"Welspun Enterprises Limited

Q3 FY '23 Earnings Conference Call"

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MANAGEMENT:

MR. SANDEEP GARG – MANAGING DIRECTOR – WELSPUN ENTERPRISES LIMITED
MR. AKHIL JINDAL – GROUP CHIEF FINANCIAL OFFICER AND HEAD STRATEGY – WELSPUN GROUP
MR. LALIT JAIN – SENIOR VICE PRESIDENT AND FINANCE – WELSPUN ENTERPRISES LIMITED
MR. SALIL BAWA – HEAD, GROUP INVESTOR RELATIONS – WELSPUN GROUP

MODERATOR: MR. SUDHANSHU BANSAL – JM FINANCIAL INSTITUTIONAL SECURITIES LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to the Welspun Enterprises Limited Q3 FY '23 Earnings 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, please signal an operator by pressing star then zero, on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Salil Bawa, Head, Group Investor Relations, Welspun Group. Thank you, and over to you, sir.

Salil Bawa: Thank you very much. Good afternoon. I welcome all of you to the Q3 FY '23 Earnings Call of Welspun Enterprises Limited. Present along with me today on this forum are Mr. Sandeep Garg, Managing Director; Mr. Akhil Jindal, Group Chief Financial Officer, and Head Strategy Welspun Group. I also have Lalit Jain, Senior Vice President, Finance for Welspun Enterprises Limited.

You must have received the results and investor presentation of the company, which are also available on BSE, NSE as well as on the company's website. As usual, we will start the forum with some opening remarks by our leadership team, we will then open the floor for your questions.

During the discussion, we may be making references to this presentation, which is uploaded on our website as well as on the stock exchanges. Please do take a moment to review the safe harbor statement in our presentation. Should you have any queries that remain unanswered after this earnings call, you can reach out to us. With that, I would now like to hand over the floor to Mr. Sandeep Garg and Team Welspun Enterprises. Over to you, Sandeep.

Sandeep Garg: Thank you Salil. Good afternoon to everyone present on the call. Firstly, I would take time to congratulate Mr. Lalit Jain for being the Acting Interim CFO. Now let me begin the call with the discussions for the quarter. First and foremost, I'd like to inform you of our Actis transaction. We are pleased to report that during the quarter, we have already received INR 2,172 crores, including partial release of working capital. This is around 90% of the fund's receivable from this transaction. Further balance money shall be received on 51% stake sale approval of BOT asset and fulfilment of other conditions subsequent. As we highlighted earlier, this transaction translates into 19% equity IRR on exiting portfolio. With the Actis transaction closure, we have demonstrated the value creation of the entire value chain that is successfully winning, constructing, stabilizing, and monetizing of Road assets.

With our unique model of asset-light execution, we are able to maintain a lean balance sheet, which results in better translation of revenues to profits. You can appreciate that we capture our profit by way of EPC business during the construction phase of these projects, as well as at the time of divestment of the portfolio.

I would also like to highlight at this time that since we entered into HAM business, including the proposed buyback, we would have distributed approximately INR 50 per share amounting to INR 700 crores plus to shareholders by way of dividend and buybacks.

So, with the successful recycling of capital, we have a net debt balance at negative INR 1,582 crores at a standalone level, which gives us a strong foundation for our next phase of growth. Out of the monies we have received, we have set aside funds to repay our debts and become debt-free at a standalone level over the next 2 quarters. In the next growth phase, we will continue to target high-value, high-margin assets. We will also continue to work with our low-risk asset-light execution model.

Now coming to the quarterly highlights. We continued our performance in Q3 FY'23 on back of efficient execution of our EPC projects both in roads and water and wastewater treatment segment. In terms of standalone figures, our revenue from operations increased by 210% while our PBT before exceptional items increased substantially. We saw our improvement in margins in this quarter over the same quarter last year as input costs have begun to moderate. On the order book front, we had a very strong order book of INR 10,800 crores as of December 31, 2022. This includes INR 1,800 crores for O&M and asset replacement in the MCGM STP project.

Our business strategy is focused on two goals: First, building a portfolio that generates high value, high-margin projects; and second, diversifying our portfolio to derisk ourselves from dependency on any single sub-segment of infrastructure. Water and wastewater treatment projects account for 57% of our order book with the remainder being road projects. We see enormous opportunities in the water and wastewater treatment segment going forward.

