"Centum Electronics Limited

Conference Call"

May 24, 2024

MANAGEMENT: **MR. NIKHIL MALLAVARAPU - EXECUTIVE DIRECTOR - CENTUM ELECTRONICS LIMITED**
MR. K S DESIKAN - CHIEF FINANCIAL OFFICER - CENTUM ELECTRONICS LIMITED

MODERATOR: **MR. NIKHIL KANDOI - JM FINANCIAL**

Moderator: Ladies and gentlemen, good day and welcome to Centum Electronics Limited conference call hosted by JM Financial. 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 star then zero on your touchtone phone.

Please note that this conference is being recorded. I would like to mention a short cautionary statement. Some of the statements made in today's conference call may be forward-looking in nature. Such forward-looking statements are subject to risks and uncertainties, which could cause actual results to differ from those anticipated. Such statements are based on management belief as well as assumptions made by and information currently available to the management. Audiences are cautioned not to place undue reliance on these forward-looking statements in making any investment decision.

The purpose of today's earnings conference call is purely to educate and bring awareness about the company's fundamental business and financial quarter under review. I now hand the conference over to Mr. Nikhil Kandoi from JM Financial. Thank you and over to you, sir.

Nikhil Kandoi: Today, we have with us senior management represented by Mr. Nikhil Mallavarapu, Executive Director and Mr. K S Desikan, CFO. Without taking much of time, I would like to hand over the floor to the management for the opening remarks, post which we can open the floor for Q&A. Thanks and over to you, Nikhil sir.

Nikhil Mallavarapu: Thank you, Nikhil. Good morning, everyone, and welcome to our Earnings Call for the Fourth Quarter and Financial Year Ending March 2024. I would like to mention a special thanks to our host, Mr. Nikhil Kandoi and the team at JM Financial for hosting the call today. Let me first brief you with the key performance highlights for the year and the quarter under review, after which our CFO, Mr. Desikan, will take you through the financial highlights.

First off, I'm pleased to inform you that our company crossed the INR1,000 crores revenue mark this financial year at a consolidated level for the first time in its history, making it a major milestone and proud moment for us. This was primarily driven by the strong performance at the standalone level, which delivered a 26% year on year growth in the top line and 87% year on year growth in the bottom line for the year.

As a reminder, the standalone operations is comprised of the EMS business and strategic electronics business, which provides BTS products for domestic defense and space customers. The standalone operations have delivered well and as mentioned at the beginning of the year as well. There were many positive steps that the company has also made during the year in improving its financial position, including the significant reduction in debt and working capital at a consolidated level, which Mr. Desikan will cover in further detail.

For the quarter, consolidated revenue stood at INR297 crores, which was flat quarter-on-quarter and slightly lower compared to Q4 FY23. However, it is important to note that due to the lumpy nature of the domestic built-to-spec business, most of the revenue for the business was realized in the last quarter of the last financial year due to the major project deliveries. On the margin front, unfortunately, in the last quarter, as well as on a full-year basis, the subsidiary has pulled down the margins.

Firstly, we were faced with a few one-time expenses and exceptional items related to severance costs to employees amounting to about five crores as a result of our overhead reduction program, and also some higher provisioning in Q4 to the tune of about five crores. We also anticipated to receive a variation order to the tune of about 800,000 euros for work already completed and expenses incurred on a specific project for our built-to-spec transportation business in Canada. This, however, was delayed by the customer and we expect to receive it in the current financial year.

Had it not been for these points, we would have surely ended the year with a positive note on a much higher side. We also continue to work on our margin improvement plan for the subsidiary with a strong plan to reduce overhead costs, shift our business model away from the risky low-margin, fixed-price projects to higher-margin business, and improve the onshore-offshore mix. On the order book front, Q4 was a good quarter with a major win for the defense satellite payloads and we closed the year with an order book of INR1,640 crores, which was higher compared to the previous quarter and where we ended in the last financial year.

Our pipeline remains strong with new opportunities from existing customers as well as new customers with an especially strong outlook in the defense and industrial segments. With the strong pipeline on the demand front and the actions that are being taken to fix our margins, the outlook for profitable growth remains good. Now I would like to hand over the call to our CFO, Mr. Desikin, to brief you on the financials.

K. S. Desikan: Thank you, Nikhil. Once again, a warm welcome to everybody. There will be a little bit of overlap or a repeat of what Nikhil said and what I'm going to say, but nevertheless, it is intended for a clear clarification to the investors.

So, at the outset, I'm happy to inform you that our consolidated revenues have crossed the INR 1,000 crores mark for the first time, which is a happy occasion for the company. Also, I wish to inform you at the outset that we had an excellent year in the standalone entity with higher revenue and profits. On the subsidiary, while the revenue grew for the year, the margins continue to remain under pressure.This is for the full-year overview.

Now let me talk about the figures for the quarter. First, let me talk about the consolidated. At a consolidated level, the revenue from operations is about INR297 crores, which is flat Q on Q, and 6% lower Y on Y, mainly due to the lower revenues in the standalone entity. The EBITDA for the quarter is about INR18 crores, which is 6.1%, as against INR50 crores year on year, which was 15.9%. This reduction is mainly due to the lumpy nature of the domestic BTS business, which Nikhil already mentioned. A significant part of last year's revenue of the domestic BTS was booked in Q4 FY23, if you could recollect.

