"ISGEC Heavy Engineering Limited Q2 FY2022 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to ISGEC Heavy Engineering Company's Q2 FY2022 Earnings Conference Call, hosted by Emkay Global. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhineet Anand from Emkay Global. Thank you and over to you, Sir.

Abhineet Anand: Thanks Steven. Good afternoon everyone, and on behalf of Emkay Global I would like to welcome you all for 2Q FY2022 earnings call of ISGEC. The management is being represented by Mr. Aditya Puri, Managing Director; Mr. S K Khorana, Executive Director and Company Secretary; Mr. Kishore Chatnani, Whole Time Director & CFO. We will have an initial opening remark regarding the results and the recent outlook by Mr. Aditya Puri, post which will have the Q&A session. I hand it over to Mr. Aditya Puri for the opening remark. Over to you, Sir.

Aditya Puri: Good afternoon everyone and thank you for joining us on our earnings conference call. I hope that all of you and your loved ones are all well and safe. This is our seventh investor conference call, and we look forward to a fruitful interaction. We have also uploaded our presentation on BSE, NSE and then on our website www.isgec.com earlier today.

For the benefit of the new investors and analysts joining for the first time, I will give a brief introduction about our business. As you know we are a diversified heavy engineering company engaged in manufacturing and project businesses. We manufacture process plant equipment, presses, and iron and steel castings. We execute turnkey projects for setting up boilers, power plants, air pollution control equipment, sugar plants, distilleries, factories, and bulk material handling facilities.

We have also developed strengths in construction. We address the requirements of a wide spectrum of industries mainly power, fertilizer, sugar and distilleries, oil and gas, automobile components, steel, cement, chemicals, railways, and defense. Our presence across multiple industries and geography helps us to spread any sectoral or geographical risks.

Let me now talk about our consolidated financial results for the second quarter of this financial year. The total consolidated revenue for Q2 of FY2022 is Rs.1,379 Crores which is about 2.5% higher compared to Rs.1,352 Crores for Q2 of FY2021. The total consolidated revenue for H1 of FY2022 is Rs.2,513 Crores which is 3.5% higher compared to Rs.2,426 Crores for H1 of FY2021. The consolidated EBITDA for Q2 of FY2022 at

Rs.50 Crores is however lower compared to Rs.148 Crores for Q2 of FY2021. The consolidated EBITDA of H1 of FY2022 at Rs.103 Crores is also lower compared to Rs.244 Crores for H1 of FY2021. The consolidated profit after tax for Q2 of FY2022 is Rs.10 Crores as compared to Rs.78 Crores for Q2 of FY2021. The consolidated profit after tax for H1 of FY2022 is Rs.24 Crores as compared to Rs.120 Crores for H1 of FY2021.

The profitability has been sharply lower due to a) in times of commodity price increase, b) time and cost overrun in EPC projects due to impact of COVID related disruptions coupled with shortage of skilled manpower, c) sharp increase in trade cost both for purchase of materials and supply of goods to customers, and d) normal employee cost as you know last year, we had salary cut. The major impact is due to increase in the commodity prices. As you may know steel prices for steel structures and fabrications are about 25% higher in H1 this year as compared to H2 of last year. Similarly stainless steel item prices are 30% higher during H1 of this year compared to H2 of last year. There has been a sharp increase in the price of motors, cables, accessories, transport, and electrical panels because of increase in copper and aluminium prices.

With commodity price hikes continuing the future looks uncertain. We also face difficulties in having adequate skilled manpower at project sites in spite of offering higher compensation and arranging transport and other facilities. Some difficulty continues in the current quarter also. Travel has picked up compared to previous quarters and airfares have also gone up, therefore travel costs have also gone up compared to last year. As you know last year, we had salary cuts in ISGEC Engineering Limited and ISGEC Hitachi Zosen Limited, but we restored normal salaries in December last year. So salaries are higher for this quarter as well as half year.

During H1 ISGEC Hitachi Zosen sales and profit was impacted as dispatch of some large equipment was deferred by customers as they could not arrange shipping. The equipment has been ready for some time now and the customer has also paid full advance, but revenue and profits will be booked only after this is lifted and billed to the customer. In case of Saraswati sugar mill, the year is looking good; however sales and profits have been lower during H1 as export quotas were completed in earlier quarters therefore total sugar sales are lower.

