"Pennar Industries Limited Q1 FY 2020 Earnings Conference Call"

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MODERATOR:	**MR. VIKRAM SURYAVANSHI -- PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Pennar Industries Limited Q1 FY 2020 Earnings Conference Call hosted by PhillipCapital (India) Private Limited. 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 entering "*" then "0" on your touchtone telephone.

I now hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital. Thank you and over to you, Sir!

Vikram Suryavanshi: Hi, good morning and very warm welcome to everyone thank you for being on the call of Pennar Industries. We are really happy to have with us here today, Mr. Aditya Rao -- Vice Chairman and Managing Director; Mr. P. V. Rao -- Joint MD; Mr. Shrikant Bakkad -- Vice President (Finance); Mr. J. Krishna Prasad -- CFO; Mr. Manoj -- Head (Corporate Finance); and Mr. K. M. Sunil for Question-and-Answer Session with the investment community.

Before we get started with the Question-and-Answer Session, we will have some opening remarks from the management. Over to you, sir.

Aditya Rao: Thank you. Welcome to all the stakeholders of Pennar Industries to the Second Quarter Investor Conference Call. We have closed a good quarter. We have been able to record in most of our revenue verticals. We are quite happy with the performance we have delivered in this quarter.

I would like to request Mr. P. V. Rao -- our Joint Managing Director to brief us about the overall financial performance of the company.

P. V. Rao: Good morning, everybody. We started this financial year on a strong note with a good set of Q1 number. Our net revenue is Rs. 541.4 crores and if it is compared to last year corresponding quarter, it was Rs. 466.5 crores, so there is an increase of growth of about 16% year-on-year.

And EBITDA is Rs. 55.2 crores compared to Rs. 45.6 crores in the corresponding quarter previous year. So, there is an increase in the margin of 10.2%. The profit after tax after minority interest is Rs. 16.5 crores compared to the corresponding quarter prior about Rs. 13.1. So, there is an increase of 25.8% year-on-year.

During this quarter, we received steady orders across business verticals such as building products, tubes, solar, railways, industrial components and pre-engineered buildings.

The order book for the pre-engineered buildings stands at Rs. 554 cores as on June 30th, 2019. The order book for water treatment and chemical segment is Rs. 86 crores.

We have reasonable backlog for other segments also like building product, tubes and solar since they are short cycle projects. So, we are not telling her what is the backlog for that. But yes, we have a positive outlook for the rest of the year.

Aditya Rao: So, with that, we would like to hand over to the moderator for any questions that they have with respect to the company's performance or any other aspects or any other of the recent corporate action that has been completed the merger or anything else as well. Thank you.

Moderator: Thank you. Ladies and gentlemen, we will now begin the Question-and-Answer Session. We have the first question from the line of Lokesh Mane from Vallum Capital. Please go ahead.

Lokesh Mane: This is with reference to Pennar Enviro. In about FY 2018, we saw a sudden spike in profitability for the company. If you can just enlighten us on the source of the profitability and sustainability going forward?

Aditya Rao: These are one-time profitability events which we had in Pennar Enviro about two years ago. This was relevant to some contracts we have had with Nuclear Power Corporation and others. These are not really sustainable as it stands right now. Enviro as Mr. P. V. Rao had mentioned has a strong order book and we expect fully expect a scale revenue and profitability in this fiscal, but what happened two years ago that is not sustainable or repeatable.

Lokesh Mane: Okay. And in the past few years, we have also been seeing a little bit of compression on the gross margin front coupled with an increase in working capital requirement. So, your view on that going forward?

Aditya Rao: We have a blend of businesses. So, on an overall basis, we believe that working capital usage is controlled through several ways within the company specifically by restricting capital to the businesses which have the possibility of overusing it. So, ROCE based limits have been applied. And if a business tends to overuse them, we tend to penalise them for that. That being said, our working capital cycle over the last one year, if you see for definitely, which is I think a relevant period, the last four quarters to discuss, in several of our businesses, we have been able to bring it down on average. And I think, working capital interest cost over the last four quarters as a percentage of our sales has actually declined. So, that I think is sustainable. We believe there will be further enhancements improvements in our working capital cycles we brought for which means our inventory days, account receivable days, we think we will be able to reduce those substantially. We are working on that. But right now, you should assume that what we are currently using will largely remain the working capital as a percentage of sales, I think it would go hand-in-hand with revenue growth, if our revenue grows, it will grow and it is kind of almost an industry standard now.

Lokesh Mane: So, just to understand clearly, our revenue increase, our working capital incremental will be in line with revenue in treatment?

Aditya Rao: Yes, exactly.