The current year Q4 domestic BTS revenues were lower by INR50 crores compared to Y on Y business, and that is the reason for the EBITDA reduction. Additionally, there is a one-time expenditure of INR6.5 crores, which is an impairment of an investment of INR1.3 crores in the standalone entity, which is covered in the other expenses, and a provision of 5.2 million in the French subsidiary.

So, for the standalone for the quarter, the standalone revenues for the quarter are about INR169 crores, which is lower by 4% Q on Q, and 14% on Y on Y, which is due to the domestic business revenues.

Standalone EBITDA for the quarter is INR17 crores, which is 10.1% compared to INR38 crores Y on Y, which had much higher domestic BTS revenues, as mentioned earlier. Also, an amount of INR1.3 crores, as mentioned, impairment of investment is accounted for in the other expenses.

Now, moving on to the full-year results.

At a consolidated level, the revenue from operation is INR1,091 crores, which is 18% higher than the previous year. The EBITDA for FY24 is INR86 crores, which is 7.9% compared to INR76 crores, which is 8.3% for FY23. It's important to note that an amount of INR6.5 crores of one-time expense, which I told you, is towards the impairment of investment in standalone and provision made in the subsidiary, which impacted the EBITDA by 60 basis points. Additionally, we have also shown an exceptional thing towards the severance of employee costs in the subsidiary before the PBT. On the balance sheet side, the working capital has come down from 78 days to 61 days. The consolidated debt reduced from INR263 crores to INR174 crores in FY24.So, the debt-equity ratio has improved significantly from 1.25 to 0.85 ratio.

So, on the standalone, the revenue for FY '24 is INR 632 crores, which is an increase of 26% from the previous year. This was mainly driven by the EMS revenue growth.

The standalone EBITDA for FY '24 increased by 47%, which is INR79 crores to the previous year's EBITDA of INR54 crores. On the balance sheet side, the working capital was flat around 140 days. Debt reduced from INR106 crores in FY '23 to INR102 crores in FY '24, which includes a debt of INR15 crores term loan, which was taken during FY '24.

So, with that, I will stop and probably I will open the Q&A session and will answer them. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Aditya Chheda from InCred Asset Management. Please go ahead.

Aditya Chheda: Hi, morning Nikhil. Congratulations on a solid standalone performance. My first question is on the order book. We were anticipating some orders in the second half of FY '24, but we have closed at around INR1,660 crores for FY '24. So, if you can share some outlook on how you are placed in terms of the order inflow going forward? And my second question is about your growth on the standalone business. What were the key drivers and how do you see this business placed for FY '25?

Nikhil Mallavarapu: Great. So, quickly on that, with regard to the order book, as I mentioned in Q4, we had some good order intake. We had a substantial order for military satellites, military satellite payloads basically, which was to the tune of just about INR200 crores, which we won.

And so, with that and also the regular order intake on some of the other businesses, we were able to increase our order book over the last quarter and also where we ended last year. Also, it's important to keep in mind that the way our orders are received is quite different for each of the business units. As I've mentioned in the past, typically, built-to-spec kind of orders we receive and are executable over a 2.5 year period or so.

Whereas on the EMS side of the business, it varies. It can be anywhere from 6 to 12 months. In the past couple of years, due to the supply chain challenges, customers had loaded longer horizon purchase orders on us.

Whereas now with the supply chain easing out a little bit, the mode of engagement is moving back to a normal way where we have typically 6 to 8 months of firm purchase orders, in some cases even less, and then customer forecast beyond that for up to 18 months. So, while our order book itself is improving, the demand visibility is improving, and the horizon of firm purchase orders versus forecasts from the customers is slightly shifting back to a normal state. So, what we are reporting here is purely a firm purchase order number.

We don't report our customer forecast, but with that also in mind, we have good visibility for continued growth. And just to add to that, on the subsidiary side as well, as I've mentioned in the past, we've also been looking to move our business model towards more delivery center or time and material consulting type business, which also has shorter cycle purchase orders compared to fixed price projects, which can typically last a little bit longer. So, while the visibility remains strong, the horizon of purchase orders is slightly reducing, firm purchase orders are slightly reducing from the customers itself.

But from the demand side, as I mentioned, it continues to be strong visibility. Coming to your second question, with regard to the outlook for the standalone business, with the order intake we had on the domestic defense side, as well as some new customer additions that we've had, we continue to see a strong visibility for growth in the coming years. The new customers basically, again, on the EMS side, first of all, we're seeing new opportunities and new orders coming in from some of our existing customers.

This is for areas including defense exports, where we've seen an uptick in demand from some of our existing customers. In addition to that, we also have a pipeline of a few customers with substantial opportunities from Europe, one from North America, and one from the Middle East. All of these customers are primarily basically defense, again, or industrial, and the third was electric mobility. So, with all of these, we feel good that we can grow in the next year as well.

Aditya Chheda: Right. Just one final question.

K. S. Desikan: Sorry, just to add on the number point, see on 31st of December, our order book was INR1,489 crores, and on 31st March, it is INR1,640 crores, which is roughly a 10% increase in the order book. I just thought that point would help you. Please go ahead.

