"Pennar Industries Limited Q4 FY20 Earnings Conference Call"

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MODERATOR: **MR. VIKRAM SURYAVANSHI – PHILLIP CAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and Gentlemen, good day. And welcome to Pennar Industries' Q4 FY20 Earnings Conference Call, hosted by Phillip Capital (India) Private Limited.

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As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Vikram Suryavanshi from Phillip Capital (India) Private Limited. Thank you and over to you, sir.

Vikram Suryavanshi: Thank you, Inba. Good morning, and a very warm welcome to everyone. Thank you for being on the call of Pennar Industries Limited. We are really happy to have with us management of Pennar Industries here today for questions-and-answer session with investment community.

The management is represented by Mr. Aditya Rao – Vice Chairman and Managing Director, Mr. P.V. Rao – Joint MD, Shrikant Bakkad – VP Finance, Mr. J. Krishna Prasad – CFO, and Mr. Manoj and Mr. K.M. Sunil. Before we start with question and answer session, we will have some opening remarks from the management. Over to you, sir.

Aditya Rao: Thank you. A warm welcome to all of our stakeholders at Pennar for the fourth quarter and the financial year conference call on our results. So, in the fourth quarter, we have achieved gross sales of about Rs. 524 crores, EBITDA of about Rs. 31 crores and a net profit of around Rs. 90 lakhs. We came in heavily under budget from a PAT point of view due to our revenue in March being substantially lower than what our expectations were. And for the financial year in question, we had gross sales of Rs. 2,446 crores. EBITDA of Rs. 189.4 crores. Net profit of Rs. 53.3 crores. While in Q1 to Q3 we saw substantial growth in revenue and profitability of around 20%, 24%. For the financial year we are down by 20% on PAT due to a very suboptimal fourth quarter profit.

As we all know, we are going through a COVID pandemic and the associated lockdown. And the brunt of the impact of this pandemic and the lockdown has been faced by us in the first quarter of this financial year. The adverse impacts included shutdown of all of our manufacturing plants in April, a slow restart of our operations in May. A slow supply chain restart in May and June, and persistent lockdowns, openings, volatility in some of our plants, specifically in Chennai and Hyderabad.

Furthermore, we were unable to cut our fixed costs to the extent necessary to address the harm that is being done because of this issue. So we do expect to be loss making in the first quarter of the financial year. And we will talk more about this. And however, we believe that a lot of the damage that has been done has been addressed and we believe the second quarter would be a lot better. And the third quarter for us we expect to even reach profitability.

For the financial year 2021, we obviously will have to revise our strategy and our budgeted plans and all of our projections that we have made. We will come back to you at a time once the situation stabilizes on what we expect for the financial year in question. But as of right now, we have focused for the last three months, since the start of the lockdown, on three aspects. The first being ensuring that our employees are safe and their health is taken care of. So we have put in place distancing norms by the government's recommendations. We also have strong sanitization infection control and contact tracing capabilities. And we are enforcing work from home for a lot of our staff.

In spite of our best efforts, however, we have had seven employees at Pennar who tested positive for COVID. Four of them have recovered and are back at work, and other three are stable. We expect the next 60 days to be very challenging from a point of view of dealing with this pandemic. So we intend to strengthen our existing distancing norms and employee safety measures for July and August. And after that, we believe that the situation should gradually improve.

So in conclusion, our priorities for the last few months have been addressing the problems of liquidity, profitability and growth, with the background being employee safety. And we are very, very confident of being liquid, we will absolutely be able to meet our cash outflow obligations, so that issue has been solved. Our goal now is to reach profitability as soon as possible, which we expect to get to in the next couple of months definitely. And post that, our challenge would be to grow our profitability back to what it was pre-pandemic and pre-lockdown. And I look forward to speaking with all of you in more details as we implement this plan.

And with that, I would like to hand this over to our joint Managing Director, Mr. P.V. Rao for his comments.

P.V. Rao: Thank you, Aditya. A warm welcome to all of you for this investors call. I would like to share with you some of the details of the financial highlights and the business highlights. Our Q4 performance, as explained by Aditya, they got impacted due to challenging business environment and due to global pandemic COVID-19. Consequently, on a yearly basis, we reported 1.25% decrease in revenue to our corresponding previous year. Our net revenue is Rs. 2,106.55 crores compared to the net revenue of Rs. 2,133.11 in financial year 2019. Our EBITDA is at Rs. 189.39 crores, compared to previous years' EBITDA of Rs. 199.91 crores. Our PAT after minority interest is at Rs. 53.05 crores compared to the corresponding PAT previous year of Rs. 66.44 crores.

And we got orders during Q4, we received orders across business verticals such as building products, tubes, solar, railways, industrial components and pre-engineered buildings. The current order book position for pre-engineered buildings segment is about Rs. 335 crores. The order book position for water treatment and chemical segment is about Rs. 65 crores. And the order book for railways division stood at Rs. 303 crores.

