"Pennar Industries Q4 FY21 Earnings Conference Call"

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MANAGEMENT:	**MR. ADITYA RAO – VICE CHAIRMAN & MANAGING DIRECTOR, PENNAR INDUSTRIES LIMITED**
	MR. SHRIKANT BHAKKAD – VICE PRESIDENT, FINANCE, PENNAR INDUSTRIES LIMITED
	MR. JS KRISHNA PRASAD – CHIEF FINANCIAL OFFICER, PENNAR INDUSTRIES LIMITED
	MR. K M SUNIL – PENNAR INDUSTRIES LIMITED
MODERATOR:	**MR. VIKRAM SURYAVANSHI – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to Q4 FY'21 Earnings Conference Call for Pennar Industries Limited 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 call, please signal an operator by pressing '*' then '0' on your touchtone phone. I now hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital. Thank you and over to you, Mr. Suryavanshi.

Vikram Suryavanshi: Thank you, Nirav. Good morning and very warm welcome to everyone. Thank you for being on the call of Pennar Industries. We are happy to have with us management of Pennar Industries for question-and-answer session with the investment community.

The management is represented by Mr. Aditya Rao, Vice Chairman and Managing Director; Mr. Shrikant Bhakkad – VP, Finance; Mr. JS Krishna Prasad -- CFO and Mr. K.M. Sunil.

Before we get started with the question-and-answer session, we will have some opening comments from the management. Over to you, sir.

Aditya N Rao: Thank you and warm welcome to all the stakeholders of Pennar Industries to the Fourth Quarter and for Financial Year ending March '21 Investor Conference Call.

So, once again, a good morning and thank you for attending this Investor Call. I hope all of you are safe and are taking all necessary precautions during this pandemic.

We will follow the following structure for the conference call; I will first provide an Overview on the Performance of the Company on the Fourth Quarter and for the Financial Year. Our CFOs will then provide Details on Major Financial Metrics. And post this initial summary, we will open up the call for Questions from our Stakeholders.

So, to give you an idea of the performance of the company, in the fourth quarter, we have achieved improvements we wanted to our revenue line; we were able to record net revenue of Rs.556 crores compared to net revenue of Rs.451 crores in the fourth quarter of the previous financial year. Our EBITDA had Rs.74.56 compared to EBITDA of Rs.30.95 crores in the fourth quarter, up by about 140% and the profit after tax after minority interest is at Rs.33.32 crores compared to profit after tax of the minority interest of Rs.10 crores in the fourth quarter of the previous year.

For the financial year in question, we recorded net revenue of Rs.1,525 crores compared to Rs.2,106 crores in the previous financial year. Our EBITDA was at Rs.131.5 crores compared to EBITDA of Rs.189 crores in the previous financial year and a profit after tax was Rs.2.27 crores compared to the previous year's profit after tax after minority interest of Rs.53.3 crores.

So, in summary with regards to performance in the fourth quarter, we achieved and exceeded in fact in some cases, the metrics, and the target we have set for ourselves. As I mentioned to you in our previous calls, going forward, our updates will be broken into three aspects -- Profitability, Liquidity and Growth. On the Profitability front, in the third quarter we achieved a moderate level of profitability and liquidity. And our focus was on achieving a pre-pandemic profitability. We have since achieved that in the fourth quarter and also in terms of PBT and cash profit. Now, our goal will be to start generating growth quarter-on-quarter improving our numbers further. And in the first quarter of this financial year with the second wave having come into being, we had expected moderation in some of these numbers, but we have reached a steady state level of profitability which we think will continue.

On the Liquidity front, we continue to work hard to bring working capital usage down. Current working capital utilization is an improvement over the last quarter. As I mentioned last quarter, our target is to reach 75-days and in the second quarter we were at 120-days, improve that to 100 days, we are right now at 96-days. And we expect these improvements to continue and for us to reach 75-days in working capital number of days in this financial year.

