



“Mahindra EPC Irrigation Limited Earnings Conference Call for Audited Financial Results of FY20”

May 15, 2020



MANAGEMENT: MR. ASHOK SHARMA – MANAGING DIRECTOR

Moderator: Ladies and gentlemen, good day and welcome to Mahindra EPC Irrigation Limited Conference Call for Audited Financial Results of the Year-Ended on 31st March 2020.

As a reminder, all participants' 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 touch-tone phone.

I now hand the conference over to Mr. Ashok Sharma, Managing Director of Mahindra EPC Irrigation Limited. Thank you, and over to you, Mr. Sharma.

Ashok Sharma: Good afternoon to all of you, ladies and gentlemen and welcome to the 4th investor call for Mahindra EPC Irrigation Limited. I would really like to thank each one of you as you have taken the time off to be over here and I hope all of you are taking adequate measures to be safe for yourself, your family, and the community around you.

Today, I am going to talk to you about the progress of the last quarter and the full financial year of FY20. I'll also talk a bit about the business environment because we are going through some very unprecedented times. I will talk to you about what's happening on the agricultural front and the impact on micro irrigation industry.

To start with, at the risk of repetition, I just want to emphasize that the importance of water is the key for the survival of the planet and as you all know that the water scarcity is becoming a bigger crisis and issue year on year and we expect that in the next 10 years in India, most of the districts will be water scarce, and in water management, 80% of the water consumed in India is for agriculture. So, clearly, saving water and ensuring that water is properly used in agriculture requires use of precision technology like micro irrigation, and this is precisely the business which your company is in. So, ensuring that the water is provided at the right time in the right quantity to the farmers, it is very critical to ensure that the plants get the right nutrition at the right time and they are able to get higher output and we have seen through various data points that almost 25% to 30% increase in productivity is achieved by the farmers in many crops once they use micro irrigation, and saving of 30% to 40% of water has been recorded by most farmers.

I also mentioned in the past. Again I will repeat. India, as we know, is an agrarian country. We have more than half the population dependent on agricultural income directly or indirectly. And the opportunity for your company is that only 11% of the total suitable area is under micro irrigation. So, out of the 70 million hectare, only 11% is currently under micro irrigation. So, clearly, there is a huge move and a big scope for increasing micro irrigation in our country. We are all aware of the various programs the government has been initiating over the years. The PMKSY scheme has given a lot of thrust in this area and annually allocates around 3000 to 3500 crores for micro irrigation towards subsidy from the central side. The fundamentals, the need, the impact, and the commitment from government continues, and we

have been hearing about mission of more crop per drop and many such communications are happening by the various government authorities.

Now, let me talk about Mahindra EPC. For Mahindra EPC, the vision has always been working towards farmer prosperity and the whole idea is that how we can offer better technologies to farmers so they can increase their income from their farm produce, and micro irrigation as I mentioned before, is clearly a big enabler in improving the farmers' income. And through this, we also want to contribute towards the nation's priority of doubling the farmers' income.

Mahindra EPC also works very closely with other companies of the agriculture sector of Mahindra & Mahindra. We have businesses in seeds; crop care, i.e., agrichemicals; we export grapes; and we have other business of fruit imports. We try to see how we can leverage our connect with farmers across the agri sector and give the necessary synergy for helping Mahindra EPC business.

To promote micro irrigation, we have a large number of demo plots where we offer advisory services. We invite the farmers, we explain to them about the benefits of micro irrigation and more so about the unique technologies and benefits of our products and encourage them to adopt this technology. Our company has always been known for good quality, good design of the system, good installation of the products, and prompt & reliable service to the farmers. And that reputation we have built over the years due to the good work being done by our channel partners and by their team members in Mahindra EPC.

Now, let me talk to you about the performance which we announced. I am sure you have seen the performance. Our revenue growth for quarter 4 of last year has been 12%. Our PAT growth has been 75% for the quarter. If you look at the whole year, our top-line growth has been around 9% and we have more than doubled our profit after tax. You may be wondering what is the reason behind this performance. Let me give you some key points that what have been the reasons for this performance. And clearly, this is a performance which has been a buildup of many years of efforts put by your company towards farmers' productivity, towards developing good products, and ensuring that the farmers are satisfied with our products. Also, a sharp focus on managing working capital and on managing the subsidy system in a manner which is sustainable.

Having said that, we clearly have a very well defined strategy of focusing on select markets and only dealing in products which are solving the farmers' needs for certain applications, ensuring that our channel partners are always satisfied with the best service from the company.