All of the above factors contributed to lower profitability. I will now talk about the order booking.

The consolidated order books for Q2 of FY2022 is Rs.849 Crores compared to Rs.1,396 Crores of orders booked in Q2 of last year. The consolidated order booking for H1 of

FY2022 is Rs.3,215 Crores compared to Rs.1,922 Crores for H1 of last year. The orders in hand as on September 30, 2021 are Rs.7,518 Crores as against Rs.6,761 Crores as on September 30, 2020. The order book position is very satisfactory of our consolidated order book 80% is for the project business and 20% for the product business. The order book includes Rs.926 Crores for export orders, which is just over 12%. The order book for ISGEC Hitachi Zosen is also good, it has Rs.537 Crores of orders as on September 30, 2021. Order booking for H1 is good and the overall demand trend is encouraging as the inquiry position is very good.

Of our order book about 40% is from PSUs. These orders have price variation clause and the price increase for some of the materials can be passed on to the customers. For the rest of the book we have six price contracts from customers, while we keep contingencies for unforeseen situations such as increase in material cost, variation, freight, and changes in design: however given the unprecedented increase in material costs and labor costs for sites and the extra time for project execution due to COVID related disruptions, the contingency certainly have not proved enough. The situation will continue for some time at some of the longer duration orders presently under execution, which will be booked before the increase in the commodity prices. So the new orders we have taken into account higher contingency and margins on costs.

Regarding the Cavite Biofuel's ethanol project in the Philippines we are on track to restart construction for the completion of the plant. We continue to think it is a good business and will be profitable to run though we will keep the option of selling it when it is complete. We have given special emphasis on vaccinations and also organized some camps for vaccination at our offices and factories. 99.55% of the eligible manpower, our employees and contractor workers have received the second dose.

I and my colleagues will be happy to answer any questions. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Vishal Prasad from VP Capital. Please go ahead.

Vishal Prasad: I have two questions. So the first one is, if I look at what has happened in our Philippines project, we as a company must have had internal meetings discussing the issue. Could you share why did we get into such a situation, could you also share the learnings and is there anything we have done to avoid getting into such a situation in the future.

Aditya Puri: So, as far as the Philippine project is concerned, we have been talking about it in the earlier conference calls, the project as well as supplies are concerned was very much completed. In fact more than 50% and more 95% of the supplies were at the site. The company was basically, I do not want to say, it was a private equity company, which decided to close its fund in the Philippines and because this project was still a little while away and they had made good money on their other projects they decided to in cash the bank guarantees and close the project as far as they are concerned. So I think one learning is that we will not be sort of going after projects which are purely private equity fund, it has to be a long-term promoter who will be in the project. As far as the project itself is concerned yes there might have been some weaknesses or there were weaknesses on Isgec' s side. But they were not significant, the main reason was that the person did not want to run the project.

Vishal Prasad: Right so generally when we look at private equity, they have a mandate of six, seven years that is the fund there is and then they have to return it back to the investors. So did we are in doing the due diligence while picking up the project.

Aditya Puri: So we did not earn, but the point is that they made good money on their projects and decided to exit and close the fund.

Vishal Prasad: And the second question that I have is if I look at the company level for last 10, 15 years we have been very strong in manufacturing but over the last 10 years we have primarily focused on EPC and manufacturing is at the same level where it was few years back, So, could you share your thought process behind we not looking for getting into new domains or getting some building some capability in new areas and manufactured.

Aditya Puri: Yes, I can certainly share. So we have been doing marginal investments to increase the manufacturing capacity and as and when demand is picking up, I have to say that the manufacturing facilities are pretty full. So certain expansions that we had done spent marginal amounts of money, so therefore you may not know about them there were marginal amounts but some increase in turnover for next year from manufacturing can certainly be expected. And we as a group are also looking at investments in manufacturing so as to increase the manufacturing output.

Vishal Prasad: And the last question is on EPC. So generally in our country there are few good years and then the EPC contractors they suffer because of one reason or the other. We have been generally prudent with our projects but when you think about risk, what kind of risk you think and how do you try to mitigate it so that we do not get into a situation where we are into a suit.