So, as explained by Aditya, we also got affected due to this pandemic and we are trying our best to come out with each segment how it is going to behave in the times to come. We have to watch and see. And as expected by Aditya, I think we will be in the coming two to three months we will be touching profitability and then we have to concentrate on how to grow in able to reach the pre-pandemic levels.

Thank you very much. And I will give to Shrikant for your comments.

Shrikant Bakkad: Good morning and warm welcome to everyone. Apart from the revenue, EBITDA and the profit numbers which has been done, exercised as such, I would like to highlight on the other important numbers for your models. Those numbers include healthy EBITDA margins of 8.96% vis-à-vis last year of 9.29%. Employee benefits have been better, Rs. 161 crores versus Rs. 152 crores. Overall debt position has been improved slightly from the last year by close to Rs. 15 crores and we are now at close to around Rs. 397.94 crores in terms of overall debt. Interest cost has been a little challenging and we are doing all things in order to reduce our interest costs. Our interest cost overall for the year is Rs. 83.4 crores, which is 3.96%. If you see for the quarter, we are able to reduce by approximately Rs. 3.7 crores while compared to the last year same time.

Account receivables has been steady state. And overall if we compare both the amounts put together, we are at close to around Rs. 437 crores, inventory of about Rs. 439 crores. The important point is, the receivables we were able to bring down from 81 to 76 days. And though the inventory has gone up from 120 days to 128 days, this is because of the production that was done in the March could not be shipped out and the inventory was there at the plant. So, the inventory has increased approximately by 6 days. And similarly, in terms of accounts payable, we are a literal high in terms of 125 days to 139 days.

We have a healthy treasury of close to Rs. 65 crores plus that we have. We have been operating cash flow before working capital, and after working capital changes we have been highly positive and including the CAPEX amounts that we have done. In the current year, we have completed the buyback, close to around 1 crore shares have been purchased back.

And we have invested in Oneworks acquisition which has come in as a special note in the financial statement. And the investment value was close to around Rs. 3.26 crores and the outflow of around Rs. 61 lakh has been happened till now, and the balance is linked to certain performances. We also plan to invest around close to around $800,000 for which we have sought the Board approval in our Pennar Global.

So, what this, these are the broad financial numbers. And if you have any further questions, we can answer.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of is on the line of Mr. Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: If we look at, we had a challenging time earlier because of BS-VI norms and had the slowdown and economic, and now we have another issue of COVID. So, how do you see that impact on, is the transition to BS-VI norms and all that is over the impact of slowdown? And I thought it is now more related to COVID an economic slowdown. And how do you see the impact on different verticals of COVID? If you can just explain a bit segment wise impact pre-COVID and post-COVID.

Aditya Rao: So, I will speak about, I think you mentioned BS-VI first. I will speak on the automotive side and the railways and the engineering services side. Mr. P. Rao will brief us about PV business and their associated verticals. So, the environment is challenging. Since the removal of the lockdown has been initiated, we have been able to scale up revenue. Right now we see the maximum demand coming from the solar, warehousing, ITES and the pharma sectors, they seem to be doing quite well. And I would say, all of our solar verticals are over performing, all of our ITES business are over performing, and all of our export verticals are also over performing, hydraulics also is doing quite well.

We expect that railways will come back over the next two to three months. We are at currently only 30% of our pre-pandemic revenue there. And I think with the new investments we are making in body in white and others, maybe automotive takes an extended period of time to recover. But we are quite confident that over the next few quarters we should see an improvement in that. The transition to BS-VI is obviously going to help us because it will mean a lot more supplies, and it will mean replacement of a lot more stocks. We are working with all of our automotive customers on new product development. So as I said, we are quite optimistic that we are up to the challenge. Liquidity is not a problem for us, so the next thing automatically comes profitability. So currently, we are reaching at 60%, 65% of our pre pandemic revenue capacity utilization wise, and there is constantly new addressable market which are opening up. The U.S. market, for example, we think is going to be very profitable. And it's going to do well from a tubes point of view also.

So I would say that the impact of COVID will probably mean that we will have a depressed Q1, a flat Q2, and probably a Q3 where we are profitable and started growth again. So hopefully, by the end of Q4, our hope is that we get back to where we were before the pandemic. So it looks like it's the lost year basically for us. But after that is done, with or without a vaccine or whatever happens, we are quite confident that we get back on the growth path. We are already back on the growth path, but we get back to scalability, our own level of profitability over the next two, three quarters.

Vikram Suryavanshi: And how has been the outlook on PEBS?