Moderator: Thank you. We have the next question from the line of Soniya Varnekar from Equentis Wealth Advisory. Please go ahead.

Soniya Varnekar: I would like to know PEBS, numbers. I mean, it's sales figures, EBITDA, EBITDA margin and PAT numbers for this quarter? And also, your thoughts on how the EBITDA margin of PEBS is improving and how do you see it improving in future?

Aditya Rao: I can give you the revenue number. I will just hand over to Mr. P. V. Rao, but we are not giving segmental EBITDA with that because of segmental attribution itself is undergoing a change. So, we have been saying this for the last two, three quarters have not been actually providing EBITDA margin for that. But we can talk about order book, we can talk about revenue projection, and what the industry gross margin rates are. Those we can talk about, but EBITDA, PAT all the way through we will not be discussing on this call, as we have not made information public right now. So, over to you, sir.

P. V. Rao: That is the significant increase in the order book compared to the previous year. We currently have about Rs. 550 crores order book, as against this previous corresponding period, we were having only around Rs. 375 crores order book if I remember correctly. So, there is increase in order book and definitely there will be increased revenue because of the strong order book what we have. And we have quite a quite positive on this to continue also in the in the coming two - three quarters as well. And if you go to engineering services in PEBS vertical, very significant increase in revenue and profitability of engineering services also, and we intend to have a presence in the U. S. as well, increase our addressable market size in the U. S. So, currently in the process of identifying opportunities there and we will soon be zeroing on some opportunities that come in our way to increase our market size in metal buildings as well as engineering services.

Moderator: Thank you. We have the next question from the line of Mitul Jani, an Individual Investor. Please go ahead.

Mitul Jani: The question is relating to the employee expenses, which has been on increasing front? What explanation do you have for that? And what sort of compensation plan you have in place? And let us say, if it increases in line with sales and coming time, what are the alternatives you have in like have you been considering in regard to this? And the second question is relating to the business verticals or business units? How many are there? I mean, how many business units are there, which are like with ROCE above 15%?

Aditya Rao: So, let me unpack the first fixed costs question or the salary cost question. Compensation structure in the company is based completely on business unit performance, so each business unit determines their own growth rate. You will notice that the last financial year, we actually had a pretty hefty increase in fixed cost close to 30%, if I am not wrong. That was because of two things. One, of course, was because of certain investments we were making, for growth that we are going to put in over the next few quarters, over the course of last year and over this year as well. We will probably not have 30% increase in fixed cost further, but it will be it will go in line with our overall operating profit increase. So, let us say our operating profit increases by x our fixed cost you should expect to have that increased by a certain percentage of x, as a not in terms of value but in terms of that. So, if our operating profit increases by, let us say 20% then our fixed costs should potentially increase in the 5% to 10% range. That is what I would guide you in the future as such and it is an output, natural output out of the process. That does it mean, of course, that if we have an operating profit decline, which absolutely not projecting, but if that were to happen, that does not mean we will have a fixed cost decline also, that is not what we are trying to communicate. But any growth and fixed costs will be tied directly to operating profit growth. That is our guidance. For comparison purpose of Q1, we have about a 10% growth in terms of fixed cost on quarter-on-quarter. Now, coming back to the question about which verticals or ROCE were greater than 15%?

Mitul Jani: How many, like in total, like, there are plenty of vertical units you have. But so how many out of total, let us say 30, how many of them are like giving return on capital above 15%?

Aditya Rao: Our overall ROCE is 17%, the best performers in that are typically, revenue verticals we have in railways, CDW tubes, industrial components, pre-engineered buildings, engineering services, some of our legacy businesses, which comprise our steel BU tend to come in a little less than that. But our attempt is to add revenue only at ROC of greater than 20%. So, over time, you have both margin expansion and ROC increase. And if you see I think with minor dips here in the quarter, I think you will both see ROCE improvements, ROE improvements and margin expansion over the last, if you look at the last 10 quarters, I think you can see that the general trend has been a very significant upward trend

Mitul Jani: It has been around 10 or so. But it is not a sort of expectation. But like let us say if a business like it needs two things, only growth and profitability. So, that cash can come in. And you can like unlock the value of the all the whatever business units you are working in. So, that was the primary of asking me that question.

Aditya Rao: So, it is a good question and it is a ROCE is a very important metric for us. It is perhaps the most we use to judge whether we should invest and build capital assets. We should invest in a business vertical and build teams and capabilities in any business or not. One is strategic fit and other is ROCE. So, it is a very good question.

Mitul Jani: And lastly, just a form of requests like I if you can like yesterday evening, you like announced the result. And today at 11:30 you kept the conference call. So, just as a former request that if you can just give some more time in between these two events. So, whenever you put it the next time.