Aditya Puri: So as far as risks are concerned for any project which is above a certain size and the size is not very large we look at a lot of factors including the financial status of the potential buyer or the potential customer, let me put it that way, his financial arrangements our technical capabilities our engineering capabilities our capability to execute the project within the costing of the project, the timelines of the project and if there are any technological risks associated with the project, is it a repeat project is it a new project we look at that and we also then keep a contingency for unknowns. But the sort of hike that we are seeing in the commodity business and EPC is a lot dependent on commodities has been quite unprecedented and we could not have foreseen in that.

Vishal Prasad: Right so whatever happened in the past with other companies so is there anything that we have learned from them and we have implemented in our company so that we do not get into a problem.

Aditya Puri: So one of the things that we have implemented is quicker implementation of the projects and to do more engineering upfront so that ordering can be done very fast after the project is awarded and to monitor the projects very closely and to be very clear on certain clauses that customer delays will cause delays to us and they need to be compensated by the customer.

Vishal Prasad: Thank you Sir. Thank you so much.

Moderator: Thank you. The next question is from the line of Deepesh Agarwal from UTI AMC. Please go ahead.

Deepesh Agarwal: Good afternoon gentlemen. Sir, my first question is by when do you expect this commodity headwind to be behind us in terms of margin.

Aditya Puri: So the point is that we are taking orders on the basis of new commodity pricing we are keeping a slightly higher contingency also but this commodity price hike is happening, how long it is sustained for, we cannot say at this point in time. So the orders that we have taken in Q2 are based on higher commodity pricing, but I hope there is not yet another shock that might happen. It would take a little while at least one or two more quarters for it to stabilize.

Deepesh Agarwal: So would it be fair to say FY2023 should be a normal year for us in margin and we could be doing something like 8.5% to 9% margin out there.

Aditya Puri: It should be a normal year, yes.

Deepesh Agarwal: Sir, second question was if I look at your ordering for the quarter this seems to be a quite weak number especially when there was a strong ordering momentum in the industry for your segment, any particular reason for your market share loss on orderings.

Aditya Puri: No the order book in Q1 was huge. There was a lot of EPC contracts and other contracts you give the bid and the price bids could be open much later so we have taken orders on the basis of our comfort level to execute the projects. And we have enough orders in all our segments to execute comfortably for the foreseeable future. So if it has been a conscious decision to keep order booking a slightly lower in this quarter.

Deepesh Agarwal: And sir lastly actually since last couple of quarters you have been highlighting that you will start a construction on the Philippines project again. So what are the timelines in terms of starting of the construction and completion of the project and also can you share with us what is your balance sheet exposure to this project from a consolidated level, so when I see capital employed of this under construction project that is just Rs. 110 Crores so just figuring out what is the total exposure for ISGEC.

Aditya Puri: As far as the Philippines project is concerned, as I had said last time and between last time and this time the changes that COVID continued in the Philippines in fact a lot of our own employees including the head of our unit was impacted by COVID. So that is why things got delayed. But we do hope that in the next 30 to 45 days we would be able to start construction and the timelines are after we start construction within 10 to 12 months, we should be able to compete the project. And Kishore if you want to add.

Kishore Chatnani: Yes, let me tell you, you are asking about the balance sheet our annual reports gives a breakup there, but I can just tell you as of 31st of March the value of the plant under construction is about Rs. 723 Crores but if you are asking about our exposure, the ISGEC standalone is owed about Rs. 254 Crores by this company that is Cavite Biofuel's.

Deepesh Agarwal: That is sitting in receivables right.

Kishore Chatnani: That is sitting in receivables, that is right.

Deepesh Agarwal: So a Rs. 726 of which Rs. 254 is receivables and you would be having some debt on this project right.

Kishore Chatnani: Yes, we do have some $38 million of debt.

Deepesh Agarwal: Understood and what would be the final price after completion from this Rs. 726 Crores means expected price.

Kishore Chatnani: That is a function of the market if we did not have COVID we would have hold it on the long back now we are still exploring the market. So ideally, we would like above $100 million but it has to be seen. It will depend on when we are able to sell it which means if it gets sold while before the construction starts or after the construction starts or when it is completed, and it will be depended on those three situations as to when we can find a serious buyer.

Deepesh Agarwal: Fine that is it. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Shruti Nayak from Bliss Consultant. Please go ahead.

Shruti Nayak: I wanted to ask how has been the performance of Hitachi and Canadian entity in this quarter.