P.V. Rao: Yes. I will touch base about the other set of verticals. Regarding PEB, we have a order backlog of around Rs. 330 crores. We are currently at about 55% to 60% of our revenue currently at that level compared to the pre-pandemic revenue levels. And yes, this segment has affected, definitely the industrial segment basically got affected, whereas the warehousing is still doing well because of e-commerce, Amazon and Flipkart and all. So we are still getting orders from warehousing companies and pharma companies also we are still getting orders. So we expect that we would reach pre-pandemic revenue levels maybe in another four to five months' time. That is what we are expecting as a flow. And solar module mounting structures we are doing well, and we have got a backlog of around Rs. 125 crores as well in solar module mounting structures. And that segment is doing well, there is no dip in there. And engineering services which we are doing for American companies and all, that is growing, in fact, the volumes are increasing. In fact, the reason is because of the pandemic in the U.S., so there they are working from home so the productivity is less for them. So, we are concentrating more on that to increase the revenue level as well. And then the solar photovoltaic panels also is doing well. In fact, the orders are coming up well, even compared to the pre-pandemic level also. So, we are bullish on solar, as well as engineering services and solar photovoltaic panels. And we have to wait and watch in terms of PEBs, pre-engineered buildings. And we expect that we will reach pre-pandemic level in another five to six months' time.

Vikram Suryavanshi: And can you share more about this acquisition, Oneworks, what is exactly the business model and how it will help us? As well as the investment in Pennar Global?

Aditya Rao: So, we believe right now that our addressable markets in the U.S. are substantially stronger than they are than the ones in India right now, with some obvious exceptions, of course. But broadly speaking, our U.S. revenues in hydraulics, in engineering services, in tubes are all scaling up. And in fact, a lot of them revenue streams are doing better than they were prior to the lockdown. So, accordingly, I mean, this is not a short-term venture, it's something that we believe in the long-term is going to be open a very large addressable market for us. So accordingly in the U.S., we are investing into growing our engineering service capabilities, our hydraulics capabilities. And the plan for investment into PGI, what that allows us to do is to start metal buildings and building component sales in the U.S. as well. We have a team there that is quite mature, that has already, I would say, years of experience in these fields. So both tubes, IOR and metal buildings, we believe will scale up quite well in the next couple of quarters. So we are accordingly making some investments in them.

P.V. Rao: So whatever investments we will be doing in future and currently, they are basically addressing the new addressable markets, they are aimed at margin expansion, and they are aimed at increasing our ROE. And they are aimed at upgradation of our technology.

Vikram Suryavanshi: Okay. And just more clarity on CAPEX. What was total capital expenditure in FY '20? And how is the revision looking at the uncertainty going ahead? So how is basically we are planning our growth plans in this challenging time?

Aditya Rao: Shrikant, I request you to answer this. Yes.

Shrikant Bakkad: The total overall amount that we have invested in the current year is close to around Rs. 90 crores under the various PEB segments, photovoltaic, cubes and other things. In terms of next year, we have still not come to a conclusion that we will do on the various segments which we initially thought. But we are confident that we will be doing in terms of U.S. the additional investment and also in DIW for the expansion of the market and to increase the margins parties.

Vikram Suryavanshi: Okay. Because now a lot of people are talking about work from home, or there could be cultural safety between the way we are doing businesses. So anything on like digital investment or anything you envisage, ensure that the way you were reacting with the customer or doing businesses, is there any change going to happen because of this COVID?

Aditya Rao: I think the big challenge, as far as we are concerned is that, initial months it broke alignment with everyone, so we had to reestablish alignments with our customers, because we wanted to avoid any order cancellations, we had to reestablish alignment with our vendors, because obviously everyone is going through this and nobody's immune to what is happening right now. And we had to also do a lot of rearrangement within the company as well, with our own employees and others. But we don't believe in attrition, not a single employee has been terminated, we want to retain our core strength and we want to look at getting back to profitability through revenue increase rather than cost cutting or any such measures. And we have more or less succeeded in this task also. So, I think reestablishing alignments with our customers, our vendors, internally with our bankers, all of that is what has been the challenge. But we have passed through it, I think I honestly believe that the worst is behind us. I think the number of cases will continue to increase in the next 60 days, if we are careful for the next 60 days, make sure our employees are safe, make sure our vendors and our customers are also stable, then I think it will only get better from there. So that is our current viewpoint. And we are quite optimistic that that would happen. But fundamentally, yes, obviously, there has been a lot of work from home changes. Obviously, we have had to adapt our operating procedures to be very compliant with what the government says. But we have had a lot of success, I mean, we have close to 3,000 direct and indirect employees. And the fact that we have only had seven cases and all of them, touchwood, we are very confident are, I mean, four have already recovered and are back at work, in fact, and the others also will be back. So we are very confident of our ability to manage this pandemic at the local level, at our local level in terms of the factory and our offices. And for us, our employee health is paramount, once that's taken care of only then can we look at scaling up operations. And we have successfully done that. So, we are operating in a safe manner, we will go from 60% to 70%, 70% to 75%. 80% of our pre-pandemic revenue. And that will allow us to get back to wherever we need to be, to our pre-pandemic level of profitability.

Moderator: Thank you very much, sir. Our next question is from the line of Arvind Joshi from Bateleur Advisors. Please go ahead.