Aditya Rao: I will discuss internally and come back to you, sir.

Mitul Jani: Because there is not that much of time before if I can number crunch. So, for that reason only, if you can extend it with one- or two-days period.

Aditya Rao: I understand, the rational way you are asking. Please give us some time. We will discuss it internally and we will have a response for this.

Moderator: Thank you. We have the next question from the line of Swarn Aggarwal from Edelweiss. Please go ahead.

Swarn Aggarwal: What are the revenue for the retail stores and EBITDA for the same?

Aditya Rao: We will not give out EBITDA numbers. But revenue we can probably give, for the quarter, it was about Rs. 15 crores, approximately.

Swarn Aggarwal: Rs. 15 crores?

Aditya Rao: Yes.

Swarn Aggarwal: And sir, I just wanted to understand the thought process like PEBS, you had come out with an IPO two years - three years back and now you are merging it. So, what was the thought process then? What has changed over the two years that you are merging it?

Aditya Rao: Good question, sir. I think at that point of time, the companies were going on different growth trajectories as such. But afterwards, we wanted to build and off structure our strategy and vision for what we wanted to be as an engineering organisation, underwent a change. And at the board level and with a major investor, we had discussions with them in terms of how we feel the next five years are going to go. And it was, I would say a pretty unanimous decision amongst the major shareholders and ourselves that we wanted to have one corporate entity, one clean off structure which we can use and work with, and ensure that we can have one strategy plan for our growth for the next five years. We want growth, and we want to be a good strong engineering company. So, in keeping with that vision, where we invest consistently in product development capabilities and grow, we felt that that merged entity will allow us to do that a lot better. So, that is the reason, there is a core principle, there is a core reason for the merger. But I understand where you are coming from, we are doing an IPO and then merging an entity within a period of five years is obviously mixed signalling. I understand that but only after we felt this was definitely a path, we are committing to not for the next two years, three years, five years also but for the absolute medium-term to long-term then we decided to take the step.

Swarn Aggarwal: Is there a chance you again go for a demerger? Because the PE investor has not got full exit?

Aditya Rao: I mean, it would be difficult for me to commit to you about future things, but I can assure you there are absolutely no plans. And we do not obviously take decisions taking one private equity company into account or their returns into account. Our wish is that all of our stakeholders do well and anyone who has invested capital time into Pennar they benefit from that investment as per what market return expectations are. But there is absolutely no plan right now for us to de-merge any entity. I can commit to you that there is no plan.

Swarn Aggarwal: Okay. in terms of competition, if I briefly classify into four broad division, say railway, tubes, Pennar engineering building and Pennar environment, who will be the key competitors for each of these divisions?

Aditya Rao: For railways, the primary competitor would be Tube Investments; for PEB the primary competitor would be Kirby.

Aditya Rao: Kirby, Interarch, German Steel, and Phoenix. Four - five players are there in PEB.

P.V. Rao: For Enviro it would be Thermax, Ion Exchange. That would be the competition.

Aditya Rao: That is why we benchmark ourselves again.

Swarn Aggarwal: And for tubes?

Aditya Rao: Tubes would be Tube Investments again.

Swarn Aggarwal: Okay. And railways you said, I missed that.

Aditya Rao: Tube Investments, again. Tube Investments the company, the Tube Investments in a fair number of product verticals and railways and tubes are one of time, CDW Tubes and railways are one of them.

Swarn Aggarwal: Okay. In terms of your annual CAPEX, if I see FY 2018 number was around Rs. 29 crores, which has increased to roughly around Rs. 143 crores for FY 2019 and standalone also if I see for last two - three years like FY 2016 was Rs. 27 crores; FY 2017 Rs. 19 crores; FY 2018 Rs. 12 crores; and FY 2019 was Rs. 98 crores; and I think FY 2020 you have guided for Rs. 200 crores type of CAPEX. So, what has changed in the last two years wherein your CAPEX have shot so much and where you have done mainly this type of CAPEX and what are the broad category?

Aditya Rao: The vast majority of our end use for CAPEX, I would say definitely in excess of 95%, I would say, would be in build up of fixed assets. Now, there is going to be obviously some amount of year to year variability. But you are right that our viewpoint towards CAPEX has changed in the last couple of years. I think, we may generate from our operations prior to working capital changes and prior to anything we generate about close to about Rs. 150 crores of cash last year, a little more this year perhaps. So, what we would intend to do with that capital that we generate, is to obviously look at increasing the asset generation base that we have, increase the revenue profitability. So, for opportunities that we think are viable, that we think are strong, which can help us increase operating profit,we have a consistent investment plan. So, we have plans to invest up to further Rs. 300 crores plus also. But we will do that over the next one year, two years, three years. So, for this year, you should expect CAPEX of about Rs. 80 crores, this year is what we will guide you to be. We had initially higher plans, but we are waiting on the board to approve it and we want to be a little careful on the timing of these investments as well considering current market situations. So, that is the thing.

