see that the business is earning at the market rate right now.

Charanjeet Singh: Within the Consumer segment, how has been the growth in the Fans specifically?

Laurent Demortier: Fan remained a largest part of 40% is the produced value..

Madhav Acharya: Fans, as you know, this is a quarter which is basically a seasonal impact on PAT. Every second quarter usually is very weak in Fans, but we have got around 5% growth versus Q2 last year.

Charanjeet Singh: How do you see going forward growth in the Consumer segment specifically?

Laurent Demortier:I will not make any comment on that.

Moderator: Thank you. The next question is from the line of Sumit Kishore from JP Morgan. Your line is unmuted.

Sumit Kishore: Sir, in your opening remarks, you mentioned that for the overseas Power Systems business, the buyer has completed due diligence of all plants. So is there a single buyer for all your operations in Europe, North America, and Indonesia? And you said that Definitive Offer is expected within the timeframe mentioned. So, from that I assume it is going to be before end of fiscal FY16?

Laurent Demortier: I think first of all we are in exclusive discussion with one potential buyer. So we might have different buyer, but for the time being we enter into exclusive discussion. This buyer has completed due diligence on all the units of the International Power System business and we are expecting Definite Offer at the end of the year from this buyer.

Sumit Kishore: Madhav, could you please given us the order inflow and order backlog numbers that you usually do for…?

Madhav Acharya: India Power order intake is Rs.714 crores, India Industrial System order intake is Rs.452 crores, total India order intake for the quarter is at Rs.1,166 crores, non-India Power Systems order is Rs.1,636 crores, Industrial Systems order is Rs.84 crores, total order intake for non-India is Rs.1,721 crores, Total power systems global order intake is Rs.2,350 crores, Industrial

Systems global at Rs.536 crores. So the total order intake for the quarter for CG as a whole excluding Consumer of course is Rs.2,886 crores. Coming on to the Order Book: In Power Systems in India is Rs.3,145 crores, the order book in Industrial Systems India is Rs.553 crores, so the total order book in India is Rs.3,698 crores, the order book in Power Systems non-India is Rs.4,607 crores, the order book in Industrial Systems non-India is Rs.123 crores, total order book available outside of India is Rs.4,730 crores and total Power Systems global order book is Rs.7,752 crores, Industrial Systems global at Rs.676 crores and total order book is at Rs.8,428 crores.

Sumit Kishore: Could you also give us a sense on what is the total order backlog for Automation itself?

Madhav Acharya: The backlog as on date is approximately Rs.831 crores.

Sumit Kishore: The total inflows for Automation?

Madhav Acharya: It is Rs.441 crores.

Sumit Kishore: One last clarification on the balance sheet, basically in the standalone balance sheet, the short-term loans and advances have increased by Rs.500 crores versus the position at the end of FY'15. What does that represent?

Madhav Acharya: As we had explained in the last call also, there will be an approximately Rs.700 crores of debt that will move to the Consumer business upon demerger.

Sumit Kishore: Was not that given effect to…?

Madhav Acharya: It was in the March balance sheet as well.

Sumit Kishore: So why is the increase in short term loans and advances of the order of Rs.500 crores?

Madhav Acharya: No, you are looking at short-term loans and advances given are what you are asking? That basically the money that we have given to our overseas subsidiary. Some part was payment of the reduction of debt. . That also goes to the same balance sheet, right.

Inder: This is Inder here from Macquarie. My first question is on Consumer. Though I would say seasonally we have done well on the revenue side, but on the profitability side we seem to have taken another step back with margins coming off and overall profitability coming down. Any particular reason -- was there any kind of restructuring costs involved in this quarter for that?

Madhav Acharya: You are right, versus last year same quarter we have done better in terms of top line, but there has been a reduction in the margin. Two reasons – one is of course the product mix keeps changing because some amount of increase in the material cost compared to sales; and second is this being the audited closure for Consumer because of the demerger, if you would look at our unallocated cost and gross it up with other income, you will realize that certain amount of cost which directly pertain to the Consumer business**,** the unallocated cost and now the separation is almost happening, that cost has got directly booked to the Consumer. So that reduce the Consumer margins a little bit, but nothing fundamentally happened and no restructuring have taken place.

Inder: One more question in Q1 in the Domestic Power business. There were a lot of issues in terms of Nasik plant and then some deliveries were delayed and all those kind of things. Should we assume that the run rate that we have got in Q2 is now stable state run rate with all the issues sorted out or if I have to look at versus quarter also got the benefit of delayed delivery from Q1, so actually might not be able to repeat Q2 again going into Q3 and Q4. So, how should we look at that?