Arvind Joshi: I just wanted to get some more details on the kind of competencies we hope to add to our repertoire by these acquisitions? And how do you see the footprint of our Pennar Global expanding in the next couple of years, broadly long-term basis?

Aditya Rao: So, Pennar Global is effectively everything that we do in India we want to do in the U.S. And because of the way we are structured, we have substantial advantages too in the U.S. market, especially in engineering services. So the combination of the use of India as a low cost manufacturing base, the U.S. manufacturing as a high technology base, and our engineering talent that we have in-house and a large delivery team in India is going to allow us to scale multiple verticals. So the main focus area for us from a capabilities point of view is to increase our hydraulics capabilities. We are getting into custom telescopic cylinders as well and that will continue to scale up. Our engineering services and we are currently present in offer services in structural engineering services, BIM work, building information modelling, body invite design and other mechanical engineering services. We want to continue to grow these verticals and we are accordingly building up our delivery team even in this environment.

And in the U.S., once we have some PEs on our rolls, it will give us the capability to stamp drawings and to make sure that we can interact directly with our customers in the U.S.. That is the second part.

The third part of it is improving our manufacturing operations. We have a lot of capabilities in metal buildings, obviously, in India. So by adding the Tennessee plant, what that allows us to do is to provide metal building solutions for the U.S. market which is much, much larger than the Indian market and more profitable also, double the operating profit of the Indian market. So all of that investment will allow us to expand, so addressable market increases in engineering services with these investments, it increases in our hydraulics business, also tubes our business, tubes, TDW, and metal buildings and building components. So the combination of all of three will allow us to do a very high revenue level. I mean, we fully expect PGI to contribute a very significant proportion of the company's overall revenue over the next few quarters and years.

Arvind Joshi: And largely the investment would be in physical infrastructure in the U.S. now or it will be also into some softer investments like acquisitions and all that, on technology front?

Aditya Rao: Both. We are looking to and we have already completed acquisitions of engineering services companies. We have just completed the acquisition of Oneworks Limited which specializes in building information modelling. And we were able to scale up for their revenue quite markedly. They are up by almost 40%, 50% based on prior to the acquisition what the revenue was. So we consider that to be a successful acquisition. But as you said, we will also invest in hard physical, brick and mortar infrastructure as well. And it is all in products that we understand very, very well, that we have a lot of experience manufacturing, designing. And so it will be a combination of manufacturing and design.

Arvind Joshi: Okay. And one more thing I wanted to just get a sense. We have developed certain goods competencies in manufacturing on some complicated products. Do you feel with this migration of manufacturing shifting from China, could we emerge as a partner for some of these, either non-Chinese companies or even Chinese companies wanting to get out of the Chinese footprint and have alternate manufacturing organizations elsewhere? Do you feel we stand a chance in that? And also, since you seem so optimistic about Pennar Global's growth prospects, say in the next three, four years, would it be half of our Pennar business by any chance? Thanks.

Aditya Rao: Yes. So the first question, are we seeing demand transference from China? We absolutely are. I can give multiple examples where for our hydraulics business, for our tubes business and our industrial components business we have seen our customers…

Arvind Joshi: Is this panic buying by some customers who are not getting stuff from China because of the lockdown in February and all that, or is it the strategic new initiatives that are being worked out as an alternate?

Aditya Rao: No, I think is reasonably medium-term. I can't commit to whether is its long-term, but in the medium term, I mean, some of the examples I will give you. Bailey Hydraulics, for example, has zeroed out their China business and given us that volume. Now, we have obviously asked them that we are building up these capabilities, but once they get less angry at China, are they going to transfer that back? So they were candidate for us and we agree with their assessment also that once this product development cycle and manufacturing both shifts, it's actually very difficult to relocate it. So the transition from China to India itself is very, very difficult, for them to transition that again in the medium-term would be very, very difficult. So I believe at least for the medium-term, by which I would define as a next, in the next five years I think whatever comes out of China will not be going back in. So I think it's a reasonably good medium-term transition that is happening.

The same question with a PSA who we are working with. So they are one of the largest manufacturers of body invite in the world. And their entire new product development design, their enter new electric vehicle designs they are giving out to Indian companies. And not just us, to others as well. It is not just us that are the beneficiaries. So, we literally have the option right now going ahead, picking up lots of large orders, close to Rs. 100 crores plus in terms of orders in these verticals. And the way it is once designed, product development and manufacturing moves, it becomes very, very difficult to do it again. It is not impossible, but it is not something that can be reversed easily. So I feel that there is a fair amount of, whatever, animosity or because Chinese costs are higher. But yes, definitely, it's a very clear trend and I don't think it is temporary.

Arvind Joshi: Okay. And do you see us transitioning from component suppliers to maybe supplying some sub-assemblies and all that? Since we are dealing with bigger, stronger customers now, eventually say in a couple of years we would end up supplying sub-assemblies for which our application our customers demand for the rise in value chain?