Swarn Aggarwal: And what was the broad breakup for this Rs. 143 crores CAPEX for FY 2019? if you can split railways or Pennar engineering, tube?

Aditya Rao: We do not have that number right now, but you should assume pretty much equitable distribution based on this size. I think because we effectively try to increase each of our businesses by a certain percentage each year. So, we will give you the exact break-up, we do not have it right now, but I will get that to you broken our business unit wise. CAPEX is a centralised activity for us, we do not break it into this CAPEX that CAPEX, we just look at it overall based on projects, which are increasing our contribution. But we will try to get that number to you but as of right now I do not have a breakup.

Moderator: Thank you. We have the next question from the line of Vaibhav Gogate from Ashmore. Please go ahead.

Vaibhav Gogate: What was the impact of new accounting standards on EBITDA and PAT for this quarter?

Aditya Rao: Good questions, Shrikant?

Shrikant Bakkad: The impact was close to around Rs. 84 lakhs on account of IndAS 116 on lease account and PAT was approximately Rs. 54 lakhs.

Vaibhav Gogate: So, the reported PAT is Rs. 54 lakhs more or less?

Shrikant Bakkad: Reported PAT is less.

Vaibhav Gogate: Okay. Could you share outlook on tubes and railways?

Shrikant Bakkad: Railways continues to be quite strong, order books are around Rs. 220 crores on the account. So, railways we are good. Tubes, it is primarily automotive oriented. So, out of all the revenue streams, we have tubes as the one business where we had challenges because of the auto sector slow down. We do not perceive that these will be resolved very, very soon. But we are making changes to our addressable market so that we overcome this issue, but that obviously will take us some time a few quarters to do it. But as of right now our outlook is that railways is sustainable and strong. Tubes is stable but growth will be a challenge for tubes.

Vaibhav Gogate: In the light of falling steel prices, do you expect that the margins in PEBS Pennar will go up structurally in the coming few quarters?

Aditya Rao: See, there are some contracts where we had to, the customers are asking for renegotiation of prices where the advances are not been paid. But where the projects, which are already under execution, there could be some slight change in the increase in the profitability. But overall, we do not operate in such figures and all the raw material up and down will happen in this industry, we will have to face that because we maintain order book.

Moderator: Thank you. We have the next question from the line of Tarang Agarwal from Old Bridge Capital. Please go ahead.

Tarang Agarwal: I have a couple of questions. My first question is with respect to the custom design building segment. So, the revenues here have grown at around 40% year-on-year, but when I look at margins, the absolute figure is flat at Rs. 10 crores. So, I just wanted to know what might have perhaps led to that first? Second what is the cash on books as on 30th June, 2019?

Aditya Rao: So, PEBS revenue has grown, yes. Your question is what again, what was flat?

Tarang Agarwal: The EBITDA is flat at Rs. 10 crores.

Aditya Rao: For the business EBIT, is it?

Aditya Rao: Yes. And the main reason for this is the change in the accounting standards, which has got affected, so by virtual of which, the EBITDA has actually increased, and the impact is also coming in the depreciation part of it. So, if you see business unit wise as an individual yes, the business unit also has grown up. But here it is more of an EBIT information where the actual number does not get completely reflected. And if you see the depreciation, the depreciation is higher to that extent.

Aditya Rao: So, a depreciation is higher by Rs. 2 crores - Rs. 3 crores for the quarter.

Management: Yes, for this quarter Rs. 3 crores. So, yes, depreciation is higher at Rs. 3 crores. So, you do not see the EBITDA.

Tarang Agarwal: But my question is the EBITDA impact as asked someone before was almost Rs. 84 lakhs, right.

Aditya Rao: EBITDA impact versus EBIT.

Tarang Agarwal: Yes. So, even then, if I were to consider that also, the growth in this segment, basically the main question is has there been a margin compression, substantial margin compression? If so, why? That is my question for the segment.

Aditya Rao: The EBITDA is higher, so margins are also higher.

Tarang Agarwal: For the segment?

Aditya Rao: Yes.

Tarang Agarwal: Would you give out the numbers please?

Aditya Rao: We have not given out segmental EBIT number, I do not know how that has come**.** We will have to look into that again. But we are not giving segmental right now. But definitely, the order books for PEBS remain strong, margins protection is definitely there, and we expect strong double-digit growth in line within profitability in EBITDA and PAT for PEBS in line with obviously the revenue growth. But right now, we are not giving out segment wise EBITDA.

