"Schneider Electric Infrastructure Limited Q2 FY22 Earnings Conference Call"

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MODERATOR: **MR. HARSHIT KAPADIA – ELARA SECURITIES**

Moderator: Ladies and gentlemen, good day and welcome to the Schneider Electric Infrastructure Limited Q2 FY22 earnings conference call hosted by Elara Securities India Private Limited. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for 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. Harshit Kapadia from Elara Securities. Thank you and over to you.

Harshit Kapadia: Thank you Zaid. A very good evening to everyone. On behalf of Elara Securities, we welcome you all for the Q2 FY22 and H1 FY22 conference call of Schneider Electric Infrastructure Limited. I take this opportunity to welcome the management of Schneider Electric Infrastructure represented by Mr. Sanjay Sudhakaran – Managing Director; Mr. Mayank Holani – Chief Financial Officer; Mr. Vineet Jain – Head Investor Relations.

We will begin the call with a brief overview by the management followed by a Q& A session. I will now hand over the call to Sanjay sir for his opening remarks. Over to you sir.

Sanjay Sudhakaran: Thank you very much. Good afternoon, everybody. I am Sanjay Sudhakaran, Managing Director of Schneider Electric Infrastructure Limited. I am pleased to connect with you to share an update the progress of our company. Today, we will present to you market outlook and company strategy.

Let's go straight to the presentation. I will request all of you to go to slide number 3, as we begin with a snapshot of the economy:

So, I think things are positive on the side of the economy, but I would say that we need to have a look with cautious optimism. There is a certain amount of pent-up demand which is coming up in the market and there is a certain amount of demand that is coming up due to the reforms and policies being driven by the Government. It's a combination of two that we can see right now here. So, if all goes well, India could end up with a GDP growth in excess of 9.5% for the financial year 2022. However, we must also highlight the fact that there are strong supply chain constraints which the globe is facing today in terms of your ability to deliver on projects. This can be a major constraint in the economic growth as well. So, we will take a cautious approach to these overall market indicators and forward-looking indicators that we see. But right now we remain cautiously optimistic about the market growth.

Let's go to the next slide, a brief overview on some of our large end customer segments:

Some of the segments that are very critical to this business are power and grid, transportation, heavy electrification of minerals, mining and metals and oil and gas segment. On the power and grid side, we see continued interest by the Government of India to bring more and more reforms into this segment. So you have more digitization happening here. You have the distribution level reforms, including privatization and you have a big shift towards renewables. All these are work-in-progress and consistent actions can be seen in the marketplace around these particular agendas. The transportation sector is also seeing a good level of investment as we go forward whether it's the development of Metros across India, including the B and C class towns, modernization of railways and locomotives, etc., and also investments in airports. One of the segments that is showing very good promise is steel and cement. Of course, India has gone through a turbulent period with respect to these two segments in the past. There has been a lot of consolidation that has happened, but I think finally everything seems to be falling in place and these segments are up for strong expansions as we go forward. The oil and gas segment will see some transition happening as they work towards an aid energy transition that we want to make it happen including renewables. There's a strong focus of renewables in this area as well as well as the setting up of petrochemicals facilities in the country. So, these are the 4 major segments which drive our growth for this particular organization, and we see good traction in all the 4 segments in terms of their outlook as well.

We will go to slide number 5, which are our strategic priorities:

This is just to reiterate what we have been saying before and we stay invested in these strategies and we stay aligned to these strategies, there's no major shift in what we are trying to do here. Of course, the idea is to get more and more digital. Digital gets you more services as the stickiness with the customer improves. We are partnerizing and transactionalizing our business more and more as these move forward with the addition of newer and better partners. We are accelerating on our key segments which we spoke about a while ago and we are also focusing our efforts towards bringing about change in terms of green technology and SF6-free switchgears in the country.

We now go to slide number 6, just to give you a glimpse of how we are actually actioning this out quarter after quarter:

So in the last quarter we saw good wins aligned to our strategy. We worked with a state utility company to provide digitization at the edge providing them with technologies to connect their products and their services to our software. This brings in better visibility to the customer in terms of their assets and preventive maintenance at their end as well. So continued relationship with this customer for the last two years we have been able to repeat our successes here and get a preferential win here as far as our business is concerned.

We will go to slide number 7, another digitization opportunity that we have been able to win this time with an advisory services which is called the Eco Structure Asset Advisor which is a cloud-based advisory service which the customer has signed up with us for around five years along with a CAPEX. This will help the customer in moving their maintenance from a reactive basis into more of a proactive basis thus impacting their uptime in a very big way. And this is one of the, I would say, path breaking orders that we have received the first in the country.

