Schneider Electric Infrastructure Limited

"Schneider Electric Infrastructure Limited
Q2 FY18 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Schneider Electric Infrastructure Limited Q2 FY18 Earnings Conference Call hosted by IIFL Capital 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 would now like to hand the conference over to Ms. Renu Baid from IIFL Capital Limited. Thank you and over to you.

Renu Baid: Thank you, Stanford. Good evening everyone for joining the call. We have with us today the management of Schneider Electric Infrastructure to discuss the 2Q FY18 results and the key highlights thereby. The management today with us is represented by Mr. Prakash Kumar Chandraker, Managing Director; Mr. Arnab Roy, CFO; Mr. Vineet Jain, Investor Relations. With these words, I would request Mr. Chandraker to discuss about the quarter. Thereafter, we can start the Q&A. Over to you, sir.

Prakash K. Chandraker: So good afternoon everybody. I am Prakash Chandraker, Managing Director, Schneider Electric Infrastructure Limited. I am pleased to connect with you to share and update the progress of your company. Looking back at last quarter, the market continues to be challenging. We saw liquidity stress in the industry. However, government is continuously pushing investors to revive the industry. We are cautious in terms of customers while building our healthy backlog in line with our strategy. Today I would like to update you about the market segment which is a very relevant for Schneider Electric Infrastructure and on the rebound strategy which we launched last year. So let us go through the presentation Slide #which we have already shared.

If you go to Slide #4, which is focusing on our customers in our market. So on left side this is about our customer. So there are focus energy customers like distribution utilities, electro intensive end user and EPC what you see and renewable PG. This has been our business as usual key customers. Right side, what you will see, are the customers where we focus newly; panel builders and system integrators, electrical contractors and city administrations. So these we have focused more from last 1-1.5 years and there has been good progression in this segment of the customers. We also have strong synergies with our group companies when it comes to a smart city. These megatrends are really evolving. The digitization is the focus area of most of the utilities as well as the city administrator, though it is taking time but I will say still the focus is good. In terms of market, the utilities in the power generation, if you see the green and in fact there has been a push from the government to reduce the losses. Yes, the challenges are basically the implementation by the utilities which is taking bit more time. Renewable is also positive. Conventional generation not so significant change in terms of overall capacity addition. Oil and gas and MMM is basically, orange color what I am showing is basically no significant improvement has happened for Schneider Electric Infrastructure business in medium voltage. So we need to wait more for this particular segments.

Data center, CIB and Metro we see green, in fact metro, number of opportunities are now coming up more, I would say compared to what it was in last 1-1.5 years. So overall if I see there are some market segments where not so much of activity which is basically in industries. However, utilities, renewable, data centers and metros, we do see positive progression in terms of market.

We can go to the next Slide #which is Slide #6, which is on business rebound update. This is the action which we launched last year, though it is a short period, I will say considering the business model what has started operating. So we had 6 sections, 3 towards business model. First was profitable business mix, wherein our focus was to accelerate the growth around the product sales and services which gives us much better profitability and to be selective on the systems and solutions side. I will share with you in the next Slide #how we have been able to drive that. The second is an express channel to market for transactional business which is basically to reduce the lead time to market with a standard commercial policy as well as standardization of the complete supply chain. So that is another one which we will again go with deeper in terms of what is that we have done after launching that. Third is new offer which we have launched, Easypact and Easergy T300. These are the digital offers in modular which also is helping us. So these are the three focus areas which we launched last year in terms of our business model and our 3 operational efficiency area, first is in that the fourth number what you see, CTO model is basically configured to older model which helps in terms of more product sales. So basically end-to-end process means, from customer to factory, complete value chain transformation.

Fifth one is cost structure alignment in line with the volume mix. So what we talked is the acceleration of transactional and the product as well as services and selective systems. We have to align some of the cost structure, though in short term, yes, this has some impact; however, in medium to long term, it will have a quite positive impact in terms of our overall bottomline. The sixth one is HR transformation. Since we are making the business model change as well as operational change, we are also doing some HR transformation in terms of upskilling, in terms of adjusting those costs. So we are quite well progressed on all these 6 actions.