Lastly, on the operations front. On the HAM asset, I'm happy to inform that NHAI has approved extension of time for completion of Aunta-Simaria project up to 29th October 2024, whereas extension of time for Sattanathapuram-Nagapattinam (SNRP) project is under finalization. As far as the physical progress of this project is concerned, Aunta-Simaria project has achieved a physical process of more than 40%. And SNRP HAM project has achieved a physical progress of about 15%.

With the background of the quarter, I will request Akhil to take you through the financial results of the company.

Akhil Jindal: Yes. Thank you, Sandeep. Good afternoon to everyone. This quarter has seen some exceptional performance by the company, primarily one because of Actis deal. And secondly, also because we executed a lot of orders this quarter. And naturally, the numbers are a reflection of both of these positive developments. So, the Q3 FY'23, as you would have seen, we recorded a INR 680 crores as a top line, which is nearly 2x higher than what was delivered last quarter, I mean the same quarter on a Y-o-Y basis. This, of course, includes the successful execution of large projects in roads, waters, and this has naturally driven both revenue as well as profit for the company. We are also seeing there has been a cost moderation. And thereby, we expect margins to improve from here on. And the whole industry should be, in my opinion, be re-rated as far as the margins are concerned.

On a 9-month basis, you would have seen our revenue has gone up to almost INR 1,800 crores. Our PBT has gone up to INR 125 crores, and the PAT has gone up to INR 576 crores. Now the PAT, of course, includes the exceptional item, which we are going to speak in a little while, and that's largely on the account of Actis deal. So, looking at the consol numbers, the revenue of the company for this quarter has been INR 717 crores. The revenue on the consol side was, of course, driven by the EPC revenue, as well as the Toll/ annuity revenue during the quarter.

You must be aware that we have got 5 annuity projects and 1 toll projects already operational. And these all 6 projects were part of the deal that we have done with Actis. And naturally, from next quarter onwards, you will not see this top line and bottom-line impact of these exits.

The PBT without the exceptional item was reported at INR 59 crores for this quarter. So thereby, if you see on an overall basis, the net profit of the company has gone to almost INR 402 crores on a consol basis, which of course, include INR 357 crores of exceptional item for this quarter.

For a 9-month basis, the total revenue consol is nearly touching INR 2,000 crores at INR 1,985 crores to be precise. PBT is around INR 132 crores and the PAT with an exceptional item is of INR 584 crores. Now this, of course, as I mentioned to you, INR 427 crores for the quarter for the Actis deal and the details of which are already provided in the Clause 41, which is uploaded on the website and also shared with the stock exchange day before yesterday.

With this, I open the floor for question and answers. If there is any question, ask the operator to assist you. And as a management team, we will try and answer it as much as we can on this call today. Anything left over, you can always reach out to our IR team, and they will be happy to answer any of your questions, which are unanswered today. Thank you very much.

Moderator: Our first question is from the line of Sudhanshu Bansal from JM Financial.

Sudhanshu Bansal: Congratulations for the good set of results. With respect to the acquisition of Welspun Energy Limited, it would be great if you could share your vision for the new venture in terms of one, target areas like solar, wind or other. Second, the size of the project, what we are targeting? And the third, the business model like what you want to become in terms of EPC player or a developer?

Sandeep Garg: So firstly, the Board has given us a clearance to evaluate new sustainable energy options, for us to decide where we want to be in this whole chain of sustainable new energy business. We need a team of competent people as well as certain experts to advise us. We have taken an initial clearance from the Board to explore this. We shall come back to you once we have decided as to which sub-segment of the sustainable new energy we want to play and the business plan that we have for the same.

Moderator: We'll take the next question from the line of Rohit Natarajan from Antique Stockbroking.

Rohit Natarajan: Congratulations on this fantastic deal and a good set of results. My first question is now that you have almost like INR 1,500 crores cash as you made in your opening remarks, help us understand the big picture, what exactly is the quantum of HAM assets you could deploy this capital as equity. So, if I understand it correctly, this can support at least INR 10,000 crores of additional order inflow if we're looking clearly from HAM assets. Can you throw some colour on those big picture part?