Aditya Chheda: Yes. So, on order book versus last March, we are up 8% from 1540 to 1660, and we've had a good execution year this year. It's more than 70%. So, does that taper the growth rate for FY '25, given the order book growth is only 8%, or we will have more orders that will be executable over 8 to 12 months, which should add to the growth rate for FY '25? Or we should have a slightly tapered expectation for revenue growth for FY '25, based on what the order book was letting you down on today? Yes, that's what…

Nikhil Mallavarapu: Yes. So, as I mentioned, I would not relate the order book growth to the revenue growth, because as I mentioned, the horizon of firm purchase orders varies. So, what we're basically saying is that the demand visibility continues to be strong, and our target to grow over medium term, definitely at 18% to 20% at a consolidated basis, continues to be something that we target to achieve.

Moderator: Thank you. Next question is from the line of Ankit Babel from Subhkam Ventures. Please go ahead.

Ankit Babel: Good morning, sir. A few questions from my side. Now, there is a remarkable improvement in your balance sheet, as you mentioned, both in terms of working capital and the debt side. So, just wanted to know, is this improvement structural in nature, or it was one time in nature?

K. S. Desikan: Yes. Mr. Ankit. I think, you know, thanks for that observation. Yes, it is structural in nature, and it will continue to stay in that range.

Ankit Babel: Okay. So, just to reconfirm, should we now assume that 61 days of net working capital will sustain and will only improve from here on, and also on the debt level, which is at INR174 crores, which you mentioned, will only come down in FY '25, and it will not go up, considering the growth prospects?

K. S. Desikan: Yes. In spite of the growth, one on the working capital, though we closed it with 61 days, I expect this to be around 65 days in that range, and it will not increase significantly beyond that. That's number one. And on the debt, yes, we are at INR174 crores, and we will be in that range of INR170 crores to INR180 crores, because there is some capex planned also.

Ankit Babel: How much is that, sir, capex?

K. S. Desikan: Capex is about INR25 crores.

Ankit Babel: Okay. And, sir, your interest cost was still high at around, what, I think, INR45-odd crores for the FY '20. Sorry, it's INR37 crores, okay, in FY '24. So, do you feel that, I mean, what is your target for the interest cost in absolute terms in FY '25, considering the reduction in debt and everything?

K. S. Desikan: It will be in the same range, because with the higher revenue that we need for higher working capital, and also when you see the finance cost here, there are two components. One is the interest, which is a function of the debt, and which is a function of the working capital. But there are also the bank charges, which include the Bank Guarantee Commission. You know, when we work with the domestic BTS business, we have to give a lot of bank guarantees for performance, bank guarantees -- free issue material bank guarantees and all. And that will continue. So, there is a component in this finance cost.

When you read the annual report, you will see the bank charges. That will continue to be there. So considering both the parts, one is the working capital side, and also the BG side, I expect to be in the same range, between INR37 crores to INR40 crores, and not beyond that.

Ankit Babel: Okay. Second question is on the margin front. So earlier you had guided for a 12% EBITDA margin at the consolidated level for FY'25, considering the cost reduction plans and improvement in the profitability in the overseas subsidiaries. So is that target still doable in FY'25, the 12% EBITDA?

Nikhil Mallavarapu: Yes. So, Ankit, in short, that's what we're working towards. I would say, obviously, some of these cost reductions, a lot of them are already in place. Some of them will be executed in the next couple of quarters. So, overall, we're targeting 12%, but I would say the range I would provide is probably maybe 10%, 11% to 12%.

Ankit Babel: Okay. And sir, last question is on the order inflow side. What was your total order inflows in FY'24 at consolidated level, and what kind of order inflows you are expecting in FY'25?

K. S. Desikan: So for FY'24, it's about INR1,200 crores of order inflow and that's how the opening INR 1,538, like the other gentleman mentioned, it has increased to INR 1,640, because we executed only INR 1,097. And our order inflow will be in line with the growth that Nikhil indicated.

Ankit Babel: So in the range of the 20% growth in order inflows, in line with the revenue growth, which you are targeting?

K. S. Desikan: The revenue growth, I would say, it is in the range, I would say, correct me, Nikhil, it will be in the range of 18% to 20%.

Ankit Babel: Okay. That's it from my side, sir. Thank you.

Moderator: Thank you. Next question is from the line of Amar Morya from Lucky Investments. Please go ahead.

Amar Morya: Yes. Hi, sir. Thanks a lot for the opportunity. Just to understand more on this built to specification, in our overall order book, what would be the built to specification order book currently?

Nikhil Mallavarapu: It's roughly about a third of our overall order book there. So it's probably, maybe Desikan, you can correct me specifically, but I would say it's about INR600 crores or so.

Amar Morya: And this you are saying executable over the next two and a half years, right?

Nikhil Mallavarapu: That's right.

Amar Morya: So, then, sir, basically, then how the margins will improve? Because what I understand here is that this is the segment, which is like a large contributor to the EBITDA. And based on the run rate, which we will be having, I believe the built to specification run rate will reduce from here on, right, on a yearly basis?

Nikhil Mallavarapu: We also see an operating leverage contribution from the EMS business itself, right? I mean, EMS is a volume game in many ways. So, while we see the higher mix coming in from the EMS side, we should also see some slight improvement in terms of EBITDA margin in the EMS business itself.