Coming to growth, as I mentioned on my previous calls, we had a new plant in Chennai, we have commissioned Ascent Metal Buildings in Tennessee in the US, and our Tubes **(Inaudible) 5:07** operations have started bearing fruit as well. So, all these investments are starting revenue generation very soon. Some of it came in in the fourth quarter. But the BIW plant and Ascent plant will be starting operations from next month. And we believe that the addition of all of these three over the next couple of quarters will allow us to substantially grow PBT and cash PAT. We have funded the vast majority of these investments. We only have around Rs.30 crores more of CAPEX to be deployed in order to make sure that these assets are up and running. And we will complete that investment and make sure that they become good revenue generating assets.

For the other revenue streams, we also have small moderate CAPEX investments and growth investments in our industrial components line and other businesses. And with the exception of Railways, and our Water EPC business, all of our businesses have very robust growth plans ahead of them. The Railways vertical continues to be unclear. Because of the second wave, most of our customers in the railways are not operating right now. ICF is not operating. So, in that environment, it is difficult for us to give guidance about what is going to happen as I had mentioned last quarter as well. So, this quarter as well, we will be unable to guide you to what is going to happen in the railways vertical, but our order books are quite strong in that and we expect whenever the second wave recedes, for us to benefit from a profitability growth.

PEBS order book has come back quite strongly as well it started delivering realization at higher level and we expect to hit our target profitability in PEBS also quite soon.

We are as usual not going to give guidance. But in spite of the second wave, in spite of a lockdown, we believe we have a strong level of profitability in Q1 which is superior to what we had in Q3. But what we can expect is a good level of profitability, a good level of cash flow generation, further improvements in working capital in the first quarter of this financial year.

In conclusion, before I hand over to our finance heads, I would like to conclude that we have achieved what we had committed on our last call. That is what is most important for us that what we say we do we do, and we are quite confident that we are well placed to continue to operate and improve our profitability and our working capital position and also increase our revenue over the medium term.

On that note, I will hand it over to our finance controllers, Mr. Shrikant Bhakkad and Mr. Krishna Prasad for their Briefings on the Performance on the Fourth Quarter and the Financial Year.

Shrikant Bhakkad: Good morning, everyone. Welcome to the Investor Call. I would like to give you the highlights of the Q4 FY'21 versus the Q4 FY'20. In terms of net sales, we have increased from Rs.451 crores to Rs.556 crores, that is up by 23%. Correspondingly the raw material cost has also gone up from Rs.255 crores to Rs.340 crores. Employee benefits, now that we are back to normal, we have started all the employee related full payments of the thing and it has increased from Rs.31 crores to Rs.33 crores, moderately by 2.12 crores. Finance cost from Rs.18.28 crores has come down to Rs.18.1 crores. So, there is a decree. These are based on the various measures that we have taken in order to reduce the working capital in terms of number of days and also getting the interest advantage in terms of the LC discounting. The precision has been more or less the same from last quarter to current quarter of FY'20 versus FY'21, 11.53 to 11.79.

Overall, there is a profit before tax of Rs.44.67 crores. The profit before tax consists of an exceptional item of Rs.19.96 crores. This was on account of the land sale that we did from the surplus land and as per the board approval this has been sold. So, this is an exceptional item and one-time event. The existing profit also includes the one-time profit which we have got from the tooling revenue, which is close to around approximately Rs.7 crores. So, if you take out from Rs.45 crores, if we reduce this Rs.27 crores, Rs.18 crores is the revenue that has been there from the operations which is the normal course of the business, so, that is Rs.18 crores revenue. And overall, we have clocked the cash profit from Rs.12.49 crores last quarter to cash profit of Rs.45.85 crores in the current year.

Just because it is a financial year, I would just like to take you through the balance sheet numbers as well. In terms of property, plant, and equipment, from Rs.572 crores, it has decreased to Rs.554 crores, is on a combination of the capitalization that we did close to Rs. 123 crores in factory building and plant and machinery and the depreciation that we have charged off in the current year. The increase in the working capital from Rs.33 crores to Rs.61 crores is on account of the new initiatives that we have taken in terms of BIW and Ascent Buildings, which we are setting up in the US.