Madhav Acharya: We have been historically doing around 680-700 crore topline in Power in India every quarter and this quarter also we are at close to that number. So, this looks more or less like steady state business.

Inder: And should we hold on to the margins level here or is there room for us to kind of further improve?

Madhav Acharya: There is always issue around the product mix. In any given quarter if you do more exports and less domestic, your margins will be higher, in a quarter you do more domestic less exports, so there is a little bit of mix issue there which will always remain depending on the scheduling of the shipments, but other than that, broadly, on a top line number why should look at a steady state situation.

Inder: Through Consumer divestment and through the non-core asset sale, debt would have got reduced by 12 billion or cash would have been raised that much. So how do you deploy – are we looking to pay down the international in debt we carry or we want to keep that as a cash just on higher interest rate on that from the Indian treasury operations?

Madhav Acharya: As we had said earlier also, our objective is to reduce the debt primarily; In India, there is no debt; so in the international operations we want to reduce the debt. That is what exactly we will be doing at this point of time.

Moderator: Thank you. The next question is from the line of Bhoomika Nair from IDFC Securities. Please go ahead.

Bhoomika Nair: Sir, you mentioned earlier to a question on Consumer that there has been on the split of the demerger the margins have come down because of some extra allocation of costs. So should one on a steady state basis look at this as a new level of margins for the Consumer segment or is it a one-time impact in that sense because of the demerger?

Madhav Acharya: A lot of it would be driven by what the top line would be going forward, because that gives a lot of operating leverage. As far as the costs are concerned, because of the demerger date being specific, the costs, which were part of the unallocated cost, have got booked directly into the Consumer business. So, if higher the volumes, higher the leverage you get for advantage.

Bhoomika Nair: So basically some unallocated costs have moved to Consumer segment and which is why the market has come down?

Madhav Acharya: Exactly, that is why the unallocated costs have come down.

Bhoomika Nair: In Power segment, we were also going to deliver some lower rating Transformers you had some order backlog, which is pulling, down our margins over the last couple of quarters. So, has the delivery of that ended?

Laurent Demortier: I think we are full in terms of order for Power for India is we are correct what we said. First, we have the spike in Nasik that impacted us on Q1 and Q2 half . The second, we had the mix of Power Transformer in T3 as we said we get lower rating. I think this will still continue because we need to deliver the backlog but as I said we got a very large order for PGCIL on larger rating transformer, that have been booked in Q2, that will be realized in 3-quarters from now in the phase. Again, it would take a few quarters to go back to this T3. T1 is margin has been driven by a mix of export, that Q1 factor in that export almost half of the production, I think for timing would remain at the level where we are in terms of mix between India and non-India.

Bhoomika Nair: So the benefit of the higher Transformer rating will be visible in FY17?

Laurent Demortier: That is correct.

Bhoomika Nair: Sir, in terms of a bookkeeping question, could I just get the export revenues, backlog and inflow for the quarter and corresponding number for last year 2Q as well?

Madhav Acharya: The export sales for the quarter are Rs.329 crores. In the first quarter we were at Rs.133 crores, so there has been an increase of 147%, last year was Rs.317 crores. Backlog in exports is Rs.883 crores.

Bhoomika Nair: In Automation, what were the revenues in the current quarter?

Madhav Acharya: Rs.197 crores.

Bhoomika Nair: Which would be versus last year?

Madhav Acharya: Almost the same.

Moderator: Thank you. The next question is from the line of Sanjeev from Sharekhan. Your line is unmated.

Sanjeev: Sir, the Consumer margin that you said these time, some unallocable expenses was charged on. So, how much will that be beyond normal operations that has been charged? Just to understand like in case demerger expenses will be over, what kind of normal business margin that could sustain?

Madhav Acharya: The cost has been specifically directly now charged on to the Consumer instead of being a part of the unallocated cost, it is approximately Rs.15 crores in the quarter.

Laurent Demortier: As you know, this business has the new CEO, Mr. Shantanu Khosla, so basically the new team is looking at improving this business. I think they will be in a better position to give you a forward-looking statement on this business. So we can just explain the situation as it is from our side.

Sanjeev: The pledged shares have gone up again in this quarter. So can you help us to understand like how, what scenario over there?

Madhav Acharya: I guess we are the wrong people to answer that question.

Deepak: This is Deepak from Antique. Sir, my question is again related to the Consumer margin. You have said that Rs.15 crores has been directly allocated to Consumer business. So, relating to that, my first question is, is it a recurring kind of cost and this cost is related to what activity exactly?