Last year also, we saw a reduction in raw material costs which also helped us to improve our margin and that has been one of the contributors in our last year's results. I had mentioned before about our strategy of distributed manufacturing where we open plants in Coimbatore and Baroda. They have also contributed significantly to the profit of the company. Also, you

are aware that over the years, we have shifted our mix more towards higher profitable products like drips and that journey continues.

Now, about the topic which I am sure is in your mind and it is very much in the discussion in our management team is about the current situation. Obviously, all of us know that the world has never seen a situation like this in the last so many decades and clearly all of us have been impacted very heavily because of this situation. I will talk more about agriculture. I will not get into other areas on this call.

If you look at the agri sector, in the month of April and also the last week of March, we could feel the turbulence and the challenge that the supply chain in our business at Mahindra EPC. We were not allowed to open our plants and there were issues on labor availability, permissions, and clearly, the month of April was rather difficult for us; not only for us, for the entire industry, and not only MIS industry but overall as you very well know of.

The good thing is that now our plants are operational and I must appreciate the efforts being taken by the various government authorities starting from the central government to various local administration authorities to give a lot of priority to the agri sector, and we have got a lot of support from the local authorities for restarting our operations and we are also seeing relatively a good rabi harvest for our farmers where in important markets, the harvest has been done on time. Though there have been challenges of labor, but overall, our farmers with mechanization and with local support have been able to harvest a reasonably good crop, and what is again appreciated is that certain states have been very proactive in buying back the produce and also making prompt payment to farmers. These are in the given situation some positives as far as the agri sector is concerned. But, surely, we have challenges ahead because the situation is still evolving in this area. What we have done at Mahindra EPC is we have focused on first ensuring the highest level of safety for our employees. We have been ensuring that they are properly educated, continuously communicated on the various protocols for safety, and we are ensuring that the necessary equipment is provided to them for safety and we have internal mechanisms to ensure that all our employees are following the protocols which have been recommended. Another area which our company has taken extra efforts on under the guidance of the board, a very robust review mechanism has been put to understand the various risks and what kind of mitigation we need to do and very careful monitoring of that is being done, different scenarios have been looked at, and in each scenario, we have tried to see how we can ensure the shareholders' interest and the company's long-term interest and always we are trying to see that we manage our company in a much frugal way, manage cash, relook at all the cost, and ensure that in these difficult times, we are able to manage our resources very wisely and also come out much stronger as things open up and get the maximum advantage when the situation becomes better.

As far as the industry is concerned, because this question I am sure is there in everybody's mind that what is the outlook, what will happen this year, where will the business go. Clearly, if I look at the industry, until now, there has been no policy which is not promoting micro

irrigation. From the government's side, all the facilities are going on and with a recent stimulus package announced, our farmers will be significant beneficiaries. So, from that side, we expect the farmers will help the bandwidth and the money and the states will have the money to support micro irrigation.

Having said that, we do see that quarter 1 will not be like a normal quarter. The demand will be subdued because April has seen a severe disruption in the supply chain. Now, most of the companies in this industry have resumed their operations. We have resumed our manufacturing and things are every day, every week, getting better. So, Q1 may be a quarter which is tough for the industry. I am sure as things unfold; we are hoping that the situation will get better going forward from quarter 2 onwards. So, I will reserve more comments on this for the question & answer session.

Friends, I have just recapped in terms of our commitment to water management in the country and how EPC is always focused on the farmers' prosperity, long term working on quality, our performance I shared for last year, and also I have given my perspective in terms of the COVID situation, impact on agriculture, and impact on micro irrigation.

With this I will now stop, and I am happy to listen to your questions and whatever best way I will try to answer your questions. Thank you very much for your patient hearing.

Moderator:

We will now begin the question & answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles.

The first question is from the line of Sreemant Dudhoria from Unifi Capital. Please go ahead.

Sreemant Dudhoria:

In the context of the current situation, how is going to be the subsidy released from various state governments and the center given that the states are facing financial stress in the current times? What is going to be the trend in the next say 6 months to 1 year? That's the first question.

The second question is, how is going to be the working capital, especially the receivable and inventory days? Given the current situation, do you think that the number of days are going to stretch than what has been a historical trend?

Thirdly, you talked a bit about the labor situation, and that's a thing which various sectors are facing. How is the situation at Mahindra EPC and what are we doing towards resuming production towards the normal level?