Overall, if you see the trade receivables, has increased by Rs.7 crores, trade receivables and non-current has reduced from Rs.41 crores to Rs.17 crores while the trade receivables in terms of current have increased from 396 to 427. So, overall, even with the increased revenue, we were able to maintain the receivables because of the old collections which has been followed up and collected in the coming quarters. In terms of inventory, it has increased from 439 crores to 486 crores. This is predominantly on account of the increase in the prices, the inventory value has gone up. In terms of the metric tons, the overall metric tons remaining more or less similar or reduced levels in various business units. We continue to hold Rs.55 crores in terms of cash while compared to the last year of Rs.59 crores.

In terms of investments, some of these investments have reduced from Rs.45 crores to Rs.17 crores. This is predominantly on account of deploying this money for BIW and Ascent and resultant you can see the increase in capital work-in progress.

Equity is more or less similar. There is a slight reduction due to the buybacks that we carried out a year ago which we have completed in May 2020. If we remove that, there is growth in terms of the total equity. Borrowings from Rs.102 crores to Rs.112 crores in terms of the long-term borrowing. And in terms of working capital, it was from 297 crores to 490 crores. So, overall if you see the working capital, it has slightly increased in terms of Rs.524 crores. While the other numbers in terms of trade payables have come down from 478 crores to 440 crores. Also, we have reduced the other current liabilities from Rs.80 crores to Rs.51 crores.

Let me take one more minute to explain in terms of cash flows from the operations. So, on the balance sheet, cash flow from the operating activities has increased by Rs.43 crores and this has been used to deploy in terms of investing activities by Rs.6 crores and financing activities by Rs.43 crores So, overall, we were able to maintain from Rs.39 crores to Rs.33 crores in terms of cash and cash equivalent that we have in hand. This is the brief in terms of the finance numbers. If you have any further questions, we will be happy to take it.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Digant from SVIP Capital LLP. Please go ahead.

Digant: Sir, I have a few questions about the freehold land that we sold at Bandalguda, sold at a profit of Rs.20 crores is what I see. So, I wanted to know what is the total sale price of that property? Have we received all the money and if not then by when will we receive all the money from the sale proceeds?

Shrikant Bhakkad: The total cost of the land that was purchased is approximately Rs.4 lakhs. And in terms of the taxable profit, the tax computation on that is approximately around Rs.4 crores. From the Rs.20 crores, only Rs.4 lakhs is the cost, Rs.19.96 crores are the profit. And out of this 19.96 crores, as we speak, we have received almost 85% of the money and balance 15% will come before the month end as per the timelines.

Digant: I see the proceeds from sale of current investment in the cash flow statement of Rs.28 crores. What is that relating to?

Shrikant Bhakkad: That is the amount of the money that we had in terms of investment and which we have deployed in capital work-in progress. So, that is mutual fund amount which has been withdrawn and used for CAPEX purposes.

Digant: So, the change in inventory is about Rs.20 crores, bow much of this would comprise of the inventory revaluation?

Shrikant Bhakkad: Inventory, we did not carry out any revaluation and we just add cost or net realizable value, whichever is lower.

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

Arvind Joshi: So, looking at the scenario that is developing and also some green shoots developing partly due to the upturn in the economy and partly due to the efforts you guys have been taking since last two, three years, I think both sides, the green shoots will sustain is what we hope. So, in that context, I had a few questions. Now looking at the fairly devious footprint that you have except a couple of parts which are becoming a little dormant in the short term, which components excite you the most in terms of scalable profit. So, other than this, I have been looking around, and I think there is a fair amount of consensus that water and clean tech are emerging as huge opportunities. How is our footprint currently? And how are we planning to enhance that? And any new initiatives taken? And especially on our Chemical Treatment and Resins business, what is the status and any expansions or any more value-added qualitative improvements in that which we could expect? And also on the defense front, if you recall, a couple of years ago, when we had met and visited your facilities, you were very excited about the defense vertical shaping up very nicely. We are one of the key vendors to a major ballistic component manufacturer in the PSU arena. How is that business shaping up? And in general, what is the outlook for the defense sector in this thing? And also, we were very excited about being suppliers of almost entire coach for the Train 18 Project. Has it been sidelined due to some internal problems with our government authorities at the railways end or this project eventually will start, and we should see the good times coming back?

