“Mahindra EPC Irrigation Limited Investors Conference Call”

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MANAGEMENT: MR. ASHOK SHARMA – MANAGING DIRECTOR

Moderator: Ladies and gentlemen, good day and welcome to Mahindra EPC Irrigation Limited Investor Conference Call.

As a reminder, all participant lines will be in a 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. Ashok Sharma – Managing Director. Thank you, and over to you, sir.

Ashok Sharma: Thank you very much. A very good evening, ladies and gentlemen, and a very, very warm welcome to all of you at the eighth investor call for Mahindra EPC Irrigation Limited. On behalf of Mahindra EPC, I would like to thank each one of you for joining this call, and I am sure all of you had a wonderful Diwali and a very nice start to the New Year.

Today, I will briefly talk about the industry in terms of how the micro irrigation industry is impacting Indian agriculture and the impending water crisis, then will talk in more detail about how the industry is performing in H1 and outlook of the industry, and how we see Mahindra EPC's performance, and going ahead, how does it look for our company?

I normally start my talk on how this business impacts the environment and how crucial it is in terms of creating enough water in the system. As all of you are aware that India is facing huge challenges of water scarcity and population explosion, and we are moving from a water-stressed to a water-scarce economy, and it's only going to get more challenging as the country's population is expected to increase to 1.6 billion and very soon will be the most populous country in the world.

Now agriculture consumes almost 80% of the freshwater available in our country. So, there is no option for a country like ours but to save water in agriculture. One of the best ways of saving water is through micro irrigation. And over the last few decades, we have seen that traditional practices have had ill effects on groundwater quality, soil health and crop productivity. And that's where micro-irrigation becomes very important. It not only saves water but also increases yields and lowers the input cost for the farmer. Water goes right into the root at the correct time in the correct quantity reducing overall losses. As a result of this, there is much higher productivity and improved cost efficiency for the farmers. We have seen water savings of 75% to 80% and a 25% to 30% increase in yield by using micro-irrigation. So, that was briefly about the industry.

Now, let me just talk about Mahindra EPC to understand the company's strategy. As per our overall vision, we are excited about the whole industry in terms of its impact on the environment, our commitment to ESG, and sustainability, and making a difference in the lives of farmers by improving farmer prosperity.

We have always focused on customer satisfaction. We have used the latest technology in water management so that our farmers get the right kind of drips with the proper technology and can use it efficiently. This has been our effort for many years. Our focus on good design of micro irrigation solutions, proper installation and explaining benefits to the farmer has been our broad strategy, which remains unchanged.

In the last few years, I have mentioned that we are now focusing on a very precise strategy of focusing on a few critical markets, where we have also seen a year-on-year increase in our market share. Consciously we have been moving to a more profitable portfolio which is largely drip driven. And over the last few years, we always are very mindful of our working capital, and we have tried to maintain the balance of growth and working capital to manage the company in a balanced way.

In the last 2-3 years, given the challenging environment, the focus on cost reduction has been phenomenal. I am very happy to say that we have had success in lowering our costs. We are also using this opportunity to move into non-subsidy businesses which I will talk about later.

Now let us talk about the industry for this year:

All of you who are following our company, know for a fact that the last two years F21 and F22 have been very challenging years for the industry in terms of growth and margins. And in H1 of F23, the challenge continues. The industry has declined in H1, we estimate a decline of around 25%, largely in Q2. The main reason as per our analysis is the drop coming from Tamil Nadu. Last year in H1, Tamil Nadu had an overall industry of approximately 300 crores, and our company has a dominant position there with around 10 % to 12% market share. This industry has dropped by around 90%. So, there was virtually no business in the first few months. Some business has recently started. So, that has been one big contributor to the drop in the industry in H1 and largely Q2.

The second reason has been Maharashtra. Maharashtra has been impacted due to some delays in subsidies released to the farmers. So, new farmers are not easily joining in.

Though we have a strong brand in Maharashtra but in Q2, because of incessant rains, there was less opportunity for companies to install solutions, and that also impacted the industry in certain states like Maharashtra.