Aditya Rao: Yes, absolutely. I think the more we integrate, the better operating profits get and the better our addressable market also gets. So it's good in multiple ways, but that is absolutely our goal to ensure that we keep going from components to systems. Absolutely, that for each one of our business verticals it's targeting that.

Arvind Joshi: Fine. And my last question on the possibility of Pennar Global becoming, the export business becoming almost half of your total turnover in the next three, four years, probably?

Aditya Rao: I think, half maybe difficult to say, but at least 20% to 30% I think is extremely likely because it will have a very, very high growth rate. So even if it reaches something like 100…

Arvind Joshi: And more profitable than the domestic business, probably?

Aditya Rao: Every one of our verticals in the U.S. is more profitable than the domestic business.

Moderator: Thank you. Our next question is from the line of Venkat S. from Organic Capital. Please go ahead.

Venkat Subhramanyam: Aditya, we spoke as late as some mid-November, at which point in time we had no clue of how bad the last quarter was going to be. What exactly went wrong? Because the last 20 days was a washout. And March being dependent in the last two weeks is well known for a company like ours. But the level of drop in revenue and profitability has rather stopped. So would you like to throw some light on that?

Aditya Rao: It's a good question. I think I wouldn't say we were surprised; we were expecting it when we knew that lockdown was coming. But I think what the financials for the fourth quarter that have been, have taken a lot of the impact of COVID also into account. So I guess what I am trying to say is, yes, we only had about 20 days approximately of revenue drop, in some verticals it was only 15 days. So how can we go from what we were expecting, which was a very substantial profit to something which is barely profitable. The idea there is that a lot of our very profitable businesses just froze, we could not ship material out at all. And that had a much more stronger impact on our operating profit than we thought. So our fixed cost stayed the same, because we wanted to ensure that we support our people. It was a shock for multiple people. So we didn't want to immediately start looking at salary cuts or anything. So our fixed costs, our interest costs, all of that stayed the same and our revenue for the month of March was at a far smaller level.

The other thing, which is a little bit of a nuance in our industry is, most shipments happen in the second half of the month. For us the first half comprises of planning, getting raw material and producing it, getting clearances. And the second half is when we see a vast majority of the revenue happening. So though while it looks like March only 20 days, in effect it was basically the entirety of the month of March. So effectively we lost 33% of our revenue. And since our operating profits are roughly around 15%, 16%, the net impact on our margin after variable, prior to fixed cost, was quite heavy. It also includes, as I said, several one-time significant items, we believe that the pandemic, the brunt of the impact was taken into Q1 but we had to take some amount of provisioning, everything was also taken in in Q4. So that is another reason. But the majority reason is that, most of our revenue happens in second half and we were just unable to have that revenue come out.

Venkat Subhramanyam: In the normal course, what didn't get billed in the last quarter, some of it will actually flow through in the first quarter. But from your commentary, we are probably seeing a very, very soft first quarter as well. So that overflow from the last quarter is not coming through, have people seriously canceled a lot of orders and we carrying inventory that's not good? So what are the issues in the first quarter there?

Aditya Rao: So let me just say, so the first quarter being, as you said, soft, will directly be because of we were just not operating for close to six weeks. So that is difficult. And once we started, it was a slow start. We had to vacate our manufacturing plants, we had to make sure that we were operating in a safe manner, that thousands of workers going in and out every day can do it without risk of infection. We also had to ensure that our suppliers themselves got into a thing. And one of our suppliers, I won't name them, had a very, very serious COVID issue were significant parts of their workforce, transporters were an issue as well. So getting our supply chain logistics back into thing was a big challenge, which is why Q1 was. So revenue was very, very bad in Q1, which is why Q1 is soft. But our goal wasn't to have a strong Q1, our goal was to make sure that we understood the way the pandemic was going to impact our addressable markets and make a plan to ensure we address that and come out of it as quickly as possible. So we broke that, as I had said, into three parts; liquidity, profitability and growth. All three, we have successfully made a plan. I can confidently tell you we have, I mean, we have a low debt to equity, so it's easier for us to say, but we don't foresee any complications or concerns as far as our ability to meet our cash flow obligations are concerned.

Then the subject automatically moved to profit. We have been working on profit for the last few months. And we have substantially scaled it up. And we are quite profitable, quite confident of getting back to profit in this quarter itself. So Q1, we will not be profitable; Q2, we expect to be; Q3, we expect to get back to growth; and q4, hopefully, by the end of Q4 we are back to where we were before any other started, if not better. And that is assuming that the macroeconomic headwinds persist, that the current issues in India, which is not just pandemic rated, it is credit related, there is a fair amount of banking contagion, we expect some of our vendors, some of our customers to face significant amount of trouble. In spite of all of those, the combination of our addressable markets recovering and the investments we are continuing to make, we are quite confident will get us back to growth by the end of this year. So, once you have figured out how to fix all three, then it is just a question of when you get back to your pre-pandemic levels. So that's what, every business for us has a plan to get back to pre-pandemic and grow beyond it. And over the next few months, each of our verticals one by one, some are already profitable, and all of them will get back to profitability. That's our projection right now. And we are quite confident and it will happen.