Tarang Agarwal: Okay. And what would be the cash in books as on 30th June?

Aditya Rao: Cash on the books is Rs. 75 crores.

Moderator: Thank you. We have the next question from the line of Ramakrishna from Genwealth. Please go ahead.

Ramakrishna: So, just wanted to understand the order book of around Rs. 540 odd crores in PEBS, can you please help us understand in terms of the segments where this particular order book is coming from? So, I am asking this question is more coming on the background of the slowdown in terms of activity which is happening on the macro front? And similarly, even in terms of the non-PEBS segment, have you faced any impact in terms of slowdown that has been happening in the auto segment?

P. V. Rao: With regard to PEBS order book, mainly see, we cater to 3-4 types of business segment in PEBS; one is industrial, one is warehousing, and another is high-rise building, any structural steel base building. Though there is reduction in manufacturing activity all over India, which resulted in less orders for us in manufacturing segment. But we have got more orders in warehousing segment because of the increase in e-commerce business as well as introduction of GST. So, these two resulted in significant increase of warehouse construction activity all over India. So, that has contributed a lot in our order book. Then structural steel also, some companies are coming up with plans which require structural steel for support structures. So, that also the order book consists of more orders from that segment as well.

Ramakrishna: You talked about automotive sector slowdown as such.

P. V. Rao: Yes, automotive there is a slowdown definitely, which currently we are executing orders from our Bridgestone and all. But we do not have any signals from them whether they will be going ahead with the future budgets or not. But overall, as I told you the order book consist of more orders of warehousing rather than industrials.

Aditya Rao: So, far, only tubes we have seen a direct impact because of the auto slowdown. Now, with the auto slowdown becomes a general consumption, capital goods problem, infrastructure declines, all of those then obviously, we are not immune to most of our revenue stream is India, so we are not immune to it. As of right, I think what we are adopting is a wait and watch approach. We will align our capital and make sure we chase opportunities that are there in the market. And there are some opportunities that are still available. The warehousing industry, as Mr. P. V. Rao said, is doing well. Pharma is doing reasonably well; cement is all right. Some elements of capital goods are okay in terms of those with what cash rich were trying to build up capacity because slowdown is a great time to build up do CAPEX also, if you have cash. So, those industries what we are targeting, engineering services will continue to be strong. So, overall, I would say right now we will look to preserve and grow further, I guess. But obviously, we have to keep watching the market to see what happens.

Moderator: Thank you. We have the next question from the line of Sunil Kothari from Unique Investments. Please go ahead.

Sunil Kothari: Sir, my question is, do we have any scope to reduce the debt by maybe using our extra land or maybe factory, any debt reduction plan is there? I am not asking about a ratio to revenue, which you will be paying as an interest, absolute numbers I am asking about.

Aditya Rao: Yes. So, you are saying absolute reduction in total debt is what you are asking.

Sunil Kothari: Yes, by utilising some spare assets, extra assets, some lands we always talk about, we have extra factors which we may not be utilising or we shifting some low-cost destination?

Aditya Rao: I would, describe it a little differently. Sir, I would not say we have extra factories. But certainly, we have some factories, some older factories, which are on good prime real estate things. But we are not a real estate company, so it is the idea of using that to remove debt on a longer-term is a very good idea. But please do bear in mind that right now, we are not promising anything, this is a decision for the board to take sale of assets, where we look into all options that are available. As of right now, we have nothing to communicate to you on this. But what I can definitely tell you that the vast majority of the debt we have is non-cash. So, we use LCs, we use BGs. It does not matter how much cash we have; we will never be able to retire that because that is part of business debt. I mean, if we, if I buy steel JSW, if I buy some equipment from equipment providers, I have to give them an LC. So, it is not going to have the impact of removing our debt. But yes, obviously, sale of any asset can obviously, of any good land asset can increase our cash flow or cash pile. But the interpretation should not be reduction of debt. I think our focus should be on judicious use of debt, reducing working capital, I think is a very good idea by being more efficient, by reducing operating cycles. But I would not term reduction of debt by selling land assets as the metric. Increasing the cash pile of the company, sure, but it does not matter if you sell thousands of crores of assets. It would not matter because I still need to give an LC and BG.

Sunil Kothari: Sir, my concern is, say we have done Rs.16.5 crores of debt and if you look at our finance cost. I mean is sometime is very discomforting feeling for any reason if you have low EBITDA margin then you will be definitely moving towards lease profit or losses. So, that is why my concern I conveyed and whatever you feel like you can take the decision. Second my question is, what guidance you are having for revenue growth**,** any profitability guidance and ROCE guidance?