Sandeep Garg: If I were to understand your question correctly, your question is that if this INR 1,500 crores cash surplus were to be deployed purely for HAM-related projects, how many projects could it practically support? So, on a principle of past experience, we believe that this kind of liquidity should be able to support these projects of about INR 12,000 crores to INR 15,000 crores easily.

Rohit Natarajan: So, my question is what sector are we looking in, like, I mean, are we really confined our opportunity space to roads in terms of capital allocation? What percentage of this interest will be?

Sandeep Garg: So, as I said in my opening remarks, we are already present in road and water vertical. And we have taken a decision to explore the new energy, sustainable energy solutions. The capital allocation towards each of these segments will be taken up in the annual business plan exercise for the FY'24. And once that clarity emerges, we will share the details with you.

Moderator: Maybe Mr. Natrajan, I would request you to return to the queue. We'll have an operator check your connection and join you to the call. The next question is from the line of Akash Mehta from Capaz Investments.

Akash Mehta: I just had a quick question. How much money are we planning to invest towards oil and gas and roads?

Sandeep Garg: So, as I had stated earlier, we are awaiting the field development plan, which is expected within the February. Once the field development plan is clear, we would know exactly how much money will be required for developing the project, the assets. Based on the numbers thereafter, we will be able to give you a clarity. At this point in time, before the FDP is finished, we need to invest about INR 15 crores, INR 20 crores, which we will continue to do during this period while the FDP is accepted by the government.

Akash Mehta: All right. And do you have any plans to invest in warehouse business?

Sandeep Garg: We surely have no plans to invest in the warehousing. This money is going to remain in the infrastructure space itself.

Moderator: We will take a next question from the line of Harshit Toshniwal from BU Research.

Harshit Toshniwal: A few questions there. So first, I just wanted to clarify that post this Actis deal our net debt position basically gross debt minus cash, because I think we have INR 600 crores in gross debt. Net of that, we are having around INR 1,100 crores, INR 1,200 crores cash.

Akhil Jindal: As on 31st December, our net debt position is INR 1,582 crores, okay? Then the company announced special dividend and the buyback amounting to almost INR 400 crores plus. So, the net cash position as of March, in our opinion, will be in the range of INR 1,100 crores that you have to rightly mentioned.

Harshit Toshniwal: So, this INR 1,582 crores is not net debt, it is net cash?

Akhil Jindal: Yes. So, you're right, post retirement of all the debt and everything, some of this may fall due in May also. After the retirement of the debt in May, this will be around INR 1,100 crores net cash.

Harshit Toshniwal: So, if I understand it correctly, just to calculate, INR 2,200 crores is what we have received, INR 400 crores will be for dividend and buyback. So, INR 2,200 crores minus INR 400 crores is around INR 1,800 crores. INR 600 crores, we have an existing gross debt, which we will repay over the next 3, 4 months. So, net remaining will be around INR 1,100 crores of cash.

Akhil Jindal: Yes. And this is, of course, after investing some amount in the working capital of the company because we are in execution phase for almost INR 10,000 crores of the project. So, the money that was received earlier is also allocated towards the day-to-day working capital, and we are ensuring that we are not withdrawing any CC, CP. I mean, we are not drawing any CC or CP and managing the business with the working capital allocation that we have done.

Harshit Toshniwal: Got it. Got it. Got it. Second question is, sir, so right now in 3Q FY'23, if I look at the numbers, we have a revenue of around INR 668 crores and then EBITDA of around INR 77 crores. This is a standalone and on consolidated basis our EBITDA is more like INR 92 crores and revenue INR 700 crores. I just want to understand that out of the assets which we have sold a good part of the number is something which is not going to come in 4Q. So, if you can split the total income and EBITDA of Q3 into what is not going to come from 4Q?

Sandeep Garg: Sorry, if I understand your question correctly, the question is how much of the EBITDA that we have reported is coming from discontinued operations.

Harshit Toshniwal: Right.

Sandeep Garg: So, if that's the question, we do not expect any percentage-wise impact, negative impact on the EBITDA due to the discontinued operations. As Akhil mentioned in his earlier statement, we do expect because of the moderation of the commodities improvement at the EBITDA level that we do not see any negative coming out because of this.