So we can go to the Slide #7, which is on the business model rebound to realize profitable growth. The first triangle, what you see in the top, which is showing transactional business and service, so this has given us positive impact in the last quarter and that has given differently positive results. The third one is advanced grid solution, that is also positive as we say, that is basically focusing on digital solution. System where we are selective, we are going through this major transformation in intermediate, we do see a challenge in terms of the flat growth and this is where we are trying to work more in terms of transforming some of the business requirement of the customer by digitizing their conventional substation solution to digital substation, our secondary distribution to a smart distribution. So those kinds of activities we are doing and there is very positive response from the market, though taking time but we do see in medium term it will come up very well.

Slide #8, this is on partner express model, which I talked to you about how are we planning to accelerate our growth in transactional business. So in Slide #8 if you see, the right side are diffused partners and resellers which I shared with you in Slide #4, on the left side where there are 3 key customer segments what you see; panel builders, system integrators, contractors. These are the people who are more diffused and where it was not focused customer of energy. We are able to make them our good customers because we have launched digital tools which have standard references of the different products what they need and that is helping them in terms of really having with short lead time. We have also launched right commercial policy which helps them in terms of operating in this transactional model which operates basically on the speed, the delivery time and consistent quality. And that is what we try to do by launching these digital tools. So if you see from right to left, there is Ecoreal and MySE, these are the tools by which customer can select what they want to buy. They can create an offer. They can submit to their customer and after receiving that order, they can place the order in Schneider Electric through digital tool and from our DC, distribution center, it can flow directly to plant, in fact it has already started flowing. And from plant, it is again send to the customers. So it is more like an e-commerce kind of thing, but more technical stuff in whole thing. So that is the product what you see here is like extended transformers, our secondary distribution products or standard breakers, so these kind of things we are making our partners available on guaranteed time with right specification and with right lead time. So this is where we are trying to accelerate our growth with much better profitability compared to normally the business as usual supply chain process.

Next one is Slide #nine which is on the new product portfolio in Schneider Electric Infrastructure business. So left side to what you see, LV bus duct, LV panels, these were earlier manufactured by Schneider's other vertical. This we have started manufacturing in our factory which is energy factory or infrastructure factory and transferring the product based on the transfer pricing. So we have a better cost absorption in our factory. The next two products what you see is Easypact and Inductor. Easypact is used in India as well as for the exports. Similarly, Inductor will be also used for the export with IT business. So we have a better cost absorption and this also gives us resulted revenue in terms of additional sale to our listed entity. So this is also positive considering the standardization as well as selectivity which we are trying to do through the system. So this helps us in terms of better cost absorption.

Next one, Slide #10, is on technological advanced product launch. In the New Raipur Smart City, this is the product which we are using and that's age over competition is a very unique product which integrates MV and LV and this will get commissioned somewhere in next year quarter one. There are other customers who are visiting this new reference and we hope that should give us more momentum in the market in terms of pushing this new technological product which this particular customer in our DA is seeing much, I will say effective for managing their network efficiently. So we expect much more, I will say positive trending from this kind of intelligent product as solutions in subsequent quarters.

Productivity initiatives, so one was this product launch and you saw supply chain process, transformation, profitability action through business model. Next is the productivity initiatives in the factory, what we have taken is industrial QVE is basically quality and value engineering process which we have launched. The packaging and transportation we are leveraging the volumes on the group because we have similar factories of Schneider Electric in India and we are trying to take advantage of the volume considering they also have the similar activities on that. Competition based on this another area which we are trying to do and with this methodology, we are trying to reduce our cost of goods sold and that should also help us in improving our profitability.

So now I will request my colleague Arnab to take you through our financial results.