Moving forward again with services:

I would say that here's a different application of the Eco Structure Asset Advisor focused on a State Government building where all the medium voltage and the low voltage assets have been connected to an asset advisor again to provide the customer with predictive maintenance so that the critical uptime is maintained. S, a similar software being used for two different applications and two different customer base.

Going on to the next slide, which is page number 9. Here is where our partner play comes into forte:

Here is a win by one of our licensee partners for a solar power generation in Maharashtra where they have supplied critical equipment within very demanding timelines of 8 weeks, and we managed to install and commission it along with our licensee partners. So, this is again how we are participating using the licensee model within the solar field which is more around the renewables.

Going on to slide number 10, another strong win on the data center piece which is again an exciting business that is going around in the market here in India as India transforms itself digitally. Working with an end user which is a global customer for Schneider and working with the EPC in India seamlessly, we managed to provide all the medium voltage equipment that is required to this customer to be able to set up a very large facility close to Mumbai. This project will repeat itself in different modules as time goes by.

I go onto the next slide, which is page number 11, staying close to our digital strategy we are launching more and more products that are factory connected so that they can be easily integrated in the field either to Edge software or the Cloud software, so we have the connected RMU, connected transformers and the air insulated switchgear which is now connected with easy packed.

Now I pause here, and I request Mayank Holani, who is the CFO for Schneider Electric Infrastructure Limited to take us through the financial update. Over to you Mayank.

Mayank Holani: Thanks Sanjay and good afternoon all the participants. Please move to slide number 13. The market is now looking committed and recovering and our order intake in the quarter stood at about 3087 million INR which is up by about 51% over last year same quarter. And if you see over last three quarters there has been a consistent movement in the order booking in terms of being on positive side. We have also done well in execution. However, this quarter number looks negative versus previous year due to the base effect and last year what had happened is due to the lockdown starting from mid of March, the flood of sales FG had accumulated in Q1, and the sales got executed in Q2, so which is showing a drop in sales in this quarter. But if we remove that effect the trend is positive, we have good order momentum and execution will is also picking up. If you see in terms of half year, we are at about 2% order growth sales growth versus previous year. We continue to be cautious in order booking in terms of cash security and maintaining the margins.

Next to slide 14, so, here overall P&L is aligned with our strategy. We are focused on cash and margins, and we will continue this journey. This quarter and the last couple of quarters have been impacted badly by the raw material inflation but we have tried to manage it to the best possible way. And you see the results in the numbers where the margin is maintained or even improved even in a situation where there has been so much inflation on the raw material side. Employee costs are looking high, and this is more due to the employee costs coming to more of a normal level in this quarter, in this year actually while last year there was a lot of savings due to some tactical actions. And this quarter employee cost is especially there because of the ESOP cost which is there which has not been there last year as a tactical action.

So that's it. I will close here and leave the floor open for Q &A. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Manish Goyal from Enam Holdings. Please go ahead.

Manish Goyal: I have a few questions. Just looking at the results what we see is that the closing inventory seems to be quite high. It has increased quarter-on-quarter. So, is it that we were unable to dispatch certain finished goods or what was the reason behind it and was it one of the reasons for probably seeing a degrowth in the revenues and how do we see that going forward?

Mayank Holani: So Manish, yes this is one of the reasons and there are a couple of reasons for this inventory increase. One is that some of the sites were impacted by the flooding which has happened in this quarter in many states. So that has resulted that the site readiness has been impacted and in fact the customers could not pick up those materials and there are on a lesser side but there were a few cases also where we remain focused on our security of our money or of recovering the cash and due to the customer liquidity also because we have with withheld the sales instead of dispatching and then seeing a risk on the recovery. But this will get recorded in this quarter, next quarter.

Manish Goyal: So, are you seeing that inventory which got buildup has been dispatched almost now, it's almost 45 days past that quarter. Have we seen that happening?

Mayank Holani: Yes, mostly.

Manish Goyal: And what could be the number, if you can share that which probably could not get dispatch in the Q2 in terms of revenue.

Mayank Holani: It would be around 40 crores.

Manish Goyal: Mr. Mayank, you mentioned that there was certain ESOP cost in the employee costs because the employee costs seems to have gone up significantly to 59 crores. What was that ESOP cost and is it recurring?

Mayank Holani: So Manish, ESOP what is called worldwide Employee Share Options Plan, and this used to come every year till 2019. Last year due to the COVID impact that tactical action, this was withheld in addition to other cost saving measures. And as per the accounting rules, this cost is booked, the quarter whenever it is a given, it has to be booked in that quarter. So that cost impact is in this quarter only. It will not be recurring in subsequent quarters.