Aditya Puri: So financial phases of Hitachi's Zosen has not been good and the primary reason for that has been that three major customers have not been able to ship out the goods. The goods are ready, we have been paid for, but they have not been able to ship out the goods and therefore the revenue and the profit has not been booked. So that is regarding ISGEC Hitachi Zosen and as regards Eagle also faced problems because of the slowdown in the automobile sector not because of demand but because of a shortage of chips in north America. So there was a small loss in this quarter but going forward we do not expect any, we expect positive EBITDAs.

Shruti Nayak: Thank you so much sir, and another question is like what would be our market share in this sugar distillery business and domestic market.

Aditya Puri: Maybe about 15% or so.

Shruti Nayak: All right and one more last question Sir like can you throw some light on our initiative on the green side like so how we are looking at turning the company into a greener company and are we looking at fuel cells hydrogen or some greener technology.

Aditya Puri: Yes, we are evaluating future gains, evaluating energy storage in various forms,. The technological developments you hear about it a lot in the newspapers but there to position ISGEC we are working on that.

Shruti Nayak: Perfect Sir, thank you so much and all the best for the future quarters.

Moderator: Thank you. The next question is from the line of Yachna Bhatia an individual investor. Please go ahead.

Yachna Bhatia: So my question was basically coming back to this commodity price increase. What we had understood from the last call was that Q1 was a subdued quarter and by next quarter and for the rest of the year we were expecting to come back to 12%, 13% kind of margins in the manufacturing segment and 7% to 8% in the EPC segment but Q2 again has been subdued and from what I hear on the call today it is likely to be so for the rest of the year. So my question was one on the fresh orders that you are booking right, now how are you placed in terms of any future commodity price hikes, because if we are indeed in a commodity super cycle as it is being called then we are going to run into a similar problem next year as well. And my second question was that on the existing orders itself what we hear from other companies is that they have other companies in the sector, but they have been able to renegotiate the order terms with the customers and at least partly able to pass on the commodity increase. So why is not that the case for us as well.

Aditya Puri: I will answer your second question first, we are also trying to renegotiate with customers, but we have not taken any credit for that and I am not sure how much success we will get over there it also depends upon customer to customer, but I do not know how many customers actually renegotiate a fixed price contract. And as far as the commodity price cycle is concerned, I do understand that this cycle may continue for a while. So we are being cautious to take orders at higher margins keeping higher contingency but there is no guarantee to be frank about the extent of the hike. People are saying that it is probably leveled out now or they are going to be only a very marginal increases before there is going to be a fall, but one never knows how it is going to be. So this is a real problem in the capital goods sector that we are grappling with frankly. But as of now the new orders that we are taking are at an increased price and covering the hikes that we have.

Yachna Bhatia: So are you saying that the new orders continue to be fixed price and if there was such an increase in commodity, we will be in a similar problem again.

Aditya Puri: So we have started asking customers and some customers have agreed to a steel price escalation in the contract. But the private sector is going to change slowly for it slowly and but wherever possible we are trying to get these clauses incorporated.

Yachna Bhatia: And just a last clarification so Q3 and Q4 you expect margins to be subdued only.

Aditya Puri: Q3 yes certainly Q4 I cannot say just now but Q3 yes.

Yachna Bhatia: Sure thank you.

Moderator: Thank you. The next question is from the line of Aryan Mehta from Mehta Consultant. Please go ahead.

Aryan Mehta: Good afternoon. Can you throw some light on what are the kinds of segments or industry from where we will see good order inflows and also which of them would be lagging?

Aditya Puri: So Automobiles is one which is likely to lag but power, steel, cement, railways and all metals these are the segments I think where growth can possibly come from.

Aryan Mehta: And how is the order booking for the FGD segment going on can you share some details and numbers on that.

Aditya Puri: So FGD segments we have not had any major order in the last quarter but there are inquiries for air pollution control equipment, and which may be FGDs or maybe some derivative of other pollution control equipment which are likely to be finalized soon.

Aryan Mehta: And also coming to the government and private sector, so how do you see a mixed change as private capital expenditure is expected to increase with a like the economy is growing so your views on that.

Aditya Puri: I think private will not dominate but the share of private sector investment should improve.

Aryan Mehta: And my last question would be related to joint ventures, so I mean in the current year how do you expect them to perform.