Aditya Rao: Let me answer about the interest cost. Yes, sir interest cost is about Rs. 16 crores - Rs. 19 crores but that what it was for the quarter. But please again, do bear in mind sir, that the vast majority of this is working capital debt. Our term loan borrowings are only 130 or something. So, the interest we pay on that on a yearly basis is Rs. 13 crores, on a quarterly basis is about Rs.3 crores something. We will only have lower EBITDA for lower revenue because we do not do revenue at bad ROCE. So, what I would guide you to is if there was an event where our EBITDA declined for some reason that would be in response to our revenues going down which means our working capital and interest also tremendously slows down. Our actual what is baked in interest which we will pay, call it fixed costs interest so to speak, is very-very small on the order of a crore or so a month. It is not something that is very-very material. That is as far as interest cost is concerned. This your second question, sir, was what, on guidance?

Sunil Kothari: Yes, on guidance and profitability, ROC guidance, whatever may be currently or next year, longer-term, your view.

Aditya Rao: I can give you what our aspirational targets are which is that we aspire to have ROCE of 20% and we aspire for double-digit growth this year. But as I said before, considering the market conditions which are changing, I mean, out of the six business units we have one of these businesses did not grow this quarter out of the six verticals we have had. That was zero a while ago. If we get indication that five or six growing businesses becomes four out of six or three out of six then obviously, we have to adjust our adjustments. As of right now, I do not see that. But definitely we want to adopt a wait and watch a kind of mentality and we are making. We are assuming what will happen. We know the automotive sector is bad and it is going to stay bad for the near-term, it is not going to come back in three, four months. We are adapting our strategy, our addressable markets, we can do that because our product profile is pretty diverse. So, we look to do that, but probably we will come back to you on this potential growth and guidance part of its next quarter. As of right now, there is a fair amount of uncertainty in the market. We aspire to grow but it would be a little premature right now. Q1, Q2 also will be decent. But we should wait before we guide you further, I think.

Sunil Kothari: And sir, my last question is, some thoughts on this water and chemical project segment outlook or maybe what type of situation on the ground is changing? Because so many industries now investing more towards this because of environment and pollution, maybe chemical, pharma industry, water treatment. So, some thoughts on this vertical and what is your outlook and what we are doing to capture those opportunity?

Aditya Rao: Our order books in water treatment business are growing quite strongly. We will continue to invest in that business and grow it. I think this year we should look forward to a good amount of growth in that vertical, hopefully. But yes, the addressable market with reference to desalination projects where we have many references is quite high. But we will be on industrial side. We are not chasing government revenue at all on this. So, large scale water projects are not something we are going to be chasing, we are not in that business. We will be industrial water, wastewater treatment, effluent treatment, effluent recycling, desalination, those would be the technologies that we are employing. So, the addressable market for that also is good. But it is not going to be something like municipal side, we would not be. But there are opportunities there which we want to take advantage of.

Moderator: Thank you. We have the next question from the line of Rahul Jagwani from SKS Capital. Please go ahead.

Rahul Jagwani: Can you tell me the gross debt figure as the end of June?

Management: Gross debt including term loan and the short-term is roughly Rs. 400 crores.

Rahul Jagwani: Okay, there has not been much change from March end then?

Management: No.

Moderator: Thank you. We have the next question from the line of Anirudh Shetty, an Individual Investor. Please go ahead.

Anirudh Shetty: I just wanted to clarify this return on capital invest target that we have of 20% is that post-tax?

Aditya Rao: No, it is not return on equity, it is EBITDA divided by capital employed.

Anirudh Shetty: Okay. and so, post that it is about 13%-odd?

Aditya Rao: 12% - 13% right now I think so. But our goal is to keep growing that above (+15%) and hopefully over time. So, we have our ROE target and ROCE target. But our ROCE cut off is about 20%.

Anirudh Shetty: Got it. And our ROE target, that is 15%?

Aditya Rao: Medium-term 15%, yes.

Anirudh Shetty: Got it. And sir, could you quantify the order book on the engineered product side that we have today, will that be possible?

Aditya Rao: We are changing our attribution to put all of our engineered products, engineering services and for regular scheduled orders. So, engineering products will comprise of railways, PEB and Enviro together. So, the order book for all three combined would be close to about Rs. 800 crores.

Anirudh Shetty: Got it. And we were looking at double-digit kind of growth in FY 2020, which factors in some softness in the auto sector? So, if say the auto sector revival then is it safe to assume that our revenues also should do far better than maybe a go to mid-to-high double-digit kind of sales from FY 2021 onwards, maybe?