Now on the positive side, during last call those of you who were there will remember I explained in detail how we are expecting price increases from certain states. And on the AGM call also we talked about it. So, I am happy to share some data, which is showing a positive trend in the price increase. In June of this year, Gujarat, which is an important market for the industry, increased the prices, Telangana and Chhattisgarh too increased the prices, towards the fag end of June, the impact of which came in Q2 for us and the industry. And we also mentioned that Tamil Nadu and Andhra should be increasing the price very soon. In August-September, they also increased prices. So, that is very positive for the industry, and that should do well in the coming quarters.

Having said that, the raw material cost remain a challenge. In Q2, there was an increase of 24% in raw material prices. However, in the last 8 to 10 weeks, we are seeing some stability in the prices, and there are opinions that now the price increase should not be as steep. Perhaps it will be stable or might have some minor corrections. So, this is on the industry for H1.

When I look beyond with a 2-3 years perspective, I can see that this industry should go back to levels of F20, and F21, and there will be a good surge in the demand for micro irrigation from various states. We are already seeing some encouraging signs.

For example, Andhra, which has been very passive for the last two or three years, has now resumed operation. We expect Andhra should contribute almost 300 - 350 crores in H2 as an improvement over last year. And the same with Tamil Nadu which has now started operations. So, that's on the positive side. Telangana is also now focusing more on micro irrigation. So, we expect some good business there.

We expect some delay in Gujarat with elections being announced. From mid-December onwards, we expect Gujarat to again come back on the growth path.

One state which is still not picked up is Karnataka. As per our understanding, other states are now all looking green. And if Karnataka also starts improving, then that's even better for the industry. But the positive news which I see is AP and Tamil Nadu, which are big states, have now resumed operations. Prices have gone up and raw material costs should now be stable. That's the essence.

Now let me talk about Mahindra EPC in specifics in terms of how we have done in H1. The results have not been as per our expectations. There has been a degrowth of 20% on the top line which we believe is in line with the estimated industry degrowth, which is around 20% - 24%. Since we have a good business in Tamil Nadu, we were also adversely affected. We have a shortfall from Tamil Nadu which overall has been the main contributor to our shortfall.

Now let me give you some specifics on the raw material price. If you look at H1 of this year, there has been a raw material price increase of 23.5% over the same period last year, whose actual impact on the material cost is 12.4%. So, the impact on our margin is 12.4% in H1.

For us, due to the various initiatives taken like focusing on profitable markets, focusing on drips, and a very strong drive on material cost saving, coupled with some price increase, we could contain this 12.4% impact to only 3.8%. The balance we could manage largely due to our internal measures and some support on the price increase. For the two months of July and August, the price increase impact was still not fully received by us. So, as a result, our loss after tax increased from 4.9 crores in H1 of the previous year to 14.6 crores for this H1.

On the working capital front, the company could show significant improvements. We could reduce our debtors significantly by almost 40 crores. Despite the losses, because of the efficient working capital, we could report a positive operating cash flow for H1. Given the environment and the industry, this seems to be a good balancing of our balance sheet in terms of managing working capital efficiently and good cost control so that the impact of the raw material cost was minimal for us.

In Q2, we had a larger degrowth. Again, the challenge was the Tamil Nadu market. Also last year we had an export order in this quarter, which was not there this year. So, these two resulted in a 53% degrowth in Q2 and the corresponding impact on the bottom line.

So, now when we look at the remaining year, what are the positives? Positives are price increases, Tamil Nadu and AP resuming operations. What are the risks? Material costs should not go ahead further. It should be stable or should improve. In Karnataka, currently, we are not assuming that it will become very dominant in H2. So, as a result, we expect that the industry in H2 should be favourable, and we should make up for the drop which we have seen in H1 of 25%. And in a reasonably optimistic situation, we might reach around 5%-10% industry growth for the year, but for that, AP & TN needs to be fully operational. If that happens, then we can expect 8% to 10% growth or otherwise, between 5% to 10%.