Aditya Puri: We expect for the year-end we expect them to perform reasonably well, Eagle may show a slight loss for the year end but otherwise all of them should performed well.

Aryan Mehta: Thank you all the best.

Moderator: Thank you. The next question is from the line of Manish Goyal from Enam Holdings. Please go ahead.

Manish Goyal: On continuing on the order pipeline would you be able to quantify like how big is the order pipeline in value terms and which are the largest segments within that.

Aditya Puri: So the order pipeline is good from power, steel, cement, railways. It is also good from oil and gas, refineries, there is lot of inquiries from there, the inquiry flow is pretty large at this point in time. Kishore would you just like to add anything here.

Kishore Chatnani: Fertilizer, cement.

Aditya Puri: Fertilizers, yes.

Manish Goyal: Okay, no, sir what I was trying to get a perspective was in value terms how would you see that the pipeline order value and how would it compare with the last year, just to get a sense that what kind of growth is there in the order pipeline.

Aditya Puri: So right now our order book, if the figures are right, is about Rs. 1,000 Crores more than at the end of the year right Kishore.

Kishore Chatnani: Right sir, but he is probably wanting to know about the pipeline.

Aditya Puri: So pipeline is also, I would say would be about 10%, 15% higher than the corresponding period of last year. The pipeline is higher and pipeline in terms of inquiries from exports have also gone up.

Manish Goyal: Yes, in fact that was my follow-up question because Sir in recent past we have been saying that export order book as well as export revenue has been on declining curve so how do you see that going forwarded like for the export.

Aditya Puri: Going forward we see in the next couple of quarters maybe beginning Q4 already we booked some export orders but beginning Q4 I think the momentum should catch up as more and more countries are allowing us to enter now, including the US and a lot of other countries so we are just in the process of now beginning to send our people abroad for marketing efforts. So for instance we have posted one person to Southeast market because it is very difficult for people to commute so we have now stationed somebody there and for the other areas also we will be coming out, we are deciding a strategy as to or we decide this strategy as to how to increase the exports.

Manish Goyal: Right Sir, thank you so much.

Moderator: Thank you. Next question is from the line of Ankit Sancheti from Kotak Asset Management. Please go ahead.

Ankit Sancheti: Hi, Sir two questions from my side. The first question is regarding your order book, you mentioned that 40% of orders do have a price variation clause but typically even those orders will not be sufficient, and we have seen in the past that even with price variation clause there is still something which is not covered, and one needs to absorb that and on top of it you have 60% contracts which are fixed price contracts. so why we cannot do much about the backlog but strategically speaking over the next couple of years do you want to change that mix to a more dynamic model where we can have more price variation clause orders, or the structure of industry does not allow you to change the mix and it will remain and ultimately, we have to bear either the benefit or the cost of RM.

Aditya Puri: Yes, so your second point is valid, we would like to minimize our risk. But there are two spectrums to it, one spectrum to it is that projects which you would have normally taken under normal circumstances, you would have taken right now some of those projects you do not take because you think that the risk reward is not in your favor. And the other thing is that you try and get customers to incorporate escalation clause in their contract but this is as you said the buying behavior of the customer and the selling behavior of people like us has to change and so we have started doing it, we have got some success. And hopefully more our competitors will also ask for it and we may be able to persuade our customers to accept it.

Ankit Sancheti: And just trying to understand on the order backlog, 20% are typically equipment order is what you mentioned is that right.

Aditya Puri: Yes, products yes you are right.

Ankit Sancheti: So at least on those orders we would have been able to minimize the impact.

Aditya Puri: There is some impact, the impact is less on those orders.

Ankit Sancheti: Because the execution cycle is lower for those orders equipment orders you make and sell.

Aditya Puri: The execution cycle is also lower and because there is a lot of manufacturing involved in it the materials cost as a percentage of the order is also lower.

Ankit Sancheti: My second question was with respect to how the reporting happens from an accounting perspective so when I see your consolidated results obviously, we are going to start constructing that ethanol plant. So just trying to understand if I look at the segment revenue there is a Rs. 13 Crores of negative value which is attributable to that plant in this quarter and then the segment results reports Rs. 17 Crores of negative EBIT because of that so how does the accounting happen for this plant because progressively once we start constructing this plant are we going to continue to provide for losses for the same till the time it is eventually sold out or ideally can we capitalize this plant and then book a net profit or loss at the end whether it gets sold or it does not get sold so just trying to understand from an accounting perspective how this is going to shape up in next few quarters till the time your execution of construction of that plant happen. Thanks.