Aditya Rao: I think FY 2020 the capital goods, infrastructure, automotive, and engineering sectors which is the vast majority of our addressable market will continue to be bad. Our attempt is to bring in good growth in spite of that. Q1 we succeeded, Q2 also will succeed. Q3, Q4 we will get back to you. We have to look at what is happening. But right now, it looks decent that is what I would say. As far as the next year is concerned, if automotive comes back then obviously, we will have not only the growth projects we are prepping right now that plus what went away in terms of tubes, for example, doing less well as they, and it should have industrial components perhaps declining a little bit. All of those come back and scale further. But obviously, that has to happen first.

Anirudh Shetty: Okay. So, when you say double-digit growth, you mean in line with what we have done in Q1 that is about 15% - 16%, this is what we hope to do for the full year?

Aditya Rao: What I would want to say instead, sir, is considering what is happening in the market right now. we will get back to you on future updates and what we think is going to happen for the full year. It is not a dodge, it is not a revision or anything also, but I am just saying that, I do want us to be fully aware of what is happening in the market, there is a fair amount of uncertainty in terms of what actions are going to be taken. Most of our order books are quite strong. My ability to project revenue is based primarily on our order book and the strength of our scheduled orders. They look good right now. But I think, for the year-end question, the healthy attitude to take us to wait and see. I think, it will become a much clearer picture in a month or two months from now. As of right now, I think we can say we are stable and growing. But we will have to evaluate over the next one - two months to see what happens macro-economically in India.

Moderator: Thank you. We have the next question from the line of Lokesh Mane from Vallum Capital. Please go ahead.

Lokesh Mane: So, just to come back again, on working capital optimisation, do you see any scope for reduction in your debtor days or the credit period?

Management: Yes, we are actively looking for reduction, we are able to reduce it from almost 81 odd days to 70 days now. So, our plan is to reach 62 days - 65 days by year end. So, our focus is to reduce the accounts receivable per se. But as of now, it is close to around 70 days - 75 days where we are.

Lokesh Mane: Okay. And would my understanding be correct that the supplier market would be more concentrated? I mean, you have the Jindals and the Tata Steels?

Aditya Rao: We will cross close to Rs. 3,000 crores this year, is what we expect, right. So, out of that close to Rs. 2,000 crores will go to steel suppliers.

Lokesh Mane: In terms of just understanding, their bargaining power would be higher, would that kind of understanding be correct?

Aditya Rao: We have alternatives, there is not too many grades or procurement options for us, there is a single source supplier, those exists for some special grade, steel procurement, especially like manganese chromium alloys and vanadium chromium alloys, C-60 high carbon steels, we get order of that only from JSW. But we have good relationships with them and there is good price discovery that goes on. If not through a competitor, definitely through understanding each other's costs and markets. so that communication does happen. For most other things, there are alternatives. We do not have single source suppliers. So, we have the ability to compare to choose vendors for the vast majority of our procurement.

Lokesh Mane: Okay. And the nature of contracts would be index based or non-index based on a particular raw material index that you would look at with them?

Aditya Rao: It varies for different products but for the vast majority, for example, the automotive SIAM index, we do not choose that. We do not choose HR price steel or stealing at price commodity market pricing, we do not take any of that. There is a price that we discuss and negotiate on a quarterly basis with JSW. It takes into account a wide variety of factors including the amount of tonnage we buy from them, which is quite high. We are probably in the top three or four buyers for JSW at least in the west and south of this country. Also, that gives us some amount of leeway. And also, the kind of grades we are buying . So, it is not an index-linked, short answer.

Lokesh Mane: Okay. And even in the customer front, it will be the same, it will be non-index based?

Aditya Rao: Absolutely. Well, automotive sometimes it is, but a very small percentage of our revenue.

Moderator: Thank you. We have the next question from the line of Vijay Kumar, an Investor. Please go ahead.

Vijay Kumar: I was hearing that plan is to have a target of 20% ROCE. What is your belief that we are in place to get there considering that raw material is a pass through, and it is big chunk of our cost?

Aditya Rao: Good question, sir. So, ROCE is directly an output of your two things – of the value addition that you do and the operating cycle that you have. The shorter the operating cycle, the more the value addition, the higher the ROCE. So, on both sides we add a fair amount of value, if you were to look at railways there is significant amount of value that we add in our products, PEB as well, Enviro as well, a lot of design know-how, a lot of technology goes in. So, on that front we are quite confident that we will continue to be able to sustain and maintain value. I do not think we are looking at the majority of our product lines getting commoditised. Commoditised meaning that it is it is basically 10 people competing and the lowest guy gets it right that kind of stuff. We do not see that happening. As far as working capital, I think VP - Finance also spoke on this. We are continuously looking to engage and improve it. There is a lot of improvements that are definitely possible. And even our independent board has taken this up that they want us to be far more efficient in terms of working capital usage. So, we are quite confident that will bring in. That that combination should ensure that we get to 20%. Value-addition, there is good margin divided by lesser capital utilisation that will be how we will ensure 20%. Right now, overall company, we are at 70, we are not at 20 yet. Whatever adding is above 20. We are at 17 for the whole entity company right now.