Manish Goyal: What could be that one-time amount Mayank which would have gone debited?

Mayank Holani: About 80 million INR, 8 crores. On a normal quarter basis if you see the employee cost would be in the range of 50-51.

Management: Manish, for this ESOP it's a combination of employee and employer contribution and the employer contribution is approximately 1 lakh per employee. So it's multiply by number of employees who have opted for it. How it's varying from year to year, it's a formula of the number of employees opting for it.

Manish Goyal: I'll just ask one more question and get back to the queue. You did mention that the momentum seems to be picking up in the economy. So, how do we probably see going forward in terms of order inflows and do we see this momentum what we have continuing in terms of I think 50% growth what we see order inflow is on a low base but going forward how do we see?

Sanjay Sudhakaran: Overall I think we should have a double-digit growth in orders through the year.

Manish Goyal: We would like to congratulate on the excellent margin management as far as gross margins are concerned in such a tough time, we have managed to control that. So, do we see that we should be able to keep the gross margins in control and then with growth in revenues we should be able to see the operating leverage benefit?

Sanjay Sudhakaran: On the gross margin side, I think it's going to be an uphill battle and it's too hard to predict which way it will go because of the volatility in the commodity situation that you see not just India but globally. It's going to be a battle that we are fighting day in and day out. We are doing our best to protect our contracts going forward wherever possible with variable pricing, with defined timelines, etc. We had done a lot of work even on the backlog in going back to customers and telling them about the difficulties which are there and being able, many of the customers have supported as well. So, I think it's going to be an uphill battle and it's going to be a battle that has to be fought every day. It's hard to put a number to it by saying that yes, we will be at this percentage or things like that.

Moderator: Next question is from the line of Harshit Kapadia from Elara Securities. Please go ahead.

Harshit Kapadia: In your initial remarks you had mentioned regarding four segments which you have highlighted where you are seeing good retraction. So, within these four segments just wanted to understand where do you see more traction for Schneider Electric and are there any product gaps within these four segments which you are looking to remove reduce it over the next one year?

Sanjay Sudhakaran: If you look at the ability of Schneider to serve these four segments, I will say that they are more or less the same and I don't see any major product gaps in our portfolio to be able to serve these segments.

Harshit Kapadia: Within the four segments where do you see the most traction?

Sanjay Sudhakaran: The most traction currently that we see taking off on the ground, see there are two things, one is a potential which is based on certain announcements that have been made or certain reforms that are expected to happen. Some of those initiatives could take time to take off the ground so you wouldn't be able to really predict in which financial year it would really take off this one or the next one. But definitely based on the investments and the decisions that have been taken in the past, I would say that cement and metals and transportation that is metros and high-speed rails and things like that, I think those things are getting off the ground pretty fast.

Harshit Kapadia: You also highlighted there were some supply issues where you are not able to deliver your products. So, do you foresee anything in Q3 as well which you could highlight, or this will be a much smoother quarter compared.

Sanjay Sudhakaran: You see it's quite a volatile situation when it comes to commodities both in terms of pricing and in terms of availability. For example, you can see from our strategy that we are trying to push more and more stuff onto the digital side, connected products, etc. There is a huge volatility as you would have seen in the market from some adjacent industries as well that there is pressure on electronics. There's a huge pressure on electronics and chips. So, we have a supply chain which is pretty robust globally controlled through a 24x7 control tower. Actions are in full swing to mitigate all possible risks not only from a revenue perspective but also from a customer satisfaction perspective. So, we are taking all those actions but there is a possibility of misses led by shortages, shortages not only in terms of the components but also in terms of availability of freight and shipping lines, etc.

Harshit Kapadia: Within the order inflow which we have announced for Q2 which is around 10 crore, would you be able to share which are the sectors we have seen the highest growth?

Sanjay Sudhakaran: I think we have seen the highest growth in terms of transportation, metals and also data centers.

Harshit Kapadia: Just to understand more on data center, how large is this opportunity for Schneider Electric? We are only in the medium voltage category in data center? Any number on that will be helpful.

Sanjay Sudhakaran: This company participates only in terms of medium voltage in data centers and the automation around medium voltage. But overall as a group, we participate in many areas which includes the low voltage, which includes UPS, which includes building automation products, a host of other things. So it's a pretty large and attractive segment for Schneider on a whole and this category is expected to grow double digit for the next 2 to 3 years.

Moderator: Next question is from the line of Nikunj Doshi from Bay Capital. Please go ahead.