Kishore Chatnani: Let me answer that, please. So presently construction is not going on but there are certain expenses which are being incurred relating to salaries of some people we have there, security and safety insurance and those kinds of expenses are there which we are charging of to some of the clause that you are talking about is because of that. The other major part of loss is because of the change in the exchange rate between Philippine Peso to dollar to rupee and so on. So and that can come positive or negative. But you are right, once we start completing the plant, we are able to capitalize whatever further investments are made for implanting machinery and construction and because today there is no construction happening so even the salaries and all the other overheads that we are incurring we are charging to P&L we are not capitalizing that. I hope I am able to answer.

Ankit Sancheti: Yes, it partially answered my query but just extending that point so if I look at the last quarter the June quarter, we had - a loss of 6.5 Crores and this quarter it has increased to 17.5 Crores, so the employee cost the salary cost and all the other…

Kishore Chatnani: It is largely Forex variation. It is an accounting loss; it is not actually a cash loss.

Ankit Sancheti: Okay and second question is on unallocated expenses, they have increased materially on a Q-o-Q basis from 2 Crores to 14 Crores what else I am missing here.

Kishore Chatnani: We will have to help me understand what is it that you are talking about.

Ankit Sancheti: So I am just trying to understand what has led to such a sharp jump in unallocated cost on a quarter-on-quarter basis from 2, 2.5 Crores in Q1 to 14.5 Crores…

Kishore Chatnani: I am not able to find, I am not able to correlate what exactly you are talking about from the results, which page of the results you are looking at.

Ankit Sancheti: I am looking at page no. 16 the segmental reporting which happened on which we have unallocated expenses.

Kishore Chatnani: For this quarter.

Ankit Sancheti: Yes, absolutely for this quarter only for Q2 FY2022.

Kishore Chatnani: You can give me a few minutes to look at that and come back maybe we can answer that question little later in the call.

Ankit Sancheti: Sure Sir, that is all from my side. Thank you very much, Sir.

Moderator: Thank you. The next question is from the line of Anshul Saigal from Kotak AMC. Please go ahead.

Anshul Saigal: Regarding the raw material cost impact that we have spoken of during the call, if we look at the EPC business that is a long cycle business while the manufacturing business is a short cycle business and even in manufacturing on a year-on-year basis as also on a quarter-on-quarter basis we are seeing a meaningful impact on margins now is that again I mean while an EPC one can understand that it is long cycle so and plus we have fixed price contract so there will be variation but in manufacturing is it only raw material or there is also other costs which have gotten added.

Aditya Puri: It is basically raw material and also manufacturing. If you see the half yearly results it is also impacted because the turnover was lower because of COVID and oxygen not being available and all those other factors. So as the turnover has started picking up in the second quarter. In Q3, Q4 the turnover should be good. So at least the overhead absorption would be better and to that extent margins would be better. Steel price hike again is unpredictable but overhead recovery would be much better than Q3 and Q4.

Anshul Saigal: How much of our contracts in manufacturing are fixed price do we have some room to pass on raw material cost here.

Aditya Puri: Manufacturing unfortunately everything is fixed cost.

Anshul Saigal: And as we book an order, we do not book back to back our raw material.

Aditya Puri: So our policy is that as you book an order you try and order as quickly as possible but what happens is a certain amount of engineering has to be done before ordering can be done so that time lag is there but as soon as the engineering is completed which as I said earlier also, we are trying to expedite the orders.

Anshul Saigal: Okay the question arose mainly because of the timeline of execution of these orders which is probably under 12 months maybe even eight to ten months and still there is a significant impact, so that is really where I was coming from.

Aditya Puri: No so I just answered that question for you also that between 90% and 95% are all engineered to order, there is a very small segment where we can keep stock or we know what to exactly order on the day we get the order and just say that the quantity is increased from just order this much it does not happen back unfortunately.

Anshul Saigal: Got it. My second question is that of our Rs. 867 crores revenue in EPC how much of that would boilers be, about 200, 220 for the current quarter.

Aditya Puri: Yes, something like that.