So, with a growth range of 5 % to 10%, an increase in prices and the assumption of no further increase in raw material cost, we should see increased margins in H2.

We have done many things to make the company leaner and stronger in terms of focusing on profitable markets, profitable products, focusing on non-subsidy businesses, tight focus on cost, and a sharp focus on working capital. And as a result, our company has become now much more ready to exploit the growth opportunities which are coming ahead. And as the industry now is poised for growth, we think we are in a good position to maximize the gain and create value for our shareholders.

So, with this, I will pause for now. I would like to thank each of you for your patient hearing, and I will be very happy to hear your comments, suggestions, and questions and share our perspectives. So, please feel free to ask your questions. Thank you very much.

Moderator: Thank you very much, sir. We will now begin the question-and-answer session. The first question is from the line of Shriman Dudhodia from Shree Capital. Please go ahead.

Shriman Dudhodia: Thank you for the details, and the opening remarks. A few follow-up questions, you know, based on the opening remarks. Firstly, on the industry growth guidance which you have given now 8 to 10% industry growth for the full year, and given that we have seen a sharp degrowth in the first half, just on the back of the annual calculation, should H2 see as high as 35% to 40% kind of a year-on-year growth? Is the assumption correct?

So, the second question was about the situation in Tamil Nadu. You said that you know, the Q2 was quite weak for Tamil Nadu, and now it is picking up. So, was there any specific reason why Tamil Nadu was weak? And for the full year, do you think that Tamil Nadu's contribution would be lower than last year, or it should still grow from the last year's growth in Tamil Nadu? That's the second question.

The third question is, so while you mention that, you know, the raw material prices look stable, but if you look at say the PVC prices, you know, that are being published by the manufacturers, there is a steep decrease in the prices that we are seeing, and from the peak, I think it is what the data that we see is about 35% to 40% kind of a decline in the PVC prices. Are you also witnessing a similar trend? That's the first part.

Second is, you know, in a situation where the raw material prices decline, would states roll back the price increases, you know, that they have recently announced? That's the question.

And lastly, on the receivables, out of the 138 crores of receivables, you know, as of 30th September, what is the contribution from the top two states, if you could quantify and the backlog which was there from Andhra, what's the status on that? Thank you so much.

Ashok Sharma: So, thanks for those questions. Let me go one by one. You are right. So, when there is a 25% drop in H1, there has to be a 25% to 30% increase in H2. We need to keep in mind that H2 normally is a bigger half compared to H1 historically. So, we do expect that growth. And as I mentioned, see if you look at the numbers, last year's H1 market was around 1,300 crores, and this year's H1 is around 1,000 crores. And last year H2 market was around 1,900 crores.

Now when I am saying these numbers, please pardon me. These are not published numbers. They are our estimates. I could be wrong by 5 % - 10%. So, please pardon me for that. So, H2 if you see, around 2,000 cores was the industry last year, and we expect around 2,500 crores this year. So, this growth of 600 odd crores is largely coming from Andhra Pradesh. So, this year we are expecting around 350 crores will come from Andhra out of the 600 crores growth. And we expect around 100 odd crores coming from Gujarat for the year.

And Tamil Nadu was the next question. So, Tamil Nadu may not grow at the same rate as last year. We see some degrowth in Tamil Nadu in H2 versus H2 of last year. But since H1 they were very low, as a 90% drop was there, so it will be growth vs this year's H1. But by now it will be flat or minus, we might see a 10 % to 15% drop in Tamil Nadu. In states like Maharashtra and others, we see some marginal growth.

Now, why is it picking up? That's a good question. See what happened is that Tamil Nadu went through some systemic changes, we have seen, when there are such systemic changes, the industry gets affected. Now we can see that the new government is as keen. The new organization is in place, and the government is also giving a positive signal for growth. That's the belief, and we are already seeing the results from October - November. So, we would like to believe that it will continue.

Now coming to the raw material cost, you know, PVC has gone down and also went up, again went down. It's been a bit volatile. Also, a couple of manufacturers are closed for maintenance.