Nikunj Doshi: Just one clarification. In annual report we had mentioned about export opportunity and related party one special resolution which we had passed. What is expected from those export opportunities and what kind of order book we are looking there?

Mayank Holani: Export opportunities we keep doing on mainly the RMUs and the transformers and as and when it comes. I think the special resolution which you are referring is for the purchases which was there. We expect that to pick up in the next 1-2, because that's a long lead time product that was for RILs and we expect it to come in the next couple of years. Because it's a product which takes at least eight months lead time from ordering to delivery.

Nikunj Doshi: So, this was related party for purchase we had passed that?

Mayank Holani: Yes.

Nikunj Doshi: We are not looking at export opportunities as such.

Mayank Holani: You must be referring to the resolution which was issued a couple of months back.

Nikunj Doshi: Because I think that was a mention that you have got some 25 crores export order and you may expect further export orders and that's why perhaps your resolution was required.

Mayank Holani: That was for import actually. If I recall correctly, it's for import.

Nikunj Doshi: In terms of the profitability when do you see company returning to profits, because I think our network is also eroded so any plans for rights issue or pumping in equity or any plans to raise resources on that side?

Mayank Holani: You see last year we had almost reached the breakeven level and with improvement in revenue we hope to improve it further this year. Once the revenues come back to normal, we should be positive.

Nikunj Doshi: And you mentioned that the order book is expected to grow in double digit. Double digit can range from 10 to 99, so can you be slightly more specific on what kind of order book growth we are looking at?

Mayank Holani: I think this year, if you see H1 we are at about more than 30% growth on order book, about 32% to be precise on outside orders. For full year basis we expect to be at least around 20% or more. For H1 we are at 32%.

Nikunj Doshi: And whatever new orders we are bidding for is raw material pass through consideration or still we have to bid based on the fixed price contracts only?

Mayank Holani: It depends on the nature of tender and the terms and conditions. As you know in public sector tenders you cannot change the terms and conditions. But now we are also covering sufficient question or provisioning for any uptick in the raw material price and inflation in the price. But again, that remains an estimate. You can do a best estimate only because if you keep too much of provisioning then your price will be too high than competitors. So, we have to strike the right balance.

Moderator: Next question is in the line of S K Damani from SKD Consultants Pvt. Ltd. Please go ahead.

S K Damani: Actually, I wanted to know from the management, can we report trading turnover and manufacturing turnover separately? So thereby we come to know that how much is manufactured by the company in-house in their works, and how much is procured and then sold. So, that will give us some idea as to is there any niche that the company has got in their own business in various verticals. Because the primary reason for asking to get this kind of detail is for the fact that the company has not been able to give some very good results. Our profitability is not there the business. So, can you kindly reply to me?

Mayank Holani: We are reporting as per the India required standards and the required data you have asked is already there in the annual reports as per the standards and the notes of the revenue. So, annually this information is published in the annual report, and you can track it.

S K Damani: What are the niche products that our company makes where there are no competition, or are all the products subject to competition only?

Mayank Holani: We are living in a competitive world. So we cannot say that any product is there where there is no competition.

S K Damani: Because when this company was formed it was told that it is a leading electrical manufacturing company of the world. So, what we thought was that this company will have no problem generating profits from that day. It was I think separated from TNB company which was there and from there this company was spring off. It's a story of before about 7-8 or 10 years. I may make some mistake. But I think this was a spring from TNB company which was there, from there it had spring off. Of course, I am a little late also in joining, can you kindly just highlight then when we are going to be becoming positive in all the quarters to come.

Mayank Holani: As I said earlier, last year were at the almost at a breakeven level, so we hope to continue the same journey. I think this year we should be positive. With sales improvement we should. And you see the order book is positive and consistently over the three quarters we are seeing good momentum in orders. As it turns into converts into revenue, we should see the improvement in numbers.

Moderator: Next question is from the line of Sonal Minhas from Prescient Capital. Please go ahead.

Sonal Minhas: I had two questions. First one was around the financials for this year. If you could strip out one-off cost from the overheads the employee costs and the expenses that could just help us understand the recurring in the one-off L1, that's one. And secondly, wanted to understand the contours of being around the L&T product business take over. If there is any update around that?

Mayank Holani: I will update you on employee cost, and then we'll request Sanjay to update on L&T side. So, the employee cost for the quarter is 588 and 81 million of non-recurring costs related to the share options. You can take about 510-515 million as a business-as-usual employee cost.

Sonal Minhas: And other expenses does not have any one-offs in that.

