Transcript of the Webinar held on August 04, 2022, to discuss HCC Q1 FY23 Results

Santosh Rai: Good evening, everyone! Welcome to the Analyst Meet for Q1 FY23. In this meeting, we are joined by Arjun Dhawan, Vice Chairman, HCC, Jaspreet Bhullar, CEO of HCC E&C, Rahul Rao, CFO of HCC and Girish Gangal. I am Santosh Rai. I head the operations and am also the company's Chief Business Officer.

I will start with the order backlog position. We have an order backlog of around ₹14,875 crore as on 30.6.2022. Again, transport leads the bulk of the order back log, followed by hydro and nuclear and special projects. Maharashtra and Uttarakhand continue to be the highest concentration geographical locations where our projects are based.

We are continuing with the BD strategy of focusing on high-value jobs in the urban infra, underground structures and hydro power space, where the company enjoys having sufficient and leading technical capabilities. Key highlights for the quarter are the consolidated group revenue at ₹2,229 crores in Q1 FY23 versus ₹2,454 in Q1 FY22. We have a loss of ₹279 crore in Q1 FY23 versus a profit of ₹180 crore in Q1 FY22. Standalone E&C turnover is ₹984 crore versus ₹1,018 crore in the corresponding quarter previous year. The EBITDA margin is 10.5% in the current quarter versus 17.1% in Q1 FY22. The standalone loss of ₹151 crore in the current quarter compared to a loss of ₹43 crore in Q1 FY22. The quarterly performance was impacted largely due to lower-than-expected turnovers in our Mumbai projects. This largely happened due to protests by fishermen at our coastal road project and a considerable shortage of skilled labour for our two large projects in Mumbai. On the other hand, we had a robust performance of the BOT assets, with our BFHL registering an impressive growth of 31% this quarter and the stake sale of BFHL is on track.

I am happy to report that the Debt carved-out resolution plan is in the final stages. We have definitive documents already signed with 100% of the HCC lenders, and the NCD issuance process has been initiated.

Talking about some of the project progresses, this is DC06 – Delhi Metro. We have done around 54% completion of the overall project. So what you see is the upline almost complete, and now the track laying work will start, whereas on the downline, we are continuing with the boring, excavation, and erection of segments.

Anjikhad Cable-stayed bridge - a very interesting project, where we have achieved around 56% of completion; what you see on the screen is the central pylon of the project, nearly 200 m tall, that has been completed, and now the stay cable erection is in progress. Here you can see the second stay cable erection is in progress, and we are continuing with the remaining cables.

The Imphal Road project, where the project completion is around 61%, and the bituminous and DBM works are ongoing in this stretches wherever the scope is available. But, again, this project suffered a little bit due to untimely rains in this part of the country. Here the rains usually start from June, but this year we witnessed rain from April onwards.

For the Tehri PSP project (4x250 MW), what you see on the screen is the hydro-mechanical works in progress for the installation of the turbines. Another view of the TRT outlet for the same project.

Vishnugad Pipalkoti Hydropower project completion is around 21%. You see the excavation works and the mining works in progress in the machine hall and the transformer hall. The segment production has already commenced, and you can see the segment stacking is done and then the TBM. Where the TBM has to enter, we have started doing the protection works.

Tapovan Vishnugad, another project with NTPC here, the overall completion is 17%, and the TBM portal here was damaged due to the floods in Uttarakhand. The restoration of these TBM portals has been completed, which is a significant step in achieving further progress. On the other side, we do the tunnel using the drill and blast method.

Nikachhu project is in Bhutan, where we have completed 85% of the overall project, and the dam concreting has been completed around 96%. The Head Race tunnel has been completed to a significant portion - almost 8 km completed out of 12 km. The powerhouse complex is getting ready to receive the equipment.