Aditya N Rao: Thank you. I will take your questions one-by-one. So, as to which revenues excite us the most I feel within the next two to three years, we will see automotive business which is BIW line, our existing auto component revenue lines will do quite well. So, that I find very interesting because I believe this massive growth potential in that. Our Engineering Services vertical is also growing quite quickly. They may only comprise 10%, 15% of our profitability right now, but I believe that going forward they will expand their profit share for us and also I think are very scalable vertical. So, that is another business that excites me a lot. Even our capabilities right now in railways though they are being used right now because the businesses were shut, I believe that the rolling stock movement, railways is a massive opportunity in India. So, where we are now will not be where we are two, three years from now. So, I am quite optimistic that once the situation does turn around, these business verticals become very, very attractive to us, and a lot of them have already become attractive to us. In Sintech, we are in water and water purification, effluent recycling, industrial water, and wastewater recycling. We are also in solar; we make modules, and we also provide module monitoring systems. And we have a line of, as you had mentioned, chemical treatment products, which includes combustion efficiency improvement, water treatment again in terms of chemical water additives, and also line of paper chemicals. All of these businesses have massive potential, and our order books are slowly growing up for all of them and all of them are also profitable. So, I believe that we are quite eager to see where the sectors go. And I am quite confident that they will do well. For defense, we currently have about 110 crores order book. I cannot reveal the names of the customers, but approximately the same margins the company makes, I can good definitely say that. And we believe these are good orders and we will continue to execute them. So, there we are looking to make sure that the revenue is out. As far as Train 18 is concerned, it was a very good initiative. And my view is obviously a personal view from ICF had done the development, that is more of the Vande Bharat Express for example. So, that may come back. Right now, we do not have a lot of clarity, but I believe that railways board is evaluating on giving large orders on that. So, we may have some good news. But right now there is not anything for me to cover because while we have some order book, not a lot of it in Train 18 right now. So, the data right now we have available, the facts of the matter are that we do not know what will happen to Train 18. But if it does scale up, I think we are definitely going to play a role on that as a key vendor.

Arvind Joshi: It seems you guys are on track now. And looking at the emerging opportunities that are showing some nascent signs, do you feel as a head of this organization, are you adequately tooled up on the management front, on the asset front to really encash big time on this opportunity if it emerges?

Aditya N Rao: I think I should not be the only person; I think in the organization, we have several business unit heads who are quite strong, some of them are very young, some of them have been for over 30-years. So, we have a good mix of managerial talent, capability wise. I am quite confident in their ability to steer the company. I think the idea we have is that we all learn from each other that I learn from them, and they learn from the outside market as well. So, I am quite confident that we have the bandwidth to execute our vision. And we will ensure that managerial bandwidth, managerial focus, and our internal human capital assets do not become a bottleneck for our growth. You are right, it is important to monitor that as well.

Moderator: Thank you. My next question is from the line of Rosham Shah from RS Capital Services. Please go ahead.

Rosham Shah: I just want to understand land possession of Rs.20 crores. How would you plan to use that – will it be for debt reduction or working capital or something else?

Aditya N Rao: It will have to go towards debt reduction, but I request our CFOs to comment.

Shrikant Bhakkad: Against this land, there has been a loan that has been taken. So, this will straight away go and reduce the term loan.

Rosham Shah: Just want to understand on the order book mix. How much is this from government entities related and how much is from private companies? And what is the trend for the company going forward?

Aditya N Rao: For railways, the majority of the order book is -- when you say government, it is PSUs, right, Integral Coach, government-to-government, the majority is from that. In none of our other businesses do we have a very high government component, I think in our defense orders we have about 30% to 40%, so it is about Rs.30, 40 crores because we have got Rs.100 crores, there is a government PSUs again. But overall, our goal is to move away from a high concentration… from direct government orders we do