Madhav Acharya: Earlier we had these regions where the cost of all getting pooled and coming at an unallocated cost. Now, that the demerger is happening and those are specified. So all the people have been identified, the costs have been identified. So they have been now directly charged to the Consumer business instead of being shown as un-allocable cost. So that figure is Rs.15 cores which is approximately equal to 2% of the Consumer top line for the quarter.

Deepak: I understand that, but is it a recurring cost and what exactly is the type of this cost?

Madhav Acharya: This is basically the people who are there in the regions and who are now working exclusively for consumer. So this is a cost, which is there.

Deepak: So, we can presume it is a recurring cost.

Madhav Acharya: You are right.

Moderator: Thank you. The next question is from the line of Mr. Girish from BNP Paribas. Your line is unmuted.

Girish: I just wanted to know the other expenses item in the consol earnings. That has dropped meaningfully year-on-year and sequentially. What are the specific reasons for the reduction in these costs?

Madhav Acharya: We keep embarking on cost reduction measures and trying to rationalize the business wherever possible. So that helped our cost also go down.

Girish: So, would it be fair to say that the power and fuel costs would have declined globally because of the global commodity decline in crude price, freight cost would have come down?

Madhav Acharya: Freight cost would have also come down, that is right, there are a lot of factors that are also helping the business.

Girish: Lower liquidated damages as well?

Madhav Acharya: There were not much liquidated damages anyway. I think most of the older issues are kind of behind us now.

Girish: Regarding the Canada Power Systems sale, you had shareholder loans of 400 crores due from that business. How much of that was paid down before the sale at CAD20 million?

Madhav Acharya: No, out of the 400 crore we are going to get CAD 20 million and rest of the shareholder loan will have to be written off in CG in Q3, which is an exceptional item anyway.

Moderator: Thank you. The next question is from the line of Salil from Premji Invest. Please go ahead.

Salil: Just trying to look at these numbers, if you can help me understand a little better, net debt seems to have gone down on consolidated basis, but interest expenses substantially jumped. So, is there some numbering that which is not part of interest cost and …? So if you look at the consolidated balance sheet, you add up the short-term long-term loan. There is a quite a bit of reduction versus March or even on a year-end basis, you have almost 50% odd increase in interest expenses.

Madhav Acharya: Firstly, you are right, there is a reduction in the overall debt, just because you also see as somebody had rightly asked the question about increase in loans and advances from India, the money was sent from India and we paid down the debt. So that was one part. Second is what has happened is if you see the balance sheet carefully we got Rs.700 crores debt for the Consumer part which is basically India rupee debt and you know the INR cost versus the dollar cost. Most of our debt is actually in Euros and dollars, whereas this particular debt was in INR which is why the interest cost has kind of moved up but from next quarter when the debt moves out this cost will again drop back sharply.

Salil: This un-allocable expenses have reduced when you reallocated some part of it to the Consumer business. If I look at the unallocated EBIT, there again I do not really see a substantial change. In fact, on a year-on-year basis, there will be substantial increase there. So, where exactly these costs would have moved from to the Consumer entity?

Madhav Acharya: What you will have to do is you need to add back the other income and then you have to compare the numbers, you will come to the same numbers that I have reached.

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

Bhavin: A question is on the Power Systems business. After we are selling the surplus land in the Kanjur, if you can help how does it impact on the operations of the business because what we understand is when the construction goes on, there will be some impact on the construction because of the dust and the sand. And secondly, we were originally expecting a facility in Baroda, which we then were not doing it. So, what is the thought of increasing the capacity on the Transformer side?

Laurent Demortier: First of all, if you go to Kanjur, you will see that there is a lot of work to prepare the site. So there will be no impact on the production for the years to come and as we said we have not sold the factory. The Baroda project was canceled for technical reasons on the purchase of the land but I think we are still evaluating as part of our strategic plan option to increase our capacity maybe in India but there is no plan, but bottom line is no impact on Kanjur for the years to come on the production. I would invite analyst community to come and see Kanjur of the transformation which have been done and are fully completed on the site to ensure much proper factory in Kanjur.

Bhavin: What is the management approach on some of the product gaps namely GIS? So are we looking at developing the product through own R&D or looking for some foreign partners for technology?

Laurent Demortier: I think GIS first of all getting partner in this technology now when you are already a big player in this segment is a little bit difficult. So, I think the vote of a partner is a little bit of remote option. We are studying right now production line for GIS in Nasik for 135 and 235 kV which is the bulk of the market, so the building is finished and we are starting the assembly right now. So I think that would be the strategy for GIS for the years to come.

Bhavin: After the Rs.500 crores sale, which we have done now, what would be the debt on the international?