T49 Tunnel in J&K - This is one of the longest tunnels for the railways, which we are now completing. The overall project completion is around 76%, with the lining works in progress for the main and escape tunnels. Some bridges are also part of the scope. Here our scope is till the substructure, which we have completed, and different agencies will do the superstructures. You can see on the screen these bridges where the substantial part has been completed. This is station work which is in progress. This is an additional scope that the client has given as part of additional variations to work.

Unit 7 & 8 of RAPP - the project is now almost 97% completed. We are looking at the completion in a very short time. This is a location where HCC has built all units. What we are doing right now is Unit 7 & 8, but unit 1 to 6 is done by HCC. Some pictures of the work in progress where we are doing the outer containment dome, and the ring beam works.

This is again a Department of Atomic Energy project - a BARC, Tarapur complex. These facilities are created for nuclear fuel recycling and are quite technically challenging structures. We have achieved 70% completion for this project—another picture showing the amount of enforcement and other detailing.

Coming to Mumbai Metro, here the overall project stands completed till 67%, the main station, CST station of this project is almost 80% complete, and now we are starting the finishing works. The tunnelling is nearly completed here. The Girgaon station is located in a challenging location in terms of traffic and everything. Here also, we have done 27% work. We have completed 57% of the Grand Road station, and the inside NATM platform widening works are in progress. The Kalbadevi station is in a congested location, and we have achieved 53% completion.

Update on the coastal road! The overall projects stand at 42% completed, with major reclamation works almost finished, and the major focus is on bridge works. Unfortunately, the progress on the bridge works was hampered due to the protest by the fishermen community in this area. They are agitating for a longer span because of which we are not able to carry out the works where the scope is available in the marine portion. Other than that, the other work like preparing for the segments and other things is in progress.

Now coming to debt resolution, I think the update with respect to the previous developments is that 100% of the lenders have signed their definitive documents. And the NCD issuance process is initiated. The rest of the details remain the same as what has been shared.

For financial performance for Quarter 1, I leave the numbers for all of you to read through; we will come back on any specific questions you have.

Concessions business, as we discussed previously, we are seeing a good PCU growth in this quarter, almost a 34% jump because we had some downfall during the Covid period. Even if we adjust for that period, we can still see a growth of 13%. Construction margins are impacted due to early monsoon, but completion targets remain unchanged. And we are working on identifying new opportunities to rebuild the portfolio. We have already submitted our first bid in the previous quarter.

Performance for the Steiner, our subsidiary in Switzerland, as on 30.6.2022, we have an order backlog of around ₹7,400 crore. There was an order intake of almost ₹804 crore this quarter compared to nearly ₹1,881 crore in Q1 FY22. The financial numbers are there on the screen. The temporary loss is being reported due to some accounting standards which we are following here.

Thank you, and now we are open to questions.

Sandeep Sabharwal: Since the debt resolution has been delayed a lot, so every quarter, you are reporting some ₹240 crore of the interest cost. The resolution was almost complete a year and a half back, so what happens to this interest cost? Does it get accumulated in your debt, or how does it happen?

Girish Gangal: Interest cost along with the debt will get transferred once this resolution plan is executed in full. As Santosh mentioned, documents have already been signed, and the NCD process has been issued. Once the NCD process is completed, the entire interest cost accumulated to date along with the debt is likely to be transferred to SPV. The Debt will get transferred, but the impact will be seen only from the 3rd quarter, reduction of interest in the results.

Sandeep Sabharwal: My question was that if the resolution happened in March 2021, then for the next 4 to 5 quarters, the interest cost appearing in your P&L that would have been reduced already. Will this get added to your overall debt, which is getting transferred? This is what I want to understand.

Girish Gangal: Interest cost did not get reduced. Because till the time resolution plan is completed, interest remains in my account, and as and when this gets transferred, all the unpaid accumulated interest will be transferred to the SPV along with the debt. So this can be seen in the results only post 3rd quarter.

Sandeep Sabharwal: But that will have to be paid by you subsequently.