Arnab Roy: Thanks, Prakash. Let us move to Slide #13. As Prakash was pointing out, the market continues to be challenging. However, we are seeing some signs of positive trends now. We at Schneider, we continue to be cautious in our order booking, particularly in terms of the cash security and margins because the liquidity remains a challenge. If you see, our order intake in the quarter stood at 233 crores which is up 4% over the last quarter. However, the sales for this particular period is down by 12%. So this period from 01st of July, the country went to GST. So as a result of that, there were transactional changes which had to be done in terms of the contracts. The old contracts being replaced by new contracts with GST clauses, lot of purchase order amendments, so on and so forth. So that took some time in July and mid August to settle down. So that was the primary reason of the shifting sales. We don't anticipate overall change in the sales for the year, but it was more a quarterly shift because of this procedural piece. So if you see in the slide, overall the results are in line with our strategy. We are selective in the conventional orders which are available in the market but have a negative impact on margins. So if you see the P&L, despite the 12% negative growth in sales, the gross margin has improved by about 7.5% or 7.5 points more precisely and EBITDA has improved by 5 points, so which shows that quarter-on-quarter we have a positive traction and that strategy is probably in the right direction. If you further go into the P&L, you will see that the other income is significant this time. We have collected about 8 crores of old debt which we had provided in the earlier year. This were 4-5 year old cases which we were able to collect, which reinforces the focus we are having now on cash and the efforts which we are making on collection of the old dues. So that is broadly the shape of the P&L. So if you see from a perspective, both the EBITDA and EBIT for the quarter is positive. So which we hope should be the trend going forward as well and the EBITDA as I told from last quarter to this quarter shows a 5 point improvement.

So we will close here. Take a pause and open the floor now for the Q&A sessions.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin with the question and answer session. We will take the first question from the line of Deepak Agarwal from Elara Capital. Please go ahead.

Deepak Agarwal: Sir, can you help us understand this 3 new customer segments which you have started targeting as per your new strategy, how large they become in let us say 2-3 year's perspective in terms of the overall revenue?

Prakash K. Chandraker: So Deepak, if you see these 3, out of these 3, third one city administrator is basically towards more on the smart city, where we do see number of tenders.

But the first two which we see as a panel builders system integrators, electrical conductors, so there was medium market which was not accessible to us earlier, there were B class players or C class local players. We were not competing. And this segment of customers were also not getting right quality product, like take example in many of the distribution utilities, we are buying substandard transformers because none of the big manufacturers were bidding and this is where we are trying to launch equipment which is secondary distribution or standard transformer through our partner and that is why we are trying to create a digital tools, we are trying to sunrise 18:24 the product to bring down the cost, so that they can become competitive in this market. So we do see this segment can give us potential market size of at least 15% to 20%.

Deepak Agarwal: In 2-3 years' timeframe?

Prakash K. Chandraker: In 2 years' time.

Deepak Agarwal: Okay. And secondly, does that mean separate set of marketing team that you have put in place versus the existing one?

Prakash K. Chandraker: So here, we have put the team who are working on the channel policy. We are working on a team who can support all these partners, they can validate their product. So if you see in page number 9, Easypact is a product which will go inside our partner's panel and so we will help them to get qualified for those markets where we are not there today. So we will have a lot of support system for our partners and partner in turn will be actually reaching to these customers.

Deepak Agarwal: Okay. And sir my second question is, in terms of the product like GIS substation or at the city level or an RMU, what kind of revenue mix that you can share with us or an order inflow mix that will be helpful?

Prakash K. Chandraker: So we normally have a mix by service, transactional products and systems, so I am not sure we have readily available or not.

Deepak Agarwal: If not for the quarter, at least for the first half, if you have the number?

Arnab Roy: So if you see here, I mean in terms of order intake, if you see the current quarter, so the systems business was roughly about 58%. The transaction was around 32% and the services was around 11%.

Prakash K. Chandraker: So, our focus will be to increase the contribution from transaction in service which is today let us say around 40% or so, to take it to 50:50, that will help us really to have a better profitability mix.