So, that's where we -- we don't want to give breakups specifically of each business unit margin, but what we have, like I said, at an overall consolidated level, we feel we can work towards that. At a stand-alone level, we are working towards 15% level. And, of course, at a consolidated, as I mentioned earlier, in the range of 10%, 11% to 12%.

K. S. Desikan: Just to add to him, as you know, the stand-alone EBITDA is intact. We are already in the range of 12.5%. And this will further increase because of the improvement in BTS execution during the year, plus the operating leverage he was talking about in the EMS. So the improvement in EBITDA at the stand-alone level is not a problem.

The subsidiary today is operating at around 5% EBITDA. And with the initiatives that Nikhil talked about, we expect that to improve to some 8%, 7% to 9% in this current year. So, that is how for the FY'24-'25, we are looking at some 10% to 12% what he indicated. And eventually, the goal is to move the consolidated itself to about 14% to 15% in the next two, three years.

Amar Morya: Okay. And just to understand, like, sir, now EMS EBITDA would be around, like, the closing EBITDA margin for FY'24 would be around 3%, 4% for EMS?

K. S. Desikan: Did you say 3%, 4%?

Amar Morya: Yes. For FY'24, the EBITDA margin for EMS business would be around 4%?

K. S. Desikan: No. It is more towards the double-digit number.

Amar Morya: Is it? EBITDA margin for EMS business is double-digit, you are saying?

K. S. Desikan: Yes.

Amar Morya: Okay. Perfect. Thank you.

Moderator: Thank you. Next question is from the line of Pradeep Rawat from Yogya Capital. Please proceed.

Pradeep Rawat: Yes. Good morning, sir. And thank you for the opportunity. So my first question is regarding our margins. As Centum Electronics, which sells mission-critical products and is a single-source supplier for most of its products, so then why is our margin and as well as ROIC so low?

Nikhil Mallavarapu: So, first of all, I would say our margins are largely driven by business model rather than the segments that we operate in, right? So, yes, you're right. We do operate in the higher reliability, high-complexity segments. But first of all, what we've basically been saying is built-to-spec kind of business should be at around 20% where you design and manufacture the products so there is IP capture that happens there. Whereas on the EMS side of the business, typically, it's contract manufacturing where the customer designs the product and we make it to their design. And there, the margins can be in the range of around 11% or so.

So, if you had to compare EMS business itself, consumer electronics business or our mobile phone manufacturing business would be probably half if not lesser compared to what margins we are able to realize in these segments. So to summarize, basically, there's two things that determine the margin. One is the business model itself, whether it is design plus manufacture or only manufacturing service. And second, of course, is which segment that you're in. So this is the summary.

Pradeep Rawat: So, between the both segments, we have 50%-50% revenue contribution. Is that right?

Nikhil Mallavarapu: It's about -- at a consolidated level, it's about 40% or so from pure EMS and then about 30% from built-to-spec and similarly another 30% or so from engineering services.

Pradeep Rawat: Okay. So with respect to competition, so who are our competitors and what edge do we have over them?

Nikhil Mallavarapu: Competitors, I would say because we are diversified in terms of the kind of business models we have, I wouldn't say there is specifically one company that is doing everything that we're doing. But if you look at specifically the business models or business units, if you look at EMS type of business, you will see typically like Cyient DLM or Kaynes or any of these guys.

And then on the domestic built-to-spec business, you would see Astra Microwave and a few other players. And on the engineering services side, that is again a pretty broad-based set of competition. We have some Indians, some European players that are of varying sizes again over there. So that's a quick word on the competition.

In terms of what's the differentiator, I think as I mentioned earlier, one of the things that we are able to offer and we do reasonably good job of it is to be a one-stop solution provider to the customers.

So, we have these different flexible engagement models. And especially where the customer is looking for higher engineering touch and deeper domain knowledge in some of these segments, I think we score quite well on some of those aspects. Also, in terms of just our infrastructure, manufacturing facilities, I think it's truly world-class. Our quality performance is exceptionally high.

In fact, in the last quarter, we received an award from one of our customers for high-quality performance, which is really a key point in some of the sectors that we operate in. And of course, I think we have good relationships with customers. A lot of our customers have been long-term engagements and that's something that we're able to focus on. And especially with large global OEMs, we're able to work with and manage those relationships very well. That's great.

Pradeep Rawat: And so, last question about, do we have six-five contract or there is a path through mechanism? And what is the order book execution timeline? How much of the order can we execute this year?

Nikhil Mallavarapu: Yes. So, in terms of the mechanism of the contracts, again, here it varies depending on the business. Typically, EMS business, yes, for the most part, the costs can be passed through because it's really a cost-plus model that we operate on. So, we have that there. Built-to-spec business tends to be more fixed price in nature, although in certain cases, especially if it's a government customer, it is really a fixed price.

But with certain private companies, you have an opportunity to discuss, renegotiate where appropriate. And on engineering services, again, I would say you have both models. You have a delivery centres or time and material kind of model, which is cost-plus. But you have some fixed-price contracts as well. But that's what I mentioned earlier.