So, we are a little bit cautious in terms of raw material cost, but on the positive side, global prices are lower than Indian prices. So, we think it will catch up as we go forward.

But today, we don't want to give an impression to all of you that the raw material cost situation is fine, and it's going to get better and better. We would rather be conservative because we still see crude oil is not softening. The Russia-Ukraine issue is still on. Winter is coming in. We don't know how the prices will play out. So, we are being cautious. We would be very happy if the costs go down, but currently, we are assuming stable as a reasonable conservative case.

Now coming to the last point about 138 crores receivables, in that, of course, Tamil Nadu is a large contributor. Also, fortunately for us, AP has started paying old dues. I don't know if those who are following our calls remember, we used to say that around 40-odd crores are there with the AP government for some time. But in the last eight months, you will be happy to know that 30 crores to 33 crores out of 40 crores have been paid back. So, that has improved. So, for us, Tamil Nadu is a big one, and then others are routine.

Shriman Dudhodia: So, how much would be Tamil Nadu's contribution, sir, in the overall receivables?

Ashok Sharma: I would say significant, around 50%

Shriman Dudhodia: That's large, and I had this follow-up on the raw material and the price increases, you know, that you are getting from the state. In a scenario -

Ashok Sharma: Roll back point. See if the price stays stable or goes down by 3% - 5%, still the margins would not be as good as the peak margins which the industry has seen. In good times, we have had 53% gross margins in F20, if memory is right. So, against that, we still have a long way to go. So, we don't expect a rollback. Even in the past, it has not been done either. But, we can't take a view on what government will do. But we don't expect that, because still there is a lot of gap between what was the price historically and where we are today.

Moderator: Thank you. The next question is from the line of Aditya Shah from Vikram Advisory Services. Please go ahead.

Aditya Shah: Sir, I have a follow-up question from the previous person. I just wanted some clarity on whether I understood it right or not that last year FY22 had a total turnover of around 212 crores. So, first two quarters if we calculate, it is around 73 crores. So, the remaining 139 crores for the full year is left to come in these two quarters, and we are expecting 10% or between 5 % to 10% growth over this number or probably something else.

Ashok Sharma: So, Aditya, first of all, thank you, you have always been coming for the calls. What I am talking about is not Mahindra EPC. As you know, we never give our guidance in terms of our numbers. What I was talking about was the industry, where I said the industry in H2 for F23 will be approx. 2,500 crores which last year was around 1900 crores. So, our outlook is 5% to 10% growth for the industry.

Now if you were to ask me the follow-up question on what kind of growth would EPC expect? Our whole strategy and track record are that we always try to work hard and grow faster than the market. So, we have increased our market share, and that trend will continue. So, if the industry grows at 5% to 10%, definitely we would target to grow at that rate or slightly better.

Aditya Shah: And one more question is about the non-subsidy business did we do better than the September quarter last year in non-subsidy business? Or was it still on the same level?

Ashok Sharma: Excellent question. In F22, we had done 15% of our revenue through non-subsidy. In H1, almost 20% of business is coming through non-subsidy, because last year we had a big export order, which is not there this year. But still this year we have done around 22% non-subsidy business. So, yes, we have done better than last year's H1, and much better than the full year.

Aditya Shah: And do we expect to maintain this in the next half as well, sir?

Ashok Sharma: Yes.

Aditya Shah: Because I understand that, you know, this 22% or 20% is also good because there is a reduction in the government business. Now let's say for the next half year when we expect more government business, would we be able to maintain this 20% for the full year?

Ashok Sharma: So, that is our target for non-subsidy business, and there is a high probability of maintaining that. What has happened in the last two years, because of the environment, we have changed our strategies. In non-subsidy segments, we are getting some success, and that will drive this growth for the non-subsidy business. I am also happy to inform all of you that recently we have been awarded Class A contractor, so we can take on larger projects also. We have done well in H1, and that trend should help us to go beyond 20% of non-subsidy for the full year.

Moderator: Thank you. The next question is from the line of Prem Raheja, an individual investor. Please go ahead.