Deepak Agarwal: Okay, And my last question is, now that we have this Naya Raipur project with us, how is the execution over there? Is expected to happen over the next few quarters and how we can leverage this for other Smart City. So any new tender that you think which can come to the market or where you can grab an opportunity in the next 6-12 months?

Prakash K. Chandraker: So next one year, one is we are seeing at least 3-4 tenders should get decided. We are working deeply on those. And New Raipur is moving in line with the timeframe what we have fixed. So phase I we see, should be there in place in next two quarters' time and then these two should come thereafter. So there are other city administrators who are quite keen to see how this customer is going to use this system and what kind of benefit they are going to get and how it is going to help the citizens. So I will say that there is a lot of keenness in the market to really see what kind of benefit they can derive in. So that will definitely give edge over others, when it comes to Schneider Electric Infrastructure business.

Deepak Agarwal: Which would be these cities?

Prakash K. Chandraker: For confidentiality reason, I think it is better that we don't divulge the names because that will become competitive information where we are trying to focus. We will share with you at an appropriate time when it comes to a matured shape.

Deepak Agarwal: Because earlier, if not the last, but the earlier concall you mentioned about Shendre, Gurgaon, Bhubaneshwar?

Prakash K. Chandraker: Okay. Since you mentioned, I do not want to talk right now because one which you mentioned in the last, we have just closed the order yesterday evening. Formal contract is yet to be signed. So I am not too much talking about that. We will share maybe at an appropriate time when we sign the contract and it becomes more visible.

Moderator: Thank you. We will take the next question from the line of Salil Desai from Premji Invest. Please go ahead.

Salil Desai: Sir, on Slide #4 you mentioned that for smart cities you have strong synergies within the group. So can you give some details on what scope of work do you usually take care of and what do the group companies bring to the table and if I have a typical order size of 100 then how would that be split between what you could do and what the group companies could do?

Prakash K. Chandraker: Good question. In fact there has been always some kind of keenness to know how this will, that is why we tried to cover this one and this time. You know, in the smart city value chain, it varies city to city. Each city has different challenges. Some have challenges with electricity, some water, some transportation, some surveillance system like this. Now, when we are driving a smart city, we are trying to create differentiation for Schneider Electric and this is where we are trying to pushing the complete value chain for this city which will really help them. So if you see surveillance system is one, which comes from our other business unit. Building management system comes from them. Water distribution system also comes from them and it will be forward distribution. So there are 3 or 4 things which comes from our group companies. From Energy, we take care of complete grid management, we take care of self-healing system. We take care of those command control centers. So these are part of the energy vertical which is managed by us. For other parts, we normally take help from them to submit their bids so that the customer evaluates Schneider Electric as one bid. And the good point is, all the solutions which is coming from Schneider Electric Group are all integrated one. If once we put command control center, then all the pieces like a brick can get added. So that is the advantage, it is modular and well integrated beforehand, so that it is easy to demonstrate to the customers that it works as a system. Whereas competition tries to buy from third party and they struggle at site during demonstration because most of the smart city solutions are based on quality and cost model. It is not purely on the cost model. So this is where we get advantage over competition.

Salil Desai: Okay. And so sir, if you to look at Raipur as an example, which you are normally undertaking, so this is an order of what kind? Is it energy management, is it surveillance, what is the scope of work for this particular order, if you can give some details on that?

Prakash K. Chandraker: So we have energy management definitely, which is integral part of this. We have water SCADA, which is water distribution management. We have the building management system, surveillance systems. So these are also part of that. There are other parts like digitization. There are distinct assets like geographical information system integration, that is also part of energy vertical which we are growing. We are identifying each assets in providing the coordinates for that and all that part of electrical assets. And then we have a partner who is doing eGov which is basically creating a platform where the customer or the citizens can apply for their connection, electricity connection, water connection or land records, those kind of things. So we have a partner and they are also doing some kind of infrastructure work. And we are doing more on the digitization part.