Harshit Toshniwal: No. Sir if I may ask, I'm not asking of margin. I'm saying that out of the INR 92 crores Q3 EBITDA, there would be some components from the assets which we sold. So, you are saying that the contribution was negative, which is why the EBITDA in absolute basis will not be impacted.

Sandeep Garg: So, if you see on the consolidated numbers, profit from discontinued operations in the Q3 FY'23 on a consol level is zero. So, if you were to look at our press release, the profit from discontinuing operations is dash in the Q3 FY'23. So, there is nothing which is contributing here for the Q3.

Harshit Toshniwal: Okay. So, this Q3 number is basically, if I remove that exceptional item, but PBT before exceptional item is a sustainable number even from Q4?

Sandeep Garg: Yes.

Harshit Toshniwal: So that's the right way.

Akhil Jindal: Because this transaction has happened in this quarter. So clearly, the profit from the discontinuing operation, you would have seen in our press release, has been indicated as zero.

Harshit Toshniwal: Okay. Got it. Got it, which maybe in the last quarter, it was INR 108 crores. So that you have already segregated.

Akhil Jindal: That's right.

Harshit Toshniwal: Got it. The other question is that we have a order book of around INR 10,000 crores. If you can give some indication of the period over which it will be executed roughly? And do we expect to maintain around 10% to 12% margin in this INR 10,000 crores number?

Sandeep Garg: So, as I said earlier, on the HAM portfolio or the development portfolio, we have a profit or gains accounted under two scenarios that is on the construction phase , it is correct to anticipate that the margins will be hovering around 11%, 12% for the development projects as well as EPC projects.

Akhil Jindal: Yes. So just to add to what Sandeep has said. We have a sustainable EPC margin, which is reflected in our books on a quarter-to-quarter basis. In addition, there are the special occasion exit margins. And as a company, we have a model of our EPC, which is regular and exit, which is periodic, which cannot be every quarter. So, what he is driving, Sandeep is as a company, we are delivering profit into two buckets. One is on an ongoing sustainable EPC margin. And also, on the exits of the road assets or other assets that we are creating which happens, say, every 3 years, 5 years as the cycle maybe.

Harshit Toshniwal: Understood, sir. So, if I can just rephrase the question slightly, that out of that INR 10,000 crores , I don't know the number, but say, for example, some portion would be EPC which would flow gradually in our P&L. And obviously, it maybe INR 4,000 crores, INR 5,000 crores and the balance INR 5,000 crores, which is more the expenditure of which we'll get a capital gain at one point of time after 3 years, 4 years? Because I just wanted to understand that how do we contemplate that of this INR 10,000 crores order book, how much will be flowing at a gradual level through the P&L? And how much would be restricted for that capital gain point?

Sandeep Garg: So, let me try and answer this question. Out of this INR 10,800 crores is a pure EPC order book of developmental as well as the pure EPC play. So, you will get 11% to 12% return on this portfolio on a regular basis. The developmental portfolio behind this is also of a magnitude of about INR 3,500-odd crores, of which you will get a lumpy exit when the projects are completed, and we exit from those portfolios.

I hope I have answered the question. Another thing that I may want to clarify at this point in time because you've been talking about EBITDA levels. Because we are into an asset-light model execution, and as I said in my opening statement the right metrics for us to be evaluated is more profit before tax. Because unlike most of the other infrastructure companies, we do not have a lever or depreciation, which is a differentiating factor in our model. And that's what my submission would be that the right metrics for us to be evaluated is PBT and of PBT over a life cycle of the asset rather than a quarterly basis, which possibly is a bit downplayed on a quarter-to-quarter basis.

Moderator: We will take our next question that's from the line of Amit from Nuvama.

Amit: Congratulations on fantastic results. I mean recently you guys had submitted on the exchanges about the Welspun Natural Resources being liquidated. And I think it includes the oil and gas thing as well. So I wanted to have some light on it, if there's anything more than what has been already known to the exchanges.

Sandeep Garg: No, I think we have been very categorical in our releases. The WNRL was intermediatory company holding our oil and gas assets for the purposes of easing up the compliances and making it light. We decided to liquidate Welspun Natural Resources. I don't think there is anything else that really is something that I can declare.