Prem Raheja: Sir, I already had one observation to make. Sir, when we took over this company in 2012-13, sir, our turnover was anywhere between 125 crores to 161 crores, and we were showing a profit of about 7 crores to 8 crores at that point in time. Sir, now fast forward to maybe 2021 - 2022, what is your estimate as to the investor community, what is the expectation they should have from EPC, sir, after 10 years have gone by?

Ashok Sharma: So, Prem, I think last year also you asked this question. Just to give you some numbers, in F17 we had around 200 crores in revenue with around 9 crores in profit. Before that, we used to make 2 crores to 3 crores profit on lower revenue of 130 crores - 150 crores.

But the big change which has happened in our business model is that the industry has grown. In those days, our maximum business was from Maharashtra, followed by Gujarat and AP in that order. And in the last four or five years, Project markets have become much more prominent.

There our cost of sale is higher. So, our margins are lower compared to what they were before. That is one major reason.

And second is inflation over time. But the good thing about fixed costs is if you look at our F20 and F23 fixed cost, they are almost the same. So, we have tried to run a tight ship and despite inflation, we have managed that.

Now comes the real question in terms of value creation. I fully understand the concern around that, as you are aware this is largely due to the industry situation of the last 2.5 years.

But if you look at F20, which was a good year for the industry, our performance was on a nice growth trajectory. And I see in the future, now with the H2, as you can see the early signs of revival in terms of margins and industry growth. I feel that F23 - F25 will be good years for the industry. And now as we enter this phase, we have almost 75% subsidy, 25% non-subsidy business, a much higher drip contribution, which was not there before and also a much better working capital situation.

With those factors, I am optimistic about the industry for the coming two to three years. And I think the worst for the industry seems to be over. And with that happening, we will continue our focus on governance, customer satisfaction, the highest level of compliance and very transparent communication with our shareholders. So, that is our DNA that continues as a Mahindra company. No question about it.

Beyond that, it is quite difficult to give a specific answer, Premji, because, here it is subject to state governments' involvement which drives the whole industry. So, that's the peculiarity of the industry.

Moderator: Thank you. The next question is from the line of Rajan Shah, an individual investor. Please go ahead.

Rajan Shah: Sir you mentioned in your opening remarks that the industry will grow at 5% to 10% approximately this year, and we normally do, Mahindra EPC normally does a little bit better than the industry growth.

Ashok Sharma: Correct.

Rajan Shah: And last year we reported about 212 crores of top line and a loss of about 9 crores. So, can we expect even assuming the industry grows at 5%, can we expect our turnover to be about 225 to 230 crores? I mean, what I want to ask is will the current year's turnover be a little bit more than last year's turnover? So, that was my first question. And the raw material prices where they are right now, and the price hike which we have got about between 12% to 18% from various states, do we expect margins to be better than last year on a full-year basis? And sir, I have a lot of questions. I would request a meeting, but I just ask another two questions. Sir, how are our products vis-à-vis Netafim, Rivulis or Finolex or Jain irrigation? Are we superior? Are we in line with the quality of products? And if we are in line or if we are superior, why can't we take the market from them? As you know, our share is at about 7% as you mentioned. I think with what, you know, the brand we have, Mahindra brand, farmers are better versed with the Mahindra brand than Netafim or Rivulis or maybe Finolex or even Jain is popular, yes, but Mahindra is a brand which is known across the country, you know, I mean, across the world. But in the country, farmers are, I mean, Mahindra brand is a very prominent brand, you know. So, why can't we be a little more aggressive and grab the little market from the other established players, you know, so to increase our revenue and maybe grow a little more fast? And that's all, sir. If you can give some, and sir, F20 we reported 285 crore top line and a fabulous profit of 24 crores. Do you expect with these raw material prices and with this price hike, we can expect something like that in F24 - F25, which you said would be a much better year, you know? So, if you can throw some light on all this?