Moderator: Thank you. Our next question is from the line of Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: Sir, we can understand that the situation from private car companies and all that. But to what extent though we can get support from government orders? Like particularly railways you highlighted, but sectors like defense and others too, are we seeing some opportunity from government side expenditure and orders?

Aditya Rao: Defense, I can't comment. And I would request Mr. P.V. Rao to brief about some government orders we are looking at. But from a railways point of view, ICF, MCF, BML, GE, they are our customers. So they are not back up yet, but we expect to get them back up in the next two, three months. So right now, if you were to rank our verticals in terms of pre-pandemic revenue percentage, railways is actually at below the average for us. But we expect that it's only about 30%, 40%, but we expect it to come back in the next two months. In fact, I am almost certain that within a month, month and a half, the utilization to go up. They have also expressed, ICF has expressed that they want to scale up further, that they want to get back to 100 coaches a month.

So those are all good numbers, I think, within this environment. So we are hopeful that that they come back. But right now the verticals which are doing very well are solar, our export business verticals, the pharma sector, supplying products, our chemicals business also is doing quite well, because we supply some hospital chemicals, we supply hand sanitizer chemicals. So, that is all doing quite well. The ones that are facing some challenges are, obviously, automotive, which may take longer to recover, but railways are which will recover much quicker. I will also request Mr. P.V. Rao to discuss on the defense part.

P.V. Rao: We are not having any indications of any potential from defence sector as of now. But other government departments, we are very careful in dealing with other government departments, except railways and all, of course, they have been paying us very well. So, though there are some opportunities for some isolation centers and all these things for the government departments, where they have asked us to work out the prices. But we are skeptical about the payments issue, because most of the state governments and the central government, we don't have any clear picture about how they would be paying us in future if we execute some job. So be very careful in choosing any government orders actually, in taking government orders, except railways, which we have been doing very well and payments are coming up very well.

Vikram Suryavanshi: Okay. And any change in outlook on this wagon side, because we are seeing that DFCC is close to completion and even railway is talking about, a lot of people are trying about expanding their railway network. So, anything happening on wagon side order?

Aditya Rao: Our order books are actually quite strong in railways, so it's both wagons and coaches. The problem isn't orders, but the problem is for these plants to start operating again. So, the challenge really, is guess Vikram, is that, we will need to have our customers start operations in full swing again. And that will only happen once there is a solution to this, or I don't know, I mean, we obviously are not experts in epidemic control. But the advice we are getting is that over the next two months if we are careful, then more or less, either everyone gets over this and all of our customers start opening up their factories, or at least it will reach a new normal of everyone being at 50%, 60%, 70%. Even if they reach that it is enough, we can ramp up revenues quickly. But right now, our problem isn't orders, the problem is our customers operating in railways. But we are quite confident that over the next two months the problem solves itself.

Moderator: Thank you. Our next question is from the line of Tejas Mehta from Aldrich Capital. Please go ahead.

Tejas Mehta: Sorry, I joined a bit late, but can you just give me answers for a couple of questions. One is, you have inventory of about Rs. 440 crores in your balance sheet, how much of this would be finished goods and how much would be the raw material? I mean, this is stuck at your end, but you are not able to deliver either because of logistical issues or the client has asked to defer?

Aditya Rao: Are you talking about inventory?

Tejas Mehta: Yes, inventory.

Aditya Rao: Okay. So our total inventory, apart for the consolidated entity, is about Rs. 440 crores. Out of this, the vast majority would be in raw material. Finished goods inventory typically comprises about 10% of our total inventory. And now these numbers are March 31 numbers.

Shrikant Bakkad: We have the break up, we can give those break up to them if you want me to add to that.

Aditya Rao: Yes, please do, please give the numbers of finished goods.

Shrikant Bakkad: In comparison to the last year, raw material is almost flat, most of our inventories were in WIP and as well as in finished goods. Finished goods we have close to around Rs. 78 crores and Rs. 50 crores in stores and spares, and then Rs. 221 crores in WIP, and then around Rs. 83 crores in terms of raw material.

Tejas Mehta: Okay, got it. And sir, the other question which I would like to understand is, off your investment book of Rs. 45 crores, how much is the investment in your subsidiaries, that is the U.S. subsidiary or whichever others subsidiaries are? And how much is short-term investments which is liquid?

Shrikant Bakkad: The Rs. 45 crores that you are seeing that amount is entirely into mutual funds. This investment is not the investment in the subsidiaries. You have other than that Rs. 12.34 crores which is a non-current investment out of the top-line, that is the total investment in the subsidiaries. So out of that, Pennar Global is around Rs. 8.62 crores.