Anshul Saigal: Now in which case, that means that in the EPC we have incurred a significant loss would that be a fair assumption on account of raw material because I am assuming that in boilers we would be making somewhat similar to manufacturing margins and given that we have only about 1% EBIT margins in EPC, in the actual EPC business we would have incurred a significant loss.

Aditya Puri: No, so boilers we do not manufacture more than 15% of the boiler the rest is all like any other project. It is not that the boiler is manufactured in Yamunanagar or in any of our manufacturing units some pressure parts are done but rest is all outsourced.

Anshul Saigal: Correct but it is all fabrication right like the pressure vessels which we have in manufacturing, so it would be more or less all fabrication and in manufacturing we are even at this time making 8% margins.

Aditya Puri: So those pressure vessels are the only thing that we manufacture which is about 15% of the value of the boiler, the rest are not fabrications those are all bought out so it could be fans, motors, structures, erections, civil all those.

Anshul Saigal: Okay and so you are saying that even on that count there has been a price escalation which has not been passed on.

Aditya Puri: It is not like manufacturing; it is not like that we are manufacturing the old boiler.

Anshul Saigal: And my final question can you just throw some light on the future technologies say batteries, hydrogen, etc. what is the strategy on that. Because I did read in the annual report that we are targeting some of these technologies and we are working around the strategy on these technologies.

Aditya Puri: Right so we are looking at what value at hydrogen could provide or batteries or the energy storage of other forms other than batteries, then energy saving, investments in energy saving and also the way the buying behavior is going to change because at sites it is becoming very difficult to work, so our people going to do more work in shops. We are looking at that how is digitization going to affect our products. We are looking at it and we have to place Isgec at the right place as a right thing because a lot of these things are very nascent world over also and so we cannot be paying a very high amount to get a technology which the world is not very sure of. But we are regularly having technology meetings to see what is going on in the world and where we can place ourselves.

Anshul Saigal: All right I will come back in the queue. Thank you.

Moderator: Thank you. The next question is from the line of Nishit Shah from Aequitas Wealth. Please go ahead.

Nishit Shah: Good evening Sir. Sir I want to understand this point about shortage of skilled labor so how are we dealing with this and what kind of cost increase are we seeing over here.

Aditya Puri: So we are very proactively trying to get labor organize transport, organize vaccinations if they have not been vaccinated before they come to the site. Labor which used to be generally available contractors who used to have labor we are seeing that currently people have got used to staying at their native places and less number of them are willing to come to site to work so basically, I cannot quantify the number for you right now, but we are seeing, but to pay people more and we have to get more people to make up for the last time and generally speaking this scarcity has and will create some problems in the times to come.

Nishit Shah: So is it improving.

Aditya Puri: It is improving, it is definitely improving.

Nishit Shah: Okay thank you.

Moderator: Thank you. The next question is from the line of Digant Haria from GreenEdge Wealth. Please go ahead.

Digant Haria: See we are running full on order book and probably we are seeing the worst of commodity inflation and labor inflation. Can it be the case that maybe next 12 months we just operate at very low EBITDA margins and negligible profits that is my question number one and question number two is that in the new orders what kind of inflation are we building, let us say the steel prices goes up even more from here and we bid orders based on today's steel prices maybe even the future order books we do not see meaningful accretion to our EBITDA or profit. So these are two questions from my side. Thank you.

Aditya Puri: So this is really a dilemma that we are also facing and therefore we are being a little more selective in booking orders. One thing is to say that you do not book orders now let the cycle stabilize and then we will see what to do. But I do not think that is a very prudent strategy to adopt, so there is a little bit of a risk involved in taking orders at this point in time. There is a point there is a tipping point when the economy will not be able to sustain these, or the world will not be able to sustain these commodity price hikes. There is no very clear explanation as to why it is happening to the extent that it is happening. Is it just pent up demand after the pandemic and that is causing it or is it because of the excess liquidity that various governments have pumped into the economy, once that effect leans out commodity prices will fall, so like nobody expected them to rise this fast nobody is talking about a call right now, but it might fall also. While the next one or two quarters remains uncertain my own feeling is that this cycle should reverse itself soon but that is just my own personal gut feel, but yes there is an element of risk in taking orders right now.

Digant Haria: Sir just one follow-up to this that, let us say commodity inflation and labor inflation both is not in your hands, you cannot be held for it in any way because it is not in your hand but if both of these things stabilize in the future, has our operations and has our learning and our execution skills improved in most of our areas that we can see 6% EBITDA margins in EPC business and maybe 10%, 12% in our products business if these two external factors were to stabilize.