We're looking to reduce the higher-risk engineering services fixed-price contracts and move towards more of a higher-margin service centre or time and material kind of model. So, that would answer your first question. Second one is regards to execution horizon for the order book. As I was talking about earlier, the horizon varies, depending on the business.

Typically, the built-to-spec business may be on a two-and-a-half-year kind of execution horizon. Our EMS side is typically around eight to 12 months, and then engineering services may be again less than 12 months, six to eight months or so. And so, at the overall consolidated basis, it's INR1,640 crores or so is, I would say, in the range of about 13 to 15 months kind of execution period. Around 15 months, I would say, typically 15 months.

Pradeep Rawat: Okay. Thank you. And all the best for your future endeavour. Thank you.

Moderator: Thank you. Thank you. Next question is from the line of Karan from Niveshaay. Please go ahead.

Karan: Yes. So, I wanted to understand this one-time increase in other expenses due to provision cost and the impairment caused by the recurring investment. Can you explain it in more detail? What does it pertain to?

K. S. Desikan: Yes. See, in total, roughly INR11.3 crores is the one-time in the consolidated results. So, if you look at that, INR5 crores is shown as exceptional, which is a cost reduction program initiated in the French subsidiary. We have provided for the severance cost of employees and which, going forward, would result in reduction of manpower expenses, employee benefit expenses. So, that is INR5 crores. And another INR5 crores in the subsidiary, again, is provided in the other expenses more towards the aged unbilled revenues.

What happens with the customers having fixed-price contracts, we keep working. These are big projects running over a couple of years, and there are overruns, and then we keep negotiating, fighting with the customers for the variation order. In fact, if you remember, Nikhil was mentioning about the expected variation order of 800,000 in Q4, which did not fructify. So, these are the aging unbilled revenues for which, with the advice from the auditors, we worked upon for a provisioning policy.

And that is the provision that we have made towards the unbilled revenues, that is about INR5 crores. And another INR1.3 crores, it is an investment made by the standalone entity, for which, we have taken an impairment for that investment at INR1.3 crores. That is a total 11.3, of which you will see INR5 crores in the exceptional line item that is below PBT, and another 6.3 is in the other expenses, in the consolidated.

Karan: So, the severance pay, could we expect it to repeat, or is it one time only?

K. S. Desikan: Sorry?

Karan: The severance pay, the thing that you are mentioning, the exceptional item, is it also one-off, or do we expect it to?

K. S. Desikan: No, no, all of these are one-off.

Karan: Okay. And also, Yes, understood. What about the contract that we are not able to, we are comfortable, we are not able to realize money, so are there any other contracts that we can expect a spill over of any BTS contract for the next quarter, the amount of this contract?

K. S. Desikan: No, I think we have provided for, that is where we have put the policy to analyse and take a provision. This is the one time, like I explained. We don't see anything more coming up in the coming year.

Karan: Okay. And also, we have been talking about those large-size BTS orders, like the one that we received in the last quarter. So, would it be okay to share some details about it, like what would be the other projects that we are targeting, what would be the size, and when can we expect it to at least get the bidding for the contract?

K. S. Desikan: Nikhil?

Nikhil Mallavarapu: We won't speak about specific, Yes, we won't speak about specific contracts, but I would say, more generally with regard to the questions with regard to the build-to-spec business for the domestic defense and space sector, just to speak, there's broadly three areas I would say that we've been focusing on.

One is essentially the space itself where we've been strong for quite a long time, and while we have won this order in the last quarter, we also have a visibility on a couple of other significant opportunities in similar sort of sizes, which are coming in. We hope to book at least some of that in the coming year, but obviously, Government of India timelines tend to be unpredictable, and especially with the election season on now, we'll have to wait and see what happens after that.

But the pipeline is strong, and we are well positioned to win a few more programs with the domestic defense military satellites space. Apart from that, we've also been working with defense public sector units in terms of end-to-end and also some DRDO labs basically on delivering import substitution of subsystems that go into various projects like land systems is one of them where there's still a lot which is being imported from Russia, and we're looking at indigenizing various products there.

And electronic warfare and radar are the two areas that we've been also focusing quite a bit on. In fact, the project that we've just won in Q4 for space was actually an electronic warfare payload itself. But this product or technology is also deployed on land systems, on airborne platforms like jets and naval platforms as well. So, we are looking at working on various programs in certain cases, even collaborating with some foreign partners to deliver a full system.

Again, here, some of these timelines are a bit uncertain. But I would say for now that we expect to maintain or improve, actually, I would say slightly improve our order booking in the domestic build-to-spec business in the coming years. And I think beyond that, there are some large opportunities which will take probably a couple of years or so to convert.

Karan: So, this will be a similar-sized contract, like INR200 crores or more?

Nikhil Mallavarapu: There's multiple different contracts. As I mentioned, I won't speak to specifically contracts. But as an overall order book, I think we should do better even compared to the past year.

Karan: Understood. And one last question. Would we expect our subsidiaries to be profitable this year or narrow the losses that we have incurred for FY '24?