Girish Gangal: That is to the resolution process, the agreements whatever we have done, you might have seen in the slide, it is a staggered payment in the SPV starting from 2026 to 2030.

Sandeep Sabharwal: The second question is that since you said you would be starting to bid for new projects, what is the kind of pipeline you see and any orders where you are L1?

Santosh Rai: Sandeep, as of the moment, we have a very robust pipeline. We are looking to bid in the areas in which we have identified volumes around ₹15-20K crore is what we are looking at to bid for. As of now, we are not L1 in any of the jobs, but we have a bid under evaluation of around ₹4,000 crore. At the same time, we have identified a couple of large opportunities where the company enjoys sufficient strength and are pursuing those opportunities.

Sandeep Sabharwal: My last question is that historically, we have seen that HCC is one of the oldest construction companies and a company where many of your projects are going into arbitration, etc. Because of cost escalations, you have to fight a lot to get that money back. Is there any change in the way you bid for future projects so that you don't get into surprised losses and arbitration processes that go on for years?

Santosh Rai: Here also again, Sandeep, you are right! It is a function of what contract conditions you are biding with. Fortunately, the government has taken many positive steps in this direction. So today, when we are getting into the bids, with lots of clearances, prior permission, and other necessary things, the government is taking it upfront. Land acquisition has also been taken to a greater extent, and the client is securing the financial support required for the projects. I mean to say, the financial closure of those things is done very prudently. Coupled with these, the new contract dispute resolution mechanisms or dispute avoidance mechanisms are being built into contracts. So we are largely choosing such contracts where such frameworks exist, which allows us to settle small matters or matters of technical complexity within the currency of the contract so that neither the client nor us get into this time-consuming litigation process. So that is our clear take on this matter, and we are prudently pursuing such bids.

Sandeep Sabharwal: How much would the interest cost reduce on a quarterly basis once the resolution goes through?

Girish Gangal: Roughly 100 crore.

Sandeep Sabharwal: Alright. Thank you very much.

Mohit Kumar: My question is on the restructuring; where are we right now, and when do we expect it to close? And let's say it closes in the next 3 to 4 weeks, post which, when do you think we can start participating in the bids, full-fledged, in a sense, we start making the order in our books, and we will have all the BG and P&L and what we require for the bidding. And the timeline, what are the steps prior to getting back on track as far as bidding is concerned?

Santosh Rai: As far as the resolution plan is concerned, 100% of the lenders have signed the definitive agreements, and then we are already into the process of completing the other administrative formalities, for which I think we expect this to be closed very shortly. That's number one, but the important thing is that you are asking how we will start bidding; in fact, we are already on with the bidding activities for the identified projects. We expect that by the time these bids come to fruition, we will have sufficient bonds and BGs available in our hands to take care of these obligations.

Arjun Dhawan: So, Mohit you said it right! We got 4 to 5 weeks to go. There is just the SEBI approval that is pending, and after that, as far as the new business is concerned and our plans as far as operations are concerned, we are looking at September onwards.

Mohit Kumar: On the cash flow, has everything come into the company or is there something that is still pending?

Arjun Dhawan: The same answer to this question is another 4 to 5 weeks. And our balance sheet will reflect that liquidity by the end of this quarter, so we expect that either end of August or probably the first couple of weeks of September is when we are looking to close that finally. So the only thing pending there is our NHAI approval. As far as the closure formalities, we have already closed all the commercials; the documentation is in fine-tuning stages and is just formalities required for the final closure.

Mohit Kumar: How much money are we looking at?

Arjun Dhawan: We have already issued a press release on that front; we are looking at; I think it was communicated that this was a ₹900 crore net, and obviously, the enterprise value is much higher than that, but we are looking at a ₹900 crore transaction in which ₹300 crore is the securitization of a future revenue share which is available to us as a loan so that is liquidity that we can draw down immediately. But the ₹600 crore, which is the base equity we will receive from this, is monies that will come into the group.