Aditya Puri: Yes, things will certainly improve and as far as the labor price inflation is concerned it is more at sites at remote locations because people do not want to leave where they are as far as our factories and all are concerned, we are not facing any significant inflation or shortages of labor.

Digant Haria: Okay sir so I get it that if things improve, we will see those 6% and 12% which we generally is our objective overall.

Aditya Puri: The things improve, the margins improve yes.

Digant Haria: Okay Sir thank you all the best.

Moderator: Thank you. The next question is from the line of Shruti Nayak from Bliss Consultant. Please go ahead.

Shruti Nayak: Sir just wanted your working capital has elongated due to higher share of government sector orders so what is your thought process on the same and will the working capital decline in future.

Aditya Puri: Kishore would you like to answer this.

Kishore Chatnani: Yes, your observation is right we have more working capital now because of higher PSU orders. Earlier if you remember maybe about two quarters ago the order book was 50%

nearly 50% was from PSUs, the percentage of order book from PSUs was declined to about 40% but most of these projects the payments are linked to milestones, so even though we spend money in cement steel and all the other materials supplied to the site the payments become due once we complete certain milestones. So as of now we have several projects which are large value projects, and which are at an advanced stage of implementation where these milestone payments have become very large.

Kishore Chatnani: So in normal terms we would not have taken the same payment terms from private customers but from PSU companies we certainly know that the money is there with them and they will pay. There is no issue about safety but yes there is a situation where we are borrowing from banks, of course all the interest costs were always factored in we knew when we took those projects that there will be some amount of cash flow and the working capital increase of course because of this COVID and some stretch on these project implementation timelines that got a little more pronounced.

Shruti Nayak: Alright Sir thank you.

Moderator: Thank you. The next question is from the line of Shiva Musumalla, an Individual Investor. Please go ahead.

Shiva Musumalla: My question is related to that ethanol we are supposed to start from the end of November. So what is the revenue and the profitability expected in this quarter from that ethanol plant and the second question is regarding the margins like what kind of margins we are expecting in Q3 maybe similar to Q2 or maybe performance will be improved in this quarter Q3 maybe slightly better than Q2.

Aditya Puri: Q3 I would not be able to tell you exactly but as far as ethanol plant is concerned the plant is all ready, we are just waiting for one excise license to come which we expect should come soon Kishore can you help me with the revenue, we will not be able to tell you the profit but the revenue from that operation

Kishore Chatnani: For the ethanol plant which will start hopefully soon maybe in about two weeks' time and this quarter will be very small for that plant. So that we would not really expect any revenue in this quarter.

Shiva Musumalla: Maybe yearly not maybe in quarter how much that is from the next year onwards to the expect ethanol plant.

Kishore Chatnani: Yearly revenue is about Rs. 200 Crores.

Shiva Musumalla: Sir regarding margins you said like Q3 might not be similar to Q2 and maybe Q4 onwards we could see some improvement.

Aditya Puri: We are hopeful to see some improvement.

Shiva Musumalla: Thank you.

Moderator: Thank you. The next question is from the line of Yachna Bhatia, an Investor. Please go ahead.

Yachna Bhatia: My question was that this commodity price inflation is something which is affecting the entire sector but if I look at the operating margins last two quarters, we are at the lowering end of the range the rest of the sector is largely starting from 6%, 7% to 12%, 13% so why is it so that we are more affected compared to the rest of the sectors. I wanted to hear your thoughts on that.

Aditya Puri: So we have done more work in the EPC segment than we have been in the past few years and also as I said earlier that we got into some new businesses which were new on the learning curve like FGD's and other businesses and the new orders in these segments are at better margins so we do hope that barring commodity price increase we would be able to perform better.

Yachna Bhatia: Sure, thank you.

Moderator: Thank you. As there are no further questions, I now hand the conference over to the management for their closing comments. Over to you, Sir.

Aditya Puri: Thank you everybody for being here and thank you for attending the conference and we do look forward to virtually meeting you again after the third quarter. Thank you and stay safe.

Moderator: Thank you. Ladies and gentlemen on behalf of ISGEC Heavy Engineering that concludes this conference. Thank you all for joining us and you may now disconnect your lines.

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