Mayank Holani: Other expenses, sometimes you have some old debts recovery or some provision like that, so it's as usual. And some of the other expenses are fixed nature while there are some like freight which are variable and directly proportionate to sales.

Sanjay Sudhakaran: On the L&T acquisition, I would like to remind you that it's primarily acquisition that is led by the low voltage synergies. The medium voltage overlap is very small and as things are progressing, we are working towards that, how do we leverage the synergies. Right now, it is a bit premature to talk about it. And as I mentioned before, the overlap is very small.

Sonal Minhas: I understand that. So, for us as minority shareholders are there some contours which we should be aware of, or this is still premature for me to ask that question as to what would be eventually the shareholding of minority shareholders in this entity? Just want to understand that. I understand because third party is a fund involved there too, so just seeking an update on the (34.39) deal for minority shareholders.

Sanjay Sudhakaran: I think nothing has changed on that landscape I would say. I think nothing has changed on the landscape of the minority shareholding pattern or anything of that sort.

Sonal Minhas: Two questions on that, just a follow up. We would continue to remain the same shareholding as minority shareholders. And secondly, there are no plans to de-list this entity. I am just asking specific questions.

Sanjay Sudhakaran: I cannot talk about the future. Right now, there are no developments on that up till date, but we cannot talk about the future because that's something that we do not want to speculate on.

Moderator: Next question is a follow-up from the line of Manish Goyal from Enam Holdings. Please go ahead.

Manish Goyal: We would like to know what is current order book and the breakup of debt which you can please share?

Mayank Holani: Our order backlog as of September end is about 845 crores and that about 69% is systems, 19% transactional and 12% services.

Manish Goyal: If you can please share the revenue break-up as well between IG and external and also give me the revenue share in systems and products please?

Mayank Holani: Revenue for this quarter was 70% systems, 19 transaction and 11 services. And from system about 18% is IG.

Manish Goyal: Also, in order inflow can you give me the IG and the break-up?

Mayank Holani: IG orders for the quarter stand at about 22 crores, 215 million and OG orders as I mentioned earlier about 3087 million.

Manish Goyal: I also wanted order inflow breakup?

Mayank Holani: Order inflow breakup from OG side, 54 and 12, 66% of systems, 19 transaction, 51 services.

Manish Goyal: On our strategy to increase revenue share from transactional products as well as services, somehow, we are hovering between around 30% between transactional products and services. Probably, we are not seeing that number going up.

Mayank Holani: What has happened is during last one and a half, this transactional strategy also depends a lot on the progress on our licensee partner and the contractor channel deployment which required a lot of approvals and validation of the partners from the end users, and which happened to be largely the government utilities and department. So, that activity has got delayed due to the last in one year or so because of the COVID people can't travel and go sit with the departments and get it approved. So, that has now started picking up from the last quarter or so. Because that is time taking. Once you are approved, your partner make is approved from any utility or department, then it will be quick improvement in the numbers from that model. And that's where the transactional model will flow.

Moderator: Next question is from Nikunj Doshi from Bay Capital. Please go ahead.

Nikunj Doshi: Just the related party resolution I got the annual report in front of me now. The members may note that the company has undertaken transaction for supply of GIS products with one of sister concern. And it says that GIS products and the products of about 270 million during the three months, and the order amounting to at least 2500 million. So, is it import or export we are talking of?

Sanjay Sudhakaran: It's import of the component which is largely the supply chain which is right now being followed in India because of the lack of…

Nikunj Doshi: It is mentioned that company has undertaken transaction for supply of GIS products.

Sanjay Sudhakaran: See, we import it from Germany and then supply to our end customers in India.

Nikunj Doshi: Sister concern to you.

Sanjay Sudhakaran: Yes.

Nikunj Doshi: I read it as exports. Sorry.

Sanjay Sudhakaran: That's why it becomes related party transaction, right?

Nikunj Doshi: Yes. But this statement gives the impression that you are exporting and not importing.

Moderator: As there are no further questions, I now hand the conference over to Harshit Kapadia for closing remarks. Over to you.

Harshit Kapadia: We would like to thank the management of Schneider Electric Infrastructure for giving us an opportunity to host this call. We would also like to thank all investors and analysts for joining this call. Any closing remarks, Sanjay sir that you would like to highlight, sir?

Sanjay Sudhakaran: I would like to thank everyone for taking time out to talk to us and to understand the progress that this company has made. I wish all of you a very good evening. Thank you.

Moderator: Thank you very much, members of the management. Ladies and gentlemen, on behalf of Elara Securities Private Limited, that concludes today's conference call. Thank you all for joining us and you may now disconnect your lines.