Salil Desai: And although you mentioned that each smart city's order is different from the other, but most of the cities cover all of these or there is a significant diversion between any two cities are doing. So let us say if Gurgaon would be the next one, then do they have like very specific area where they want to develop or they would also have same water and DMS and all of it?

Prakash K. Chandraker: Yes, so what is happening is considering the funding what is available, initially they made a big proposal which included everything. Then they found the budget what they had was limited. So Gurgaon has focused more on energy as the first part because all other verticals revolve around energy. So first part is energy, if you don't have energy, you cannot run rest of the system very efficiently. So from full smart city it has become energy dominated verticals and then they will be adding other verticals.

Salil Desai: Okay. And what would be the energy segment typically order size be, let us say if it is only energy management, would it be some 100 crores or...?

Prakash K. Chandraker: So it varies city to city. How much they are trying to cover in a circle, so it can vary from, let us say for Schneider Electric Infrastructure part where we are there, can vary from let us say 20 crores to 70-80 crores depending upon the circle they are trying to cover.

Salil Desai: Sir one final question on, now the gross margins and all have stabilized for some time now, now when do you see market actually improving? Are there any early signs or lead indicators that you track or you look forward to think that in the next 12 months-24 months you will see order flow also increasing and giving you substantial revenues that the margins could actually grow from current levels to whatever your desired numbers are?

Prakash K. Chandraker: So we are all working towards that. I fully agree with you and I can understand your question because let us say order intake we talked about plus 4% growth and that is what we are trying to convert into the sales. So when we were going through this transformation of system which we shared with you. However, today the bigger focus is to really take the order where cash is secured. That has been our focus area. So in terms of growth, I will say it will be moderate. We are not seeing too significant growth will happen in short time. Let us be honest on that because we will be focused on the cash and profitability. So we are going, we are in the right direction. We would like to make sure our systems business, our solutions business are selective to take care of the profitability and cash and we continue to grow, accelerate our transactions and services. So we see the moderate growth.

Salil Desai: And this 50:50 mix between transactions and others, is there a internal timeline that you have or expectation of when do you think that could happen?

Prakash K. Chandraker: We are aiming, let us say, next two years' time. We should try to reach somewhere closer to that.

Moderator: Thank you. We will take the next question from the line of Nayan Parakh from IIFL. Please go ahead.

Nayan Parakh: You had shared the order inflow mix between system transaction and services. Could you also share the revenue mix for the current quarter or half year?

Arnab Roy: See, quarter to quarter the revenue mix will change because depending on what you are executing for this particular quarter, so I don't think it will be a very fair representation. Order gives you a more, I would say a balanced view.

Nayan Parakh: Okay. For the half year, if it is possible?

Arnab Roy: Half year it will be almost in similar lines with the order value.

Prakash K. Chandraker: So maybe it will be good to see on year-on-year basis because sometimes what happens, you close the big systems sales in particular quarter, so it can give different view and the next quarter your mix because of the system solutions and transaction can be different. So I think annual view will be the right balance in terms of the mix which will be almost similar to what is the order mix.

Nayan Parakh: Okay. And with implementation of GST sir, what has been its impact on your revenues or adjustment revenues now. That excise component won't form a part. Can you give some color on that?

Arnab Roy: See, most of our products, I mean although we were in a dual rate, but now it is all in the 18%. So most of our products is in the 18% rate now in terms of GST. As I told you earlier during my presentation that procedurally we had a couple of months to adjust to this with all the POs and other things taking some time, but now things have stabilized, but I think for us most of it is a kind of a tendered product. So we don't see too much of difference in terms of pricing and all, but overall I think it is positive for us.

Nayan Parakh: Sir, can you also highlight what are the state investments right now undergoing into GIS and how is our portfolio placed for those investments?