Amit: So just a very basic thing. I just wanted to understand, so these businesses still stay with the Welspun Enterprise. Is that correct?

Sandeep Garg: That is correct. So, what we were holding through Welspun Natural Resources is now directly held at Welspun Enterprise level.

Amit: Correct. And any light on possibly when could these assets start their commercial production, et cetera?

Sandeep Garg: We are awaiting the field development plan, which as I said earlier, we are expecting within the February. The intent is to try and make them operational by FY'26.

Amit: Great. And sir, just one more thing. So as previously, we were focusing mainly on HAM. I think we found a very sweet spot there where competition was less now. I think the competition has sort of intensified there. But I think smartly, I think we are now more focusing on water thing, which I presume it's not everyone's expertise. So, is that understanding, correct?

Sandeep Garg: Yes. The understanding is correct. So, we are very clear that we will not play in a very intensely competitive cutthroat pricing competition environment. So, we are derisking our company by adding portfolio and the models to offer. So that is the way we look at the infrastructure play.

Amit: That's excellent. I wish you all the best. I think that's one of the best, probably very good strategies to adopt. I wish you all the best.

Moderator: Our next question is from the line of Rohit Natarajan from Antique Stockbroking.

Rohit Natarajan: Just to follow up on the earlier question, Welspun Natural Resources, is there any impairment that probably we may think about in the days to come?

Sandeep Garg: We don't see any impairment coming through this process per se.

Rohit Natarajan: Okay. Sir, my second question is on the execution track record. If I recollect, last time you said FY'24, you're looking at –INR 3 billion kind of execution every month, is that target intact?

Sandeep Garg: Yes, I think so. I mean, obviously, I said going forward from the time that I was addressing. So, we believe that the period was somewhere in the middle of November. So, we are tracking alongside that way. We do believe that going forward, that will be the run rate.

Rohit Natarajan: And sir, any update on the wastewater treatment project? Is it like already hitting on the ground, contributing to the numbers? What's the status over there?

Sandeep Garg: So, it should start contributing very small numbers in the Q4 of FY'23. However, the major contributions will start in the FY'24 only.

Rohit Natarajan: I understand, sir, when you talked about the capital allocation part, it's too early for you to make any commitment on road and the solar part or the renewable part. But if you could give us some colour on where at least the sectors will be? Like, I mean, one, obviously, roads, which is your HAM projects, what projects is essentially for EPC. But the capital allocation for other things, you were earlier contemplating railways too. So, what exactly are the sectors that we are looking in terms of capital allocation?

Sandeep Garg: Railways we have been looking for some time and we will continue to look at it if it makes economic sense and we can develop a model which is unique. So, we develop unique models, and we stay differentiated. That's the way we look at the industry. As I said, we are looking at sustainable alternate or new energy sources. So, we do believe that there are various opportunities unfolding there as well with the focus of the government.

And we do have the strength and the ability to mature a few of them. So, I think the right time to look at this would be about a quarter later from now when we have some firm capital allocations and better understanding of what the government's views are on beyond the budget announcements for us to have a conversation around allocation.

Rohit Natarajan: Yes. Sir, also earlier, you were thinking about buying a lot of equipment's and going a little bit more down the vertical in EPC part. Is that piece also intact?

Sandeep Garg: So, I do not know how where you gathered it from that we would want to buy the equipment. We have always maintained that we will be asset light. If we buy the equipment, it is primarily to support the subcontractor base that helps us complete the projects, and we transfer these assets to the subcontractor upon completion of the project. So, we don't retain these assets onto the balance sheet beyond the project completion, for which specifically these are bought.

Moderator: The next question is from the line of Preet Jain from Molecule Ventures.

Preet Jain: Congratulations on good set of numbers. Sir, my first question is how much money you planning to invest towards oil and gas and road sector? And my second question is, do you have any plans to invest in warehousing also?

Sandeep Garg: As I had said, we have absolutely no plan to invest in warehousing. As far as the road is concerned, the current commitment on the existing portfolio of the road, we have approximately INR 225-odd crores to be invested as balance. As regards to the oil and gas sector, we have about INR 20 crores, INR 25 crores of pre-committed expenses till the time FDP is received and approved. Post the field development plan being received for the oil and gas sector, will we be in a position to give the numbers that we need to invest to make them operational. I want to state only two things on oil and gas to respond to your questions.