Mohit Kumar: Understood. Thank you and all the best.

Arjun Dhawan: Thanks Mohit.

Anil Ahatajee: My first question is to understand the process a bit; when I see some of such large bids that are being awarded, typically, the work on the bid starts 6 months after the award; I just want to understand what happens during this 6 months and why does it take such a long time to start the bids. Typically, in the road sector and other sectors?

Santosh Rai: Anil, these bids are largely design and build contracts. Let's say you win a bid today; in this initial period, you spend largely on planning and setting up the facilities at the site, which will help you to do the main work. During this period, you are also closing all your design works in terms of preparing the design and taking the intermediate and final approvals. Post that, only you can start working on any permanent structure. So this 4 to 6 months usually goes into this kind of preparation.

Anil Ahatajee: So that is a fair period accordingly to you?

Santosh Rai: Arvind: Yes, it can be even bigger for large jobs.

Anil Ahatajee: Understood. The other question I have is partially answered, but to understand it better, what will be the proforma debt component after Q2 once this agreement is signed and everything is done, and the proforma interest cost? I heard the interest cost will be ₹1,000 crore, right?

Santosh Rai: No, I think what Mr Gangal said is that the interest cost will go down by ₹100 crore quarter on quarter.

Anil Ahatajee: So what will be, then it is around like ₹140 crore.

Girish Gangal: Yes, ₹140-150 crore roughly, that's right.

Anil Ahatahjee: And what will be the proforma debt on the books then? It will be like ₹5,000-6,000 crore.

Girish Gangal: Yes, lesser than that; if you take only fund-based debit would be lesser than ₹6,000 crore, it would be roughly ₹3,500 crore.

Anil Ahatahjee: Ok, thank you.

Chetan: I just wanted to know the thought process of doing the QIP issue now at this stage.

Arjun Dhawan: We have discussed in the board that it is just an enabling resolution for us to keep that option open. We have had an interest in investment in the company, and to be very frank, while we, from a cash flow perspective, have our planning for the next number of years well thought out, including the return of capital from subsidiaries including our monetization plans, our operations and our business growth, we don't want to miss the growth opportunities that we see in the next couple of years. And real growth will generate the kind of performance we would like. So should the opportunity exist, and for us in an environment where we are seeing volatility in commodity prices, the world from a captive perspective has become a little more uncertain. And we want this cushion to be extremely comfortable should we choose to execute.

Chetan: So it is not as if we are going to do the QIP now?

Arjun Dhawan: No, we are taking that resolution in place now, and as I said, I think we will keep an eye out for opportunities that are some extremely large projects that we have our eye on. The entire purpose of the QIP would have proceeds for growth capital. And there are some other strategic opportunities that we have been offered or faced with, so I think as far as shareholder wealth and value is concerned, we see this potentially as an accredited way to do that. So it's an option we would like to have in place.

Chetan: Ok.

Ashish: I quickly wanted to check on the QIP, and it is going back to the last question Arjun answered it a little bit, but from a timing perspective are you looking at doing it prior to the closure of the bank restructuring or post that because obviously once the bank restructuring is done one would expect a rerating of the company once you are able to put up your September numbers.

Arjun Dhawan: That's absolutely correct. First of all, we are a few weeks into closing the reorganization of our debt, which will lead to substantial deleveraging. Proforma, about ₹3,000-3,500 crore debt will leave our balance sheet, and the interest cost for that will also basically move off and provide us with a lighter structure; our earnings will be as considerably as risen higher. We have our eye, as Santosh said, on new jobs. Over the last 12 months, a lot of work has gone into identifying exactly those jobs we want to target and win. We recognize that any dilution of an existing shareholder base needs to be done as what we consider to be an appropriate valuation. So we will do that when we actually feel that that makes sense. Clearly, the board has to have that rerating done as you talked about and then some other positive events also basically happen alongside some of the strategic interest that we are considering.