Nikhil Mallavarapu: Yes. So, that's the objective. I think, obviously, we had a combination of two things. One is the one-time expenses, which Desikan mentioned, which we don't expect or anticipate that will happen again. And also, in terms of operational performance, as I mentioned, some of these costs that we already took were for reduction of overhead expenses and costs. And so, just with these things, we hope to at least cut the losses. And also, we have obviously a very clear action plan on the operational side to improve the utilization and margins and so on at the subsidiary level. So, with that, we do expect to see a good turnaround in the next year.

Karan: Understood. Thank you so much and all the very best.

Moderator: Thank you. Next question is from the line of Chirag Kachhadiya from Ashika Institutional Equities. Please go ahead.

Chirag Kachhadiya: Hi, Nikhil and Desikan, I have a few questions. As a great amount of revenue is coming from EMS verticals, then how do you expect that the margin will tend to in the band of 12% to 15% from CES perspective? And second, what's our strategy to participate in the indigenization program, be it run by HAL or this for Indian Air Force replacement fleet for this Sukhoi and Tejas and all?

Nikhil Mallavarapu: So, basically, you want to take the first one?

K. S. Desikan: Yes. Thanks, Chirag. See, the point is, though the revenue growth will be led by EMS, there will be a significant improvement in the domestic BTS business, which is space and defense. And as you know, they are having higher margin. So, the business mix is also expected to improve in terms of contribution from the domestic BTS business. That's point number one.

And also, in the EMS business, as you know, we are staying clearly in the high-end and high-tech areas. And also, we are onboarding customers with, you know, eventually in a couple of years should turn to at least about five to six million in a minimum scale. So, we are able to, we should be able to maintain the relationship to improve the valet share and also maintain the profitability. So, it's a mix of both. For the standalone EBITDA to improve up to 13% to 15% will be the range, I would say. So, that should be possible. Yes, Nikhil.

Nikhil Mallavarapu: So, to your second point, Chirag, in terms of what we're doing on the indigenization programs, I think, broadly speaking, there's a couple of different approaches that we use. One is, of course, where there are subsystems that are currently being imported and we are able to design our own form fit function equivalent. We actually invest our own R&D.

As I mentioned earlier, this is something we've done, for example, on the land system side. We started to see some traction on that with first orders and RFQs also coming in as a result of our qualification on some of these products. So, that's where we have invested our own R&D on a proactive basis to offer an equivalent solution.

Second is on some of the bigger programs, we obviously work with DRDO. These are tenders that come out and we compete to win some of these. Once the product is designed and realized and integrated onto the platform, then they would basically get into production from there on.

And the third is, obviously, in some cases, we are also, you mentioned Sukhoi and so on, so we also in some cases go and look at offering a full system to the tri-services, in some cases with the technology collaboration. These are broadly what we're doing.

Chirag Kachhadiya: So, in case of EMS offering, do we have a price pass-on capability, let's say, if raw material ends up due to any geopolitical or supply chain related disturbances? So, in future, if such incidents again happen, how are we going to increase the price and pass on the raw material related volatility and also maintain our margin, particularly?

Nikhil Mallavarapu: Yes. In EMS, typically, the way it works is there's annual price negotiations that happen with the customer. The products that we make itself are really long-term products. They're in production for, in some cases, 10 years plus, but there's annual price negotiations. Here again, in general, this is a cost-plus model, so we are able to pass on any supply chain cost increases to the customers. Customers themselves are quite well aware of our sub-suppliers' situation and the global supply chain situation.

So, it's a discussion that we have, but typically, there's a fair amount of the bill of materials, which the pricing itself -- is controlled by the customer, and then a smaller share of it, which is controlled by the EMS provider. So, there is a small risk, but in general, it's a pretty transparent cost-plus model with the customers, so we have the ability to pass on any cost increase.

K. S. Desikan: Just to add two small points to that. One is, I want to reassure that the supply chain situation today is a lot better than what it was probably a year back or two years back. So, that kind of ensures the stability in the supply. That's number one. Number two, as I explained earlier, we are targeting customers who understand the EMS business and allow us to make that margin.

So, there need not be a struggle to, you know, pass on the cost increases, if any. The customers do understand because, like Nikhil mentioned, it's a transparent book that we maintain, so that should not be a problem, passing on the cost increase. Thank you.

Chirag Kachhadiya: Thank you, Desikan.

K. S. Desikan: Yes, thank you.

Moderator: Thank you. Next question is from the line of Amar Morya from Lucky Investments. Please go ahead.

Amar Morya: Sir, just for clarification, so that means what the build-to-specification business in our standalone would be having like 14.5% to 15% margin because EMS is contributing 10.5% to 11% and your standalone EBITDA margin is around 12.5% reported?

K. S. Desikan: Yes, FY '23- '24 was like that, exactly.

Amar Morya: But normally what I understand, sir, build-to-specification has a better margin business?

K. S. Desikan: That is right. But this year, unfortunately, we had a lower share of built-to-spec in the standalone entity due to, you know, the customer-related issues of certifying, assessing and all of that stuff. But we guess this should not be the case going forward in FY '24-'25.

Amar Morya: Okay. And in build-to-specification, you have a bit of Canada business also, right?

K. S. Desikan: Yes, that is coming in the consolidation.

Amar Morya: Yes, that is coming in the consolidation. Okay. Got it. Perfect, sir. Thank you.

K. S. Desikan: Thank you.

Moderator: Thank you. Next question is from the line of Prabir from Ratnabali. Please go ahead.