Ashok Sharma:

Let's talk about subsidy release. One thing is very clear that agriculture and micro irrigation are the top priority for both central and state and this has been happening over the years. Clearly, whatever funds are available, I am personally expecting that the priority for micro irrigation will not change and perhaps only improve. From the expectation which I would say is that given this stimulus package and given the government's thrust on the farming and the

agriculture sector, I expect that there might be some delay in release of subsidy, especially in the quarter 1, which we experienced in the month of April, and as we speak in May, we all are seeing some improvements happening in terms of certain states already getting active and starting to release the subsidy. I do see some risk in terms of working capital. Because of this reason, they are delaying subsidy, but I am not too concerned about the quantum at this point of time. Maybe it's more of a timing issue. So, we need to be more prudent as management to ensure that for working capital we are able to manage tighter and ensure that our processes are more efficient. Our teams will work on that.

If you look at the labor situation, as far as we are concerned, we have 3 operations – Nashik, Coimbatore, and Baroda. We don't see any concern in terms of availability and most of our operation is highly automated, it's a continuous process. So, we are able to manage the labor situation fairly well. Of course, we are very mindful of following all the norms and all the conditions which the government has put in. To that extent we have to be more efficient and plan our scheduling and our operations better. Fortunately, we have enhanced capacity because of these 2 plants basis decisions we took in the last 2 years, that is going to help us now to provide the right kind of quantity at the right place at the right time.

Moderator: The next question is from the line of Ronak Sarda from Systematix. Please go ahead.

Ronak Sarda: Sir, just wanted to understand if you can share some geographical anecdotes on which regions do you think have recovered well versus which regions are lagging in terms of distribution? And the other part is, do you see the reverse migration of labor can pose a challenge or can positively impact the business?

Ashok Sharma: Ronak, as far as the geography is concerned, as you may be well aware that a few states have maximum contribution to micro irrigation demand in India and the leading states in India are Tamil Nadu, Andhra Pradesh, Maharashtra, and Gujarat. These four actually have a significant impact, then of course the other states. And there are some new upcoming states which are now showing interest but I will not talk about that in the interest of time. If you look at these 4 states, already we are seeing positive movement in Tamil Nadu where already the machinery has started working and we are able to get some collections. There is already some action happening there. As far as other states are concerned, let's say AP, Maharashtra, even Karnataka has now become one of the important states. There, we see almost 30% to 50% normalcy in the operations coming up. And Gujarat which is an important state is also expected to start very soon. We have indications from the nodal office that they will also be starting their operations very soon. These are the main markets, Ronak. If these markets perform well, then the industry gets a reasonable comfort that 60% to 70% of the business is now under control. Whatever information we have from the nodal authorities in these 4-5 states, they have all been showing very positive feedback and actually 1 or 2 states have been requesting the industry to go more aggressive in terms of giving the assistance to the farmers. That's on geographical.

On reverse migration of labor, while that's an issue for India and clearly, industries which are having high dependence on labor and they are having thousands of migrant laborers, it is a big challenge. Fortunately for us, one is we are decentralized, we have 3 units and the number of people we employ in these units is not so large. So, we are able to find local laborers. And in our case, historically, we have not really had too many migrant laborers. So, we don't have this specific issue of migrant laborers as such, but of course, we have a few cases where the laborers are staying in some villages in nearby locations but that's manageable. We don't see a concern in terms of availability of labor.

Moderator: The next question is from the line of Dhavan Shah from ICICI Securities Limited. Please go ahead.

Dhavan Shah: I have 2 questions. Firstly, about the margin improvement – EBITDA margin. We have seen the improvement largely from the lower raw material cost. And you also highlighted that you have increased the revenue from the drip side. Would it be possible to share the breakup? How much does it come from the value-added products and how much is it because of the lower crude price resulting into the lower raw material cost?

And second one is, given that the Jain Irrigation has been facing pressure because of the higher levered balance sheet, does that help you in terms of gaining market share and if you can share the order book numbers as well?

Ashok Sharma: Dhavan, as I mentioned that we have been progressing towards a higher contribution of drip in our whole strategy, that has actually helped us to improve our margins, and if you look at our mix, we are now close to 65% to 70% on drips. Of course, it varies from quarter to quarter depending on the season, and if I were to put a number, I would say almost 200 bps close to that would be because of the change in the mix. That's one of the contributors, which is fairly sustainable going forward.

As far as raw material is concerned, yes, there has been a big support for last year's financials. The current outlook which we have from our suppliers for the next few months is that they are of the view that prices may not really increase if not decrease. But these things we cannot take for granted because it's all global market dynamics, but as we see now, we seem to, as an industry, have an advantage on the raw material costing.

Coming to your next question about Jain, we don't like to comment about the competition as such, but since as an important player, in the last 1 year, we have been seeing that many companies have increased their position, increased their market share depending on the regional strength, and to that extent, even our company has benefited, but the way we work is we like to manage our growth keeping the working capital and payment situation balanced. We balance it, and based on that, we decide our overall strategy. We have also benefited like other players in the industry because of absence of one of the leading players in the industry. Hope it answers your question, Dhavan.