Ashish: Sure. And in terms of LAVASA resolution, is any further headway or is that still a work in progress?

Arjun Dhawan: You probably get more information on that than we do. Unfortunately, the IBC process, as you know from a law perspective, keeps the creditor in the possession process. We get the information from a public perspective as quickly as you do. I think our interest in this to see a resolution is simply because we were one of the promoters and key shareholders in LAVASA, and this was one of the brainchild, and we want to see this succeed. I think our information is as recent as yours, which is when a buyer has been identified and shortlisted and the NCLT needs to finalize and put all the check marks on it. I'll ask my finance team does anybody have any further details as to where that process is; maybe, in fact, what we can do is offline; just come back to you on that answer, Ashish.

Ashish: Thanks, Arjun; that will be helpful because it can also kind of take away any potential blowback of LAVASA.

Arjun Dhawan: There is a little bit of a misconception about any impact from that. As far as LAVASA is concerned, we took every rupee right off at the time LAVASA went through IBC from a debt and equity perspective. And so, as far as any recourse is concerned, voluntarily or otherwise, there is no blowback as far as that is concerned. But you're right; perhaps that perception will go away once this resolution is complete. We will surely communicate that to you as soon as we have further information.

Ashish: Surely, thanks; I look forward to connecting with you guys offline. Thanks and all the best.

Arjun Dhawan: All the best to you as well. One point that I wanted to add is Sandeep's first question: All the interest that has been accruing since we started this plan will move off the balance sheet. So you will notice that our debt numbers have slightly crept up. We have seen debt repaid out of the group level, but some of the debt numbers have crept up, but all of this will move off the balance sheet. And as far as the requirement to repay this, we are entirely committed to do so, and there is enough asset cover to do that in the SPV. The arbitration awards alongside which this debt will move off also carry interest in post-award interest. I mean, effectively, the assets and the liabilities are growing. The assets are growing at a higher rate of interest the arbitration awards carry with them post-award interest until they are paid. That interest is accruing at a higher rate than the cost of the debt. So, from the point of view of even those resolution plans that have got delayed, the fact that is, the asset cover, which is also growing at a rate that is higher than the rate of the debt, is going to ensure that it is positive equity for us in the long term than this debt. So finally, when the SPV gets repaid, we will see a considerable amount of the net asset cover that remains returned to HCC.

Anil: Are you planning any acquisitions because you are doing this QIP and some targeted assets and/or some targeted capabilities or something like that?

Arjun Dhawan: Absolutely not; our clear focus is entirely on our core engineering and construction business and the growth and the opportunities we see clearly in jobs here. Where we are competitive, pressures are less. We got in the area in which HCC has the core expertise. So that is the clear area of focus, and we are looking at an order booking over a 12-month range anywhere between ₹6-9K crore. We are looking at 6 or 7 very key profitable jobs where EBITDA margins run into their mid-teams, where competitive intensity is very low, and where we are among the very few people qualified for those jobs. Even if you look at India's entire infrastructure program and if the government ends up doing even half of the approximately trillion dollars, we are talking about our addressable market over the next 5 years is so huge that we have enough opportunities to choose from. And that's where we are going to earn our return on capital.

Anil: That sounds very interesting, and just as a follow-up, in the last quarter, we also talked about the use of the Steiner subsidiaries that we have, and you were also contemplating that maybe you need to increase focus on the building kind of projects, the iconic buildings that get made. So is that a part of the program still that you are trying?