We have a clarity that when we develop these assets, we will develop in two phases. The first phase will we have a very low capex option, wherein, for us, the fields that we are having from where we want to produce have infrastructure of alternate companies, which we can use to get the initial gas or the liquids out, which we plan to use so that the capex is at a very basic level at the Phase 1. And the next phase will be with the full development of the fields, which will be self-funded from the cash flows of the initial gas that we will produce or the initial fluids that we've produced. So, two messaging, that's number one. On the oil and gas, I can only comment upon the capex once the field development plan is available to us. And we have decided that it will be a phased development. Phase 1 will be low capex for initial gas out. And once the profitability is established, we will start looking at the full field development. And the second message that I would want to give that the from the funds that we have, we are not contemplating any investment in warehousing. I hope I have responded to your questions.

Moderator: Our next question is from the line of Vikash an individual investor.

Vikash: Congratulations on excellent set of results. Just a few follow-up questions in terms of the oil and gas that you're talking about. There's a write-off of approximately INR 57 crores on this Palej oil block. Can you just throw some colour on it?

Sandeep Garg: So, as I have been telling you in the past that Palej block was a block which was bidded in conjunction with a company called Naftogaz, and the government has taken a view that Naftogaz has committed a fraud and had decided not to let us proceed with this particular block. So, we have been declaring that this is something which is litigious. When we were liquidating Welspun Natural Resources, it was a requirement to take a write-off of this particular asset, which we have taken. However, our fight with the government in respect of this block will continue, as we generally believe that the block was terminated by the government on basis which is not fair and equitable to us.

Vikash: Sure, sir. Additional question, sir, see, because oil and gas are not a significant line of business, can you help us understand a little bit in terms of how we should be valuing this business per se? I understand INR 400 crores has been invested, but what's the kind of returns that can we expect in the longer run?

Sandeep Garg: So, as I have been maintaining that we target mid-teens returns for the businesses that we enter into. So, our endeavour for any future investment, should we make beyond what we have already committed to, will be guided by the same principle of return that can be generated in mid-teen returns. If we cannot, we shall not pursue the opportunities.

Vikash: So actually, I'm trying to understand in terms of the oil and gas assets and basically two assets in Mumbai offshore, where oil and gas has been found. What kind of potential valuations or returns, something that we can generate from this in the next 2, 3, 4 years per se?

Sandeep Garg: So, right now I think messaging would be guess work, we are expecting the field development plan from a company called CGG in France, which is like a gold standard in this industry for them to advise us for us to produce from these fields, what it will entail and what kind of margins can we expect. So, once we have that clarity, we will take a capital allocation decision and come back to the investors whether we are going ahead with the development or not and in which form and fashion are we going to go ahead with it. But giving you a writing principle that we do not look for any developmental projects until unless our return expectations of mid-teens are met. So that criteria shall apply to oil and gas equally well.

Vikash: Last question, sir. Any plans to probably exit this business similar to what the HAM assets you sold to Actis?

Sandeep Garg: So, as I said, we have an asset-light model company, and we do ensure that we get the right value for our assets. So, we will develop, we will mature provided there is a return potential of the asset and look at various options of divestment because we don't want to hold anything for a long term, which becomes more of a rental gain.

Vikash: Sir, last question, sir. Any thoughts right now, whether you are planning to exit? Or you want to be more open to any discussions with respect to exit?

Sandeep Garg: So, at this point in time if we were to go for an exit, –field development plan is not in place, and there will be a developmental risk that the buyer will take. So, we do believe that the right valuation will come, and we will derisk it from a developmental risk and demonstrate the viability of the project.

Moderator: Ladies and gentlemen, that was the last question. I now request Mr. Sandeep Garg to add a few closing comments.

Sandeep Garg: Thank you very much. I would like to thank, once again, all of you for joining us on this call today. And I hope we have been able to address all your queries. I look forward to speaking to you once again during the next quarter. Meanwhile, please feel free to reach out to Mr. Salil or SGA, our Investor Relations Advisers for any clarifications or feedback. Thank you all. Good day.

Moderator: Thank you, members of the management. On behalf of JM Financial, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.