Ashok Sharma: Now you are asking if 212 crores will become 225 crores – 240 crores. I think that's a matter of mathematics, and I can only repeat what I said to Aditya and Premji, is if the industry grows by 5%-10%, our attempt and efforts will be to manage that. And we think we are well poised. There are very fundamental reasons why Mahindra EPC should grow at the industry growth rate or faster than the industry. I can say with confidence based on our farmer feedback and dealer feedback that our product quality is one of the best in the market. We see ourselves as one of the top companies w.r.t product quality. Another good thing about our company which our research reveals is our customer service, and in our business, customer service is not any routine customer service. It starts with the designing of the solution for the farmer. We take a lot of effort and provide good installation and follow-up service resulting in good farmer satisfaction. In our regular surveys on customer satisfaction, where we benchmark competition also, we rank on the higher side in farmer satisfaction.

Moreover, as far as dealers & channel partners are concerned, we have a very transparent and professional way of dealing. So, they are also very comfortable in terms of growing with us.

Now coming to market share. We have almost increased our market share three times in the last 7-8 years, which is very significant. Now we can grow aggressively but, I have told you and others also before, in this business, we want to calibrate our growth. Because we see working capital as a big risk. I will give real examples. Now there are 2-3 companies, I will not name them on this call, they went very aggressively in Andhra in F'18 - F'20, and they have had a higher market share than us, but suddenly in 2.5 years, there was no payment. Now those companies are having tough times.

So, we don't want to be in a situation where we are too aggressive in one state. We have a very interesting model, which guides us on the exposure limit for states from a risk management perspective. As you know, we have a very elaborate management process to control all these things.

So, we are happy that we did not go very aggressive in Andhra in F19 - F20. With our brand, we can do that but we want to remain balanced. Now, where we are using our brand more is in Maharashtra and Gujarat. These two states are doing very well in terms of payments. Let me give you some data. If you look at Maharashtra & Gujarat, our sale contribution from these states has been increasing year-on-year. Just to put some numbers in F20, Maharashtra and Gujarat contributed only 18% of our business. This year in H1, it was moe than 40%. Now we can argue that Andhra and Tamil Nadu are down, hence, it has gone up, but even in absolute terms, compared to F20, we are significantly higher in F23 in these two states. So, we are focusing on states which are good for payments and margins and going aggressively on market share, but for those who are not stable on payments, we don't want to overexpose ourselves.

And now coming to the other question, i.e. if raw materials are the same, will margins be marginally better than last year? Last year, in F22, our gross margins were around 37%, and in F21 around 48%. F20 was peak at 53%. Against that, this year H1 is 36%. So, the answer is yes. Margins for the full year will be better than last year. But will they be in line with F21? The answer is no. So, they will be somewhere in the middle. We have a good lineup and products in all segments to keep growing our business. We have a manufacturing facilities in Baroda, Nashik & Coimbatore. We are also ready to put in one more location if required. We are very close to the market and our brand is well accepted with happy customers. We have a very good team. Another thing which we have not discussed in the call is our organization. We have people who have been working with the company for many years at the senior level. Our churn is very less. We have very dedicated and committed professionals. Because of the brand Mahindra, we can attract and retain good talent. So, all those basics are in place and we know the business. If the market is good, we will grow very aggressively and manage our working capital so that we don't take unnecessary risks.

So, Rajan bhai, the short answer is, if the industry grows back to the F20 level, I don't see any reason why we should not be performing at much higher levels, we are well poised.

Moderator: Thank you.

Ashok Sharma: I think the questions asked by the previous friends were so detailed and sharp, nothing is left to ask or answer. Whatever has to be answered perhaps has been answered.

Moderator: As of now, sir, no questions in the queue.

Ashok Sharma: I am happy to conclude this call, and once again thank every one of you and wish you a very happy New Year ahead. And thanks for all your interest in the company, and I am sure when we meet going forward, we will be able to discuss the growth of the industry and see how the industry positively moves in the future. So, thank you everybody and bye-bye.

Moderator: Thank you, Mr. Sharma. Ladies and gentlemen, on behalf of Mahindra EPC Irrigation Limited, that concludes this conference. We thank you all for joining us, and you may now disconnect your lines.