Prakash K. Chandraker: So, GIS, I see more and more utilities are now going towards GIS and we have a very strong offering of that and we see a positive trending because the space in the city is a challenge today for them to really expand the power system. So though the GIS base today in utilities although is not very big but we see a quite positive trend. It should grow. Metros are already GIS mostly and more metros coming which will be more GIS in tier II cities, especially like Vijayawada, Nagpur, or Delhi-Mumbai anyway phase-III, phase-IV mostly they are focusing on higher technology side.

Nayan Parakh: Okay. Because the narrowing differential between AIS and GIS, I believe is also driving higher adoption for GIS?

Prakash K. Chandraker: Yes. You are right. That also, the gap is reduced compared to what it used to be.

Nayan Parakh: Okay. And sir for the upcoming EV charging infra opportunities, do we have any offerings in that space?

Prakash K. Chandraker: No. EV charging is a low voltage activity which is not the focus area of infrastructure business.

Nayan Parakh: Okay. So, do any of other Schneider companies in India offer those kind of services?

Prakash K. Chandraker: Yes. The advantage will be when we are going to talk about smart city, recharging is offering of Schneider Electric at the lower voltage level. So that will be available definitely, The advantage for infrastructure business will be, when they go for more charging station, you will need more distribution substation which has to be smart enough because this is going to create more complexity in the way energy value chain is managed. So they will need more medium voltage power distribution station in the cities to manage the energy charging stations. So that is also positive for us in more demand growth.

Nayan Parakh: And coming back to my earlier question sir, regarding GIS. In GIS what all offerings do we have, as in the range of KVs that we offer? And if you could highlight which SEBs are more active in this space?

Prakash K. Chandraker: So we have GIS up to 33 KV. That is our focus area for Schneider Electric Infrastructure. And in terms of state utility, I will say most of the state utility will be going but it is not a big number. UP yes, there is a good number of GIS being used. Maharashtra, Bihar, Orissa, we already see at least 8-10 states have already started testing the GIS for the distribution.

Nayan Parakh: And sir, one last question. I think a part of it was discussed earlier as well. We have undertaken change in our approach with more focus on services and other things. So could you highlight when do we expect say double digit kind of growth to return in our revenues. You had mentioned that current focus is on streamlining your operations, but I do believe that once we are back on the growth track that will aid our profit growth trajectory as well.

Prakash K. Chandraker: So we definitely depend upon the government initiatives also, with the consumption driven segment like which I shared with you, while we are growing in utilities, we are growing in data centers, our metros, but the big energy intensive segment like Oil and Gas and MMM, we have to still wait I will say as the significant movement is not visible at this point of time. Maybe considering that the government is now pushing for growth in infrastructure segment, so cement requirement or steel requirement once it goes up, I am sure MMM growth will improve, similarly Oil and Gas. So it is almost 40% of the segment, we are yet to see really growth coming. And once that start growing, obviously will get translated into our growth also.

Moderator: Thank you. We will take the followup question from the line of Salil Desai from Premji Invest. Please go ahead.

Salil Desai: Sir, one question on the numbers. The bad debts which we have collected now and earlier written off, this is part of other income. Is there any special reason why that is there or that is a usual practice under Ind-AS?

Arnab Roy: That is a usual practice because these were debts which were already written off from the books. These pertained to 2009-2010, 2010-2011 that period. So we had already written that off. So it is no longer in a provision. So we have collected debt for that period. So it comes in other income.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the conference over to Mr. Renu Baid from IIFL Capital Limited for closing comments.

Renu Baid: On behalf of IIFL I would like to thank the management for giving us the opportunity to host the call and all the participants for participating. Sir, would you like to make any closing remarks?

Prakash K. Chandraker: So, thanks Renu. My closing remarks will be, the market remains challenging definitely in terms of liquidity in short term and we will remain selective. We are closely watching the development in different segment. We are also trying to drive our business in a segment where we were not there earlier to see that we bring the change in terms of our activity at ground level. And I thank once again for valuable time to understand our company to all our shareholders. Have a nice evening and thank you.

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