Arjun Dhawan: That is correct, and do expect that in the next year, you will see us win more building construction jobs. It is a good diversification from our heavy civil business. Steiner India in this last quarter has won a very nice contract. We have perhaps not shared that in our Analyst presentation. Maybe we should have. But we will see that contribute to the top line and bottom line gradually over the next few years as far as India is concerned. And certainly, if you look at any large diversified construction business, it is wise to have building construction as an important part of that. What is interesting is that the traditional building construction market has not been attractive to us in the past because many developers and clients wanted core & shell separated from turnkey solution in providing a top-class building product. But as India becomes world-class in the kind of buildings that it requires, both from a turnkey perspective and also from a quality and green perspective, I think we have a lot more to offer. Also, along with the fact that where India urbanizes, its civil infrastructure gets twined with real estate solutions. That is also an area where we have a lot of interest, and we have seen many clients approach us to take on opportunities there.

Anil: Sounds good; all the best; I hope once the debt resolution is over, we will be able to set out on the path for the lost glory that was there in HCC, and that's what I look forward to.

Arjun Dhawan: Absolutely, and thank you very much for your best wishes

Mayank: Hi Arjun, good evening; I have a couple of questions; one thing I have observed is that the promoter has sold the 2% share value this quarter, so can you throw some light on that also? I see that the margins are substantially impacted. Was that only due to the fishermen agitation, or is there another reason we see the 10% EBITDA margin this quarter? Do we see the effect in business?

Arjun Dhawan: So let's start with the last question first! We have had a change in government in Maharashtra. Leading up to this, there has been a little bit of delay in resolving this issue. The commissioners involved and all the political parties involved want to have a clear resolution to this, it is a bit of a Déjà vu situation for us, but as far as the resolutions are concerned, we are very close to a solution on this. I think Santosh if you want to jump in and give a little colour. The goal was to find an amicable solution rather than have police cover, etc., and the work and progress in this quarter were largely affected by that. Santosh met with the commissioner a couple of days ago, and we expect a resolution of this matter in the next 30 to 45 days. After that, we will see the substantial pick up in the project's progress.

Santosh Rai: That's right, sir!

Arjun Dhawan: As far as the shareholding of the promoter group is concerned, as you are well aware, during the rights issue, there was an underwriting by the promoter group in subscribing to a majority of rights issues. And now we need to have some of that deleveraging, which is a natural process. When the rights issue was done, the promoter shareholding increased from 26% to 36%. This reduction was just a function of that timeline, and our counterpart undertook that, and it was something we had to respect.

Mayank: Thanks, Arjun, for the detailed elaboration. One more final question is whether we have a RBI approved debt resolution plan, or are we just waiting for RBI approval?

Arjun Dhawan: No, there is no RBI approval requirement at all. RBI, as a regulator, only provides guidance to the banks in terms of how resolution plans can actually get done, so no RBI approval is ever required for the completion of a resolution plan. In this case, because debentures are being issued, the debt moving to the SPV will be converted into debentures. And so, SEBI approval is required for the issuance of these debentures. What we are in the process of doing in the next week is going through the very simple logistics of debenture trust deeds being uploaded, and we have some concerns that the MCA website is going to be under maintenance for 2 weeks. So, we are all done, but we are just waiting for the uploading of those documents for approval.

Mayank: So I can say that everything will be doing right in another couple of weeks?

Arjun Dhawan: I am hopeful that the next 4 to 5 weeks are what we expect, and I want to be a little conservative here, and we will be fully through.

Mayank: Thanks, Arjun, because we had a similar approach last quarter, and we were about weeks, but it has taken a quarter.

Arvind: To be fair, last quarter we did not. While 100% of our lenders had approved and what we have been painfully working on is that we required signature from every lender. One of the lenders required their board approval even to sign the document. So the point is that we had to logistically climb a tall mountain to get all these things. After everything that has happened in the banking sector for the last number of years, you can appreciate that every T has to be crossed, every eye has to be dotted, and I would love for this process to be 10 times as fast. Hopefully, it should be for the sake of our country. But we had to go through a longer logistical process**.**

Mayank: Thank you, Arjun and all the best.

Arjun: Thank you

Santosh Rai: I think we do not have any more questions. Thank you, gentlemen, for attending this meeting, and I look forward to seeing you in the next quarter.