- Dhavan Shah:** Yes sir. And the order book numbers?
- Ashok Sharma:** The order book numbers at this point is difficult to say because there is a direct correlation with one player. And as we know that currently the whole situation is going through a flux because the government machinery was shut for a month and now they are opening up. It's a function of how fast they are able to now get into action. With that, the order situation will unfold.
- Moderator:** The next question is from the line of Madhusudan Reddy, individual investor. Please go ahead.
- Madhusudan Reddy:** Congratulations on a very good set of numbers. Sir, what percentage of our sales are from the state government side and if possible if you can answer what percentage from the central government subsidies we get our sales?
- Another question is, as far as the situation looks, state governments particularly are going through a lot of financial stress. We may not be able to pull in a lot of sales in maybe this quarter and the next quarter. In that situation, is there any possibility of our company looking towards exports?
- Ashok Sharma:** Coming to the question of subsidy, subsidy as you know is a function of central and state, and different state governments have different policies in terms of how much percentage they will contribute. Typically, central government would contribute 50% and state governments would add on from 10% to 40%. We have certain states where it goes up to 90% subsidy. In some states, it is 50% to 60% subsidy. And that varies. That's point number one.
- Now, talking about availability of funds from the states, yes, we have discussed that, and we will see how the situation goes, but clearly this is something we have to be mindful of that it will not be business as usual.
- Regarding your suggestion about exports, we have done some very limited exports in the past. This is something we are now reevaluating and exploring if there are possibilities to further look in this segment. Thank you for your suggestion. This is something which our management is already studying as an opportunity.
- Moderator:** The next question is from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.
- Viraj:** Congratulations for the good numbers in such a challenging environment. I just had a couple of questions. First is, can you give some color in terms of what are the reasons behind the margin expansion? If you look at the typical trend in the industry, every 1 to 1-1/2 year or two, we see the rate contracts getting revised based on how the RM environment and other input cost elements. Given the kind of way the raw material environment is, especially crude gaining now and the kind of margin expansion all the companies have seen, from your interaction with state

governments, are you seeing any indication of downward revision in those rate contracts? Is that what you are seeing or how you are seeing things on that front?

The second question is, largely earlier there was a period in the industry where there was a significant downtrading either it was subsidy not being available and people were actually moved to a lot of non-BIS sales and even in BIS, a lot of companies introduced low-cost drips and all. Given the way the whole environment is right now, do you see any element of downtrading by farmers in terms of still choosing to invest in higher cost sprinkler but primarily towards more low cost or low capital size items?

The third question is on the receivable side. Do you see any risk of write-offs or any bad debt provisions or any of those elements? Because we have close to almost 190 days of receivables now.

Ashok Sharma:

Let me go one by one. In terms of margin expansion and the revision by states on the prices, as of now, we have got no such indication from any of the authorities to be fair. I think in the last 1 to 1-1/2 months, all the authorities have been grappling with various challenges. So, this kind of situation has not been discussed by or informed by them to the industry. That is one. And you are right; when the revisions do happen, they will factor many things, and the revisions happen for different states at different times. Some states are due for this year, some would be next year. It's an ongoing process. As of now, we have no firm information about such situation or some views coming or requests coming in. As and when the revisions happen, we will come to know. Yes, I agree with you that obviously they would factor all the reasons and accordingly they will decide. Typically, the revisions are all upwards. Very rarely we have seen a downward revision, but we never know to be honest about this matter.

In the next question you talked is a very interesting point. You mentioned about this whole non-BIS segment and this is something which fortunately your company is very well placed and we have a very good line of products which we call non-ISI products or thin-walled products. We are promoting and especially we are seeing a lot of traction in the horticulture segment for these products. And our products are considered to be quite superior and quite well accepted in terms of life of the product. So, obviously, it is a new segment emerging there, and this is one area we will be focusing more in this situation.

On the third point about receivables, fortunately for us, all our receivables are with the state governments, most of them, and upto now, our experience has been very good. While there are some state governments which take more time to pay, but if the process is followed in terms of whatever are the guidelines which we always try to adhere to, we don't see any concerns in terms of write-offs or things like that. But however, we have our own prudent accounting policy and we have a simulated credit loss formula based on which we do make prudent provisions on a regular basis so that we are not exposed to any such risks. As you'll see from our report, we have a sufficient provisioning done based on our past data and expectation of future collection. All these risks have been factored in our financials. I hope that answers your question.