Prabir: My question, I have two questions, but one from space and another is regarding your pipeline. First, in space, if you can help us understand the broad level that is the space sector and out of your INR1,600 crores of order books, what is the space portion? And I want to know if you can give us a break up of your revenue in FY '24 in how much is defined, how much is space, and the space in how much it has grown from last year?

And about your expectation of space order pipeline going ahead. This is my question related to space. And the next question related to pipeline, can you say that you are working with DRDO for some projects? If you can name some of the big opportunities or large projects that you are working on with DRDO? These are the few questions.

Nikhil Mallavarapu: All right. So, the contribution in terms of revenue by sectors, I think we've covered that in our earlier presentation. Roughly, defence space and aerospace have been about a little less than half, about 46% of the overall revenue. Mobility, which includes transport, which are railways, what we call, and automotive is about 23%. Industrial and energy is about 26%, and healthcare is about 5%. So, this is a split from a segment standpoint.

Specifically, the split between space and defence, I would say, that's not something, that's not the way we would look at it, and probably not something to share here. Obviously, even on the space side, the end customer or the application is, for the large part, defence only. So, that's where we look at it from an overall BTS defence space, aerospace numbers. So, that's that. And then in terms of some significant programs, I think I touched on earlier broadly the areas that we're in. So, I would just leave it at that. Basically, radar, electronic warfare, and land systems. I would say these are broadly the areas apart from space platforms where we are working.

Prabir: Okay. Thank you.

Moderator: Thank you. Next question is from the line of Amit, who is an individual investor. Please go ahead.

Amit: Yes. Hi. Thank you. Morning, Nikhil sir. Morning, Desikan. sir. Sir, most of my queries are with respect to understanding the overseas subsidiaries and the efforts that we are spending there. As I believe, I think most of the heavy lifting is kind of required on that front. So, Desikan sir, my first question is, so, you explained like INR4.9 crores of the expense package that has been done. So, if I can ask like how many employees have been laid off for respect to that? And then what kind of employee cost benefit will come to us in the Q1 and the next year? And do we have similar program for FY '25 as well?

Nikhil Mallavarapu: Yes. I would not like to say specifically how many employees, but I would say at a cost basis the overall program that we have identified, it is an overall overhead reduction program. It is not only a cost out, I mean, it is not only a layoff plan that we talk about. There are other overhead expenses also we are looking to reduce.

So, the impact for that we expect in this financial year is to the order of about 2 million euros. And there would be certain other things that we also take on as and when we get implemented. But this is sort of a one-time push that we have taken to make a step change in terms of the cost structure for the subsidiary. And this, I mean, some of it will fall in the first quarter, but some of them will come subsequently in the later quarters as well. So, what I mentioned was more at a full year basis.

Amit: So, just to confirm, the EUR2 million for the full year, that is a kind of a benefit?

Nikhil Mallavarapu: Yes, that is about it. Yes, again, any inputs?

Amit: And sir, any other similar kind of plans for FY '25? Should we expect something in terms of what's the roadmap and what's the plan to turn around the overseas subsidiaries on that front in terms of reducing the cost? Because as I can see right now, the cost, the employee cost that we have is to the tune of INR67 crores in the overseas subsidiaries.

Nikhil Mallavarapu: Yes, apart from this, there's also operating improvements also that we need to make, which we have a plan for that is in terms of utilisation improvements. So, it's not really a cost reduction as much as whether one part is utilisation improvements, the second is also with the shift towards the higher margin projects, as I mentioned earlier, some of the low margin businesses workers pull down the margins also a little bit. So, we are also working through the process of reallocating engineers from higher margin to lower margin, to look from low margin to high margin projects.

So, with this, we also expect some level of improvement on the operating margin. So, that's where with all of this, we expect an improvement in the margin of the subsidiary level, and that's where the number for consolidated basis, we are expecting to drive to about 11%-12%.

Amit: Okay. So, on the same line, so in the overseas subsidiaries, as I can see, the receivables have drastically come down. And right now, it is only INR7 crores-INR8 crores in the overseas subsidiaries against the sale of INR128 crores that we made in the Q4. So, is it a right understanding that whatever sale that we have done in the Q4 in the overseas subsidiaries, we have got the balances, advances from the customers, and then will it be the similar kind of a model going forward that will execute only against advances?

K. S. Desikan: No, in the subsidiary there is a factoring of the receivables, which is without recourse. So, that is how you are seeing the receivables to be lower there. So, we have entered into a factoring arrangement with BNP Bank there, and thereby, as soon as we invoice, we are able to factor that and show that as a collection because it is without recourse. And we expect this model to continue.

Amit: Okay, which is good. Just a kind of follow-up on the first one. So, even if we exclude those 5 million or 5.2 million that you have explained in the provisioning that has been done, the other expenses for the overseas subsidiaries is still at a slightly higher level. So, right now, I think we have kind of documented INR16.9 crores, out of which, if we exclude 5.2, which are we are still left with INR11.7 crores of other expenses in the subsidiary unit, which I think is still significantly higher than compared to what we had last year or even in the Q3. So, what do we expect on that front, sir? Is it like, why is it so high? And then, do we expect it to come down in the coming quarters?