Tejas Mehta: So basically we are sitting on about Rs. 59 crores, plus Rs. 45 crores, about Rs. 104 crores of cash on the books at this point of time?

Shrikant Bakkad: Yes. We are confident in terms of liquidity wise it is…..

Tejas Mehta: Right. And how much of the bank credit lines do we have which we have not yet used?

Shrikant Bakkad: We have close to around Rs. 60 crores of credit line which, as of today we are speaking, we have which is still open to us. At the March it would be a little different, but as of now it is Rs. 60 crores.

Tejas Mehta: So basically about Rs. 165 crores of cash and liquidity that we have?

Shrikant Bakkad: Basically in general we are seeing the treasury cash with the operating cash flow, and the treasury cash is generally used only for CAPEX and not for the working capital.

Tejas Mehta: Right. And on the U.S. front, how much investments have gone in so far? How much investment are you likely to make? And if you can give me the revenue and the EBITDA details here? I wasn't there on the first 15 minutes for the call, so I might have missed it.

Shrikant Bakkad: We can tell what is the investment that has been made as of now. We have made close to around Rs. 8.60 crores investment in Pennar Global as of now, and in Oneworks that is close to around Rs. 3.49 crores. The total investment is Rs. 12.32 crores in the subsidiary. And the investment which we will be doing is close to around 2 million, you can add the numbers. So it's 2 million and that will be predominant metal building systems and the tubes division which we will be doing through Pennar Global.

Tejas Mehta: So another Rs. 15 crores is what you are looking to invest on top of Rs. 12.5 crores in the next one year?

Shrikant Bakkad: Yes, in the next one year.

Tejas Mehta: Okay, got it. So I think the majority of our cash flow will be basically be invested as you told, correct?

Shrikant Bakkad: Yes.

Tejas Mehta: So, this investment in U.S. of Rs. 15 crores, will it be debt or will it be equity from the Indian entity?

Shrikant Bakkad: We are planning to raise a combination from them, for the working capital we would be doing directly in the U.S. But for that, procurement of machineries and other things, long-term we are planning to fund to a certain extent from here. And the balance we are also seeing if we can raise a long-term debt in the U.S. attempt. But as of now we have working capital in the U.S. for its operations.

Tejas Mehta: Got it. And lastly, how much debt do you have in the overseas ventures right now?

Shrikant Bakkad: There is no debt.

Shrikant Bakkad: If you see the consolidated financials and standalone financials debt wise, there are no debts.

Tejas Mehta: Okay. Got it. And what are your revenue and EBITDA there in the U.S. subsidiary right now?

Shrikant Bakkad: As of now, we do not have substantial revenues there. Whatever we do, we supply from India. So in the elimination, majority gets knocked down.

Aditya Rao: Shrikant, I think what he is asking is about PGI revenues, so PGI revenue should be close to what Rs. 70 crores this year and operating profit, EBITDA should be about 5%.

Tejas Mehta: Sir, this Rs. 70 crores revenue, you are looking to scale it up to maybe Rs. 1,100 crores of revenue in the next three years' time?

Aditya Rao: I think the addressable market should be quite high. So I mean, these are obviously aspirational numbers, we are not giving you hard commitments here. But the potential increases and our goal is to increase it to the number that you said, $100 million dollars at least.

Tejas Mehta: Okay, $100 million. With about three years' time, right, is what you are targeting?

Aditya Rao: Yes. So it will take us at about $10 million, $12 million right now. So that number in the next three years to get to Rs. 100 million is what we are aspirationally want to do. And that is why we are setting up these assets.

Moderator: Thank you. Our next question is from the line of Arvind Joshi from Bateleur Advisors. Please go ahead.

Avrind Joshi: I had one more small follow-up. Our soda business seems to have picked up after a lull of about a year and a half or two. Do you think these are sporadic orders or this is a new cycle building up, which will last a couple of years?

Aditya Rao: Right now we think it's a new cycle. So, for the next year, at least, we should be quite good. Post that, of course, it will depend a lot on what happens, because solar is obviously on power generation and new power generation. Very few thermal capacity is being built up, very few new thermal plants are being set up. So it will become the sector of choice. So let me answer your question this way. Over the medium-term and the long-term, we are very confident that solar will continue to be a very, very good market for us. There may be cycles where, for a year it is perhaps the revenues isn't where it needs to be. But definitely in this year we expect to have our highest ever revenues in solar. And I think that trend should persist next year as well.

Avrind Joshi: Any footprint enhancement measures that you are taking in solar and also climbing up the value chain?

Aditya Rao: Yes. We obviously are constantly doing new product development. So, the first time when we started making MMS solutions, for example, we had far higher structures, far higher tonnage structures, we were only doing a certain kind. Now as the company stands, from a capability point of view we can make fixtures, structures, seasonal tilt structures, we supply tracking structures, optical single axes and dual axes, we even have our own module capabilities. So the design, manufacture, erection and commissioning of systems and components for solar power plants will continue to be a big vertical for us and we will continue to invest capital to increase our addressable market in this. But right now, it seems to be very India focused right now, they are not looking at other geographies. But anywhere in India, yes, absolutely.