Vijay Kumar: Okay. I was talking about what is our reflection on the share pricing in spite of having a decent performance quarter-on-quarter, year-on-year, the where it is and is there any piece that they are missing in terms of communication or if you can throw some light about what do you think this is something that you have as a target to improve the communication or anything like that?

Aditya Rao: I would not comment on the targeting of a share price but what I can say is the share price is low his and that is that is wrong. As the management of the company, we are committed, we understand that our target for any company is ultimately market cap appreciation and obviously liquidity and profitability also. But ultimately, that has to show up in market cap. So, we have several plans. We know we understand the problem, it is low. And we think it is low because of several corporate actions we have taken over the past few past few years. Profitability, growth, and revenue that has been good. But I think, we need to communicate better, we need to be better structure in terms of giving potential stakeholders and existing stakeholders clarity in terms of our growth plan, in terms of what our business verticals are and how we expect them to scale up. It is my expectation that right now, we are not doing a perhaps an adequate job of that. But our goal will be to ensure that that we improve and obviously, we are in an environment where mid-caps and small caps are getting badgered right now. But be that as it may, I think we have been, we have a duty to our stakeholders to ensure that the market cap is an accurate reflection of the value we see in the company. And this is not just lip service, I think we definitely want to commit to you that this is a priority for us, we will look into it and we will ensure that the market cap starts reflecting true value very soon. We will work on communication, we will work on ensuring that, growth, responsibility, good use of cash all of that continues. I think the combination of that should make sure that we are we are adequately rewarded in the short-term and medium-term.

Moderator: Thank you. We have the next question from the line of Mitul Jani, an Individual Investor. Please go ahead.

Mitul Jani: What is the current exposure to the auto sector, which you still mentioned quite a few times on this conference call? I mean, as a percent of total revenue, the tubes, components or otherwise the product sales you mentioned.

Aditya Rao: For tubes 70% of our revenue was auto linked, which is why we added 10% decline in revenue because the auto sector issues. Amongst other sectors, the minority. For example, a steel business unit, it is about 20% to 30%. For others, railways at zero, solar it is zero**.** Industrial components, it is also a little substantial, 25% to 30%. But it is export auto component not Indian component**.** So, if you are Indian auto sector exposure then primarily tubes everything else is reasonably ensured.

Mitul Jani: Yes, so which figure I should take as a part of total revenue? I mean, you said 70, 30 and all. So, which one figure, which I should take?

Aditya Rao: Overall revenue?

Mitul Jani: Yes.

Aditya Rao: About 10% to 15% would be overall exposure. Sorry, I do not have exact number for you, but I do not think I am very far.

Mitul Jani: Yes, so it is just an approximation. Yes, get that. And second question is related to any update on your Pennar Enertech subsidiary?

Aditya Rao: Pennar Enertech, we have a joint venture with Enertech, which is an old defence company. As of right now, we have not had sufficient traction in that business. We have our own defence, aerospace vertical, which are incubating within the company, which do not compete with that. But on that we are starting to see some traction. We are not going to talk about it or give it too much light over it right now. Once it become big, we will show it. But right now, on the Enertech side, the defence subsidiary side, we do not have any news, sir. It is not at a traction. But there is no capital has been employed in that business. There is no CAPEX, there is no working capital, and there is no investment of any sort right now, but we will look to improve and see if we can get some traction going on that soon. But right now, nothing.

Mitul Jani: And any further like positive scope for the Pennar Global?

Aditya Rao: Yes, I think as Mr. P. V. Rao spoke, our initiative right now is to increase revenue generating assets in the U. S. on both the engineering services side and metal building side, we are quite confident. We should have some news on this for you soon. I think we expect even briefing. Next conference call we will be able to give you some news on this.

Moderator: Thank you. As there are no further questions, I would like to hand the conference back to Mr. Vikram Suryavanshi for closing comments. Please go ahead, sir.

Vikram Suryavanshi: We thank the management for giving us an opportunity to host the call and taking time out for interacting with the stakeholders. Thank you all for being on the call.

Moderator: Thank you, ladies and gentlemen. Ladies and gentlemen, on behalf of PhillipCapital (India) Private Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.