K. S. Desikan: No, we said it is INR5 crores, which is 50 million. It is not 5 million.

Amit: No, sir. I think I was referring to, if I simply do math, take out, from the consolidated, take out the standalone, I am leaving aside with I am left with the numbers for the overseas subsidiaries.

K. S. Desikan: Yes.

Amit: Which is giving me other expenses in the overseas subsidiaries that we have booked is INR16.9 crores today. Now, out of this one-time expense, you are saying 5.2, which we exclude, we are left with 11.7 in the overseas subsidiaries, the other expenses. A similar number in Q3 was 6.8 and last year it was 9.8. So, it is still like slightly on the higher end for the overseas subsidiaries, like these other expenses.

K. S. Desikan: Well, I need to check, because very clearly the extra expenses for the subsidiary is 50 million rupees, which is INR5 crores. So, if you exclude that, I do not see a huge increase at all, because are you looking at the other expenses for the full year in consolidation, which is INR112 crores, right?

Amit: No, I am looking at other expenses for Q4, only for the overseas subsidiaries, which I pulled out based on consolidated minus the standalone number of other expenses.

K. S. Desikan: You are looking at what, Q2 is it?

Amit: Q4, sir, the latest two numbers.

K. S. Desikan: Q4 consolidated was INR325 million, right? And the standalone is…

Amit: 15.9, 155 million.

K. S. Desikan: 155, correct.

Amit: So, we are left with 169 million?

K. S. Desikan: Yes.

Amit: So, if we exclude 52 from this, I think we are at 117 million?

K. S. Desikan: If I take out INR50 million from that, yes, it is 119, correct.

Amit: Correct. So, it is still higher, if I do a similar match with Q3 and last, Q4 numbers of 23, it is still slightly higher by INR2 crores. So, what do we expect going forward?

K. S. Desikan: No, just at the outset, I would say that it will not increase any further. There could be some one-time expenditure like travel, etc. which I need to check but it will be maintained at the current levels, minimum.

Amit: Overall, the roadmap for, right now we are at a stagnant sale of like INR120 crores, INR128 crores on the overseas subsidiaries. Are there any plans to take these numbers to higher levels? I know we are targeting to, improve the margins but is there also any sort of a plan for the roadmap to increase the sales on that front because it is almost static or constant at this point in time?

K. S. Desikan: So, this year the focus is mainly on fixing the profitability, but nevertheless, there will be an increase, but it may not be more than 8% to 10%. That is for sure. But it will be a complete turnaround in terms of profitability that is definitely.

Amit: Any other efforts that, the company is trying out or, to do in FY'25 or overseas, like anything you want to do, like shed more light in terms of like whatever efforts for FY'25, like you talked about numbers. I am trying to understand, how are you trying to achieve those higher margins and 8% to 10% sales.

Nikhil Mallavarapu: I mean, in terms of...

K. S. Desikan: Nikhil, Just one second. I just wanted to clarify the other expense increase we asked for. One of the problems is, last year the Euro was converted at INR83.7. And this year it is at INR89.9. So, there is a significant depreciation of the rupee against the euro. So, even for the same other expense in euros, I am showing a higher number in terms of other expenses. This is roughly INR6 over INR83. This is another point that we need to consider when we look at the numbers in rupees. Yes, Nikhil.

Nikhil Mallavarapu: Yes. So, you asked about other points to cover at the subsidiary level. I think we talked about most of this in terms of the actions to improve the margin. I think from the customer front, as I mentioned earlier, we do have a very strong profile of customers and we have got some good strong niche capabilities in some of them as well. So, there are some promising opportunities that we see from the aerospace and defence side.

Airbus is a customer that we have been engaged with for some time, but we see our share of it is quite small. So, we are working on a few opportunities to increase that. Apart from that, we also have a good opportunity with an opportunity product that we already have a device company to design and we hope to get into mass production for that in the next year.

Which should also drive a good amount of incremental revenue on the subsidiary level. So, these are a couple of points. The other thing is also the Canada part. As, it has been a drag on the margin but the technology there is again something that we have now shifted a large part to India. We are executing the Delhi Metro and Chennai Metro projects.

A lot of the work for those projects, even the design part of it is being executed from India now. And we are really, I would say, the only company at a global level able to deliver these kinds of systems to the train builders. And as a result, we have also worked on increasing our pipeline in terms of real projects for the domestic market, metros and even the passenger trains that are expected are in various stages of and all of that, where we are participating and looking to capture that, which also could be a sizable opportunity.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, we will take this as the last question for today. I would now like to hand the conference over to the management for the closing comments.

Nikhil Mallavarapu: Thanks again, everybody, for joining the call today. As I mentioned, it's been a strong year for us at a standalone level. And also at the consolidate the level, we crossed the INR1,000 crores mark, which was an achievement. The actions are put in place to improve the margins at the subsidiary level.

And I think with these points, we are having a positive outlook for what we're expecting in terms of both growth and profitability in the coming year. The pipeline continues to remain strong. So, the sustainability of the business also is very strong. And I think with all of these, it's quite positive for what's in store for us. Thank you, again.

K. S. Desikan: And we continue to stay focused on balance sheet improvement as well. Thank you.

Moderator: Thank you. On behalf of JM Financial, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.