Moderator: Thank you. We take our next question from the line of Tejas Mehta from Aldrich Capital. Please go ahead.

Tejas Mehta: Just a follow-up to what the previous gentlemen just asked on the solar side. So, we are seeing that the tariff rates are constantly declining and massively declining. So, just yesterday the news came out that a 2 gigawatt new award happened at just Rs. 2.36 per unit. It basically means that there is massive amount of reduction in CAPEX cost. And it could also mean that these players would be not trying to squeeze you also on the margin front to be able to deliver this kind of low cost. So, my question to you is, while you may see a growth over here, will it be a profitable growth or will you have to compromise the margins to grow this business? That is one Number two would be, what sort of competition do you have in the space? I know that the pie is growing, everyone is growing in this space, including you. But what sort of competition do you have today versus earlier? And number three would be, if you can just mention name of two solar players, giving us some visibility on your growth.

Aditya Rao: So, I will break your question up into three pieces. The first was your commentary that CAPEX obviously has declined, there was a time where solar was at Rs. 25 crores per megawatt, and now it's closer to Rs. 3 crores, Rs. 4 crores per megawatt. Correspondingly, tariffs themselves have declined from what used to be Rs. 20, Rs. 16 rupees per unit, all the way down to now which is about Rs. 2.2, Rs. 2.25 per unit. So, that is one of your questions in terms of margin pressure on us because of this trend. The second question you asked was on whether it would be profitable growth or whether it would be a challenge? And the third question you asked was on competitors.

So on the market, let me comment. You are absolutely right, the long-term trend has been that CAPEX has fallen, PPAs have fallen precipitously from where it was 10 years ago to now from where it was 12 years ago to now. But there is a natural border to these things, I mean, technology has gotten very, very efficient now on the photovoltaic cell side, it has also gotten very standardized. So we have had 250 watt peak panels going to 300, 400, 420, 440. So, from a percentage point of view, if you see the fall, yes, over five years, six years it fell from Rs. 24 to Rs. 10. Then the next five years, again it fell from Rs. 10 to Rs. 5, Rs. 6. Then over the next five years, it fell from Rs. 5, Rs. 4 to Rs. 2, Rs. 3. But if you specifically see the last couple of years, the fall in PPAs is not that precipitous from a percentage point of view. I mean, I think it would be difficult to shave off even more than it. So if you look at PPAs now versus PPAs two years ago, three years ago, you are not going to see a massive difference at all, you are going to see differences in 10 paisa or 15 paisa. So accordingly, I think there has been a stability that has been reached. Now we hear rumors about perovskite cells and others, which can further crash prices down. But if they do that, basically the CAPEX also will come down.

Now from where we stand, our MMS solutions have been pretty stable. And on a cost per megawatt basis if you look at the last three years, our revenue has been the same. Sure, there have been optimizations in tonnage, yes, they have been optimized in terms of kind of material that is used, galvalume as opposed to HR sections. But the megawatts that we supply and the revenue that we supply has been more or less the same. The per megawatt rate for us has not changed much over the last two or three years. So we don't perceive that this increase will come as reduction in revenue, and plus a consequent margin contraction on that. So that we don't see right now. Whatever growth is there, it will be at our acceptable current market margins, which are not very high to be honest, but they are they sustainable, and ROCE also will continue to be decent.

As far as the competitors are concerned, the large players in this field are Tata International, us, there are other companies like Ganges which are also present in it. But we are amongst the largest

Tejas Mehta: And could you just briefly mention a few names in the solar side whom do deal with in this business?

Aditya Rao: You mean customers or competitors?

Tejas Mehta: Yes, so in terms of whether you deal with Renew Power, Amplus solar, if you can mention a few names which are large clients.

Aditya Rao: Both the names, Renew and Amplus are both prior and current customers of Pennar. We also work with Tata Power; we work with the whose who’s. Every large developer in India, Azure Power for example, Greenco, every large major developer and EPC company in solar is our customer. That's as far as customers are concerned. From a competitive point of view, as I mentioned, Tata International, there is Ganges as well, these are the ones. But I would hazard that we are the one of the larger ones. If we are not number one, we are number two.

Tejas Mehta: Okay, got it. And would it be fair to assume a Rs. 400 crore revenue in the business for this year?

Aditya Rao: We will come back to you, but you are not too far off. I mean, a lot depends on what we see. But right now, our audiobooks are pretty, pretty full. So the combination of our entire solar MMS products plus MMS design, plus execution plus products, yes, that should be the ballpark. But we will confirm that number to you.

Moderator: Thank you. As there are no further questions from the participants, I now hand the floor back to Mr. Vikram Suryavanshi for closing comments. Over to you, sir.

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

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