Madhav Acharya: As of today, my net debt is around Rs.2,100-2,200 crores, knock off Rs.700 crores for Consumer, knock off Rs.500 crores for Kanjur, you knock off Canada, you knock off CAD 20 million, I think you will have to knock off a lot of things, Bhavin, not just one.

Bhavin: In Kanjur, is there any further land sale pending or are we done now?

Madhav Acharya: Kanjur basically has the total of 34 acres of land if my memory serves me right. In the first phase we sold around 8 acres, the second phase land, which we were not using for the purpose of manufacture of around 13 acres, so we have sold those two.

Moderator: Thank you. The next question is from Renu from IIFL. Please go ahead.

Renu: Sir, one small first question is on the Kanjur. Is anything beyond 21 acres due for sale anytime during the next 12-18 months or that is all what was up for sale?

Laurent Demortier: No, nothing for sale in the next 12-18 months.

Renu: Second, on the exit of a distribution franchise in Jalgaon, are we expecting or have we factored in any likely penalty from the utility to take this exit? So, do we think there could be some liability or a lease which could come on our books in the next 6-9-months or probably next 1-year?

Madhav Acharya: We have exited the Distribution Franchisee on 12th of August. So, there has been a claim made by the company on MSEDCL and vice versa there has also been a claim from them to us and this will go into arbitration, will take some time. Once arbitration award is known, then we will see. But we do not foresee any major significant issues around that.

Renu: So there could be no negative impact at least for next 1-1.5-years. But do you think the customer might charge you or penalize you for exiting the entity?

Madhav Acharya: We have no obligation towards the customer, we have relationship with MSEDCL, that was a Franchisee agreement.

Renu: On the international subs, as we are looking for definitive agreements for sale, before the final sale happens, you think you would be required to make any further provisions or LDs you will have to book… probably some provisions to be made on the books before the entity is sold off to the buyer?

Laurent Demortier: Again, as we said, we are under discussion. So the best is that we come back to you at the time of definitive on those points.

Renu: In the current quarter, we have seen there has been relative improvement in the performance of the subs, they are closer to breakeven levels. So was this primarily contributed because of better performance in the automation entity or what were the key reasons and what is the broad outlook on the performance of these subs, factoring in that there have been entities do not see much traction?

Laurent Demortier: I think improvement was driven mainly by always the same unit but it was Automation, Industrial also did good performance.

Renu: On QEI, any developments with respect to the disinvestment or the sale?

Laurent Demortier: No, the company is still for sales and we have the proposal we are discussing exclusively with one buyer and we decided to stop the discussion because we felt that we could not generate an agreement.

Renu: Just a clarification, when you mentioned by the end of the year, we expect the Definitive Agreement from the buyer for international subs. The end of the year refer to calendar year 2015 or financial year March 2016?

Laurent Demortier: December ’15.

Moderator: Thank you. The last question of the day we have from Ajinkya from Kotak Securities. Please go ahead.

Harish: Harish here. Could you give me the breakup of the Consumer business into Fans, Lighting, Appliances for the quarter and what is the growth mix?

Madhav Acharya: Can we send the information across to you if you do not mind?

Harish: On this Consumer Lighting business, what proportion would be LED sales?

Laurent Demortier: We will give you that separately. I gave the growth for Lighting this quarter which was I think 16%.

Harish: Will it be safe to assume that because of higher institutional sales, the margin got impacted?

Laurent Demortier: No, I think the LED Lighting has been quite profitable.

Harish: On the unallocated expenditure and income that we talked about. So, we simply add up the other income number, too closer to around Rs.44 crores number for this particular quarter or similar to what we get in other quarters. So, that is what you are referring to, is that correct?

Madhav Acharya: No, let us take for example 30th June ’15 numbers Rs.11.62 crores and you add back Rs.30.02 crores, that comes to around Rs.42 crores, whereas in this quarter the number is Rs.19 crores and Rs.9 crores. So that is the difference I was talking about.

Harish: The difference is Rs.15 crores, which has moved to Consumer?

Madhav Acharya: That is what I talk about.

Moderator: Thank you. I would now like to hand over the floor back to Mr. Laurent for the final remarks. Thank you and over to you, sir.

Laurent Demortier: Thank you to all of you to stay so late today. Just quickly, overall, I would say that Q2 has been showing some sign of recovery in our key businesses. Business has been up in all regions. We are also on track for the realignment of our business post the merger and look forward to see all of you on the third quarter results.

Moderator: Thank you, sir. Thank you, participants for joining the call. That does conclude our conference call and you may now disconnect your lines.