- Viraj:** You said some states are due for revision this year. Which are the states which are due for revision?
- Ashok Sharma:** Specifically, I would not be able to answer that now, but the point was that the revisions happen for different states at different times. It is not that everybody does it together. Some revise after 3 years, some after 2 years as and when they are due.
- Moderator:** The next question is from the line of Sreemant Dudhoria from Unifi Capital. Please go ahead.
- Sreemant Dudhoria:** A specific question from the balance sheet. While we quote a receivable item in the current asset which is 129 crores, there is also a receivable item in the non-current asset of about 35 crores. Just wanted to understand a bit more on this 35-crore item. What does this pertain to?
- Ashok Sharma:** What we do is we make the provisions as per our ECL formula and the provisions which are typically 2 years cut off received but the provisions we also create for between 1 and 2 years, which we put in this category. It is just for adequate precaution we also treat this and account this receivable separately.
- Sreemant Dudhoria:** If I understood right, this is again for the project revenue, sir, because this is a longer duration project?
- Ashok Sharma:** Yeah, you are right. This is a project with basically state governments. State government formality does take time, but we just want to flag it off and keep it separate so that there is full visibility of that and the data is available to all the stakeholders.
- Sreemant Dudhoria:** Project revenue continues to be a large portion of our revenue, sir, like 80% to 90%?
- Ashok Sharma:** I'll just once again define the word projects because it means different things to different people. The projects are of 2 types. One are the large projects which are done which are hundreds of crores which are macro projects. We are not talking about those kinds of projects. We are talking about individual farmers being financed through state governments in the definition of projects. I am sure that is the definition you are also having in mind. For us, that's the major part of our business. Clearly, more than 80% to 85% of our business does come from the state governments, and that's one of the reasons why our receivables are quite high. If you look at our last year, while the number of days is almost the same as previous year, but in absolute terms, the receivables increased. That's largely because the state governments take time to process and pay to the industry.
- Sreemant Dudhoria:** Finally sir, given that we have a positive outlook on the micro irrigation industry, you highlighted about the penetration level being just 11%, are we looking to add any further capacities or any satellite plans like what we have done in Coimbatore or even expand at existing locations?

Ashok Sharma: That's a good point. Clearly, from a long-term standpoint, there is a need to look at capacity addition all the time, and that is precisely the reason 3 years ago, your company took a decision to open satellite facilities in Coimbatore and Baroda which has given us additional capacity. But for this year, we don't see the need because we have enough capacity and even for next year, we are reasonably well prepared. As I have indicated before that the lead time for adding capacity is not very long. So, if required, we can add. Also, the cost of adding capacity isn't much because it's largely the machinery. We have enough plant land and facility available. So, I don't see that as a major investment in the next 2 to 3 years coming on, capacity addition. Virtually, we will have capacity as and when required.

Sreemant Dudhoria: Finally, sir, if I can ask one more question, what's been our plants' utilization level after we opened our plants? Are we at say 20% to 30% or we have more than that?

Ashok Sharma: Every day it is increasing. Clearly, we had touched the zero in the early part of April and now we are moving up. Now, we have come to 35%, 40%, 50%. It is improving every day actually. Our expectation is that in less than a week or so, we would have the right kind of utilization depending on our demand. Now, we don't see a concern from a supply standpoint. My worry today is more about how fast the state governments' machinery gets into action, how fast we get our payments so that we are able to supply. So, supply chain side is not much of an issue as of now, but we never know in the future. It's very difficult to say in this COVID environment, but as of now, we seem to have overcome that challenge and now we are seeing how we can lead the market as well.

Sreemant Dudhoria: The more benefit of lower crude is yet to come in the coming quarters?

Ashok Sharma: I am not sure because we have already quite subdued raw material cost. I am not sure how much the suppliers will pass it to the customers like us. We need to see that. Many times, a direct translation of crude price does not happen through these products. It has its own nuances. But obviously we would be very happy if it happens.

Moderator: We don't have anyone in the question queue. Would you like to give any closing comments?

Ashok Sharma: I just want to thank each one of you. Clearly, the situation is not normal, but our company has recovered well in terms of supply chain. Overall expectation is that the kharif sowing will be quite normal for farmers given the reasonably good harvest for rabi and payment to farmers.

I just want to thank all of you. You people have always believed in this company and supported us. And I look forward to interacting again with you very soon. Thanks for your time and have a safe stay. Take care of yourselves. We need to be extra cautious about our safety and community's safety which I am sure all of you are doing and I wish you all the best.

Moderator: On behalf of Mahindra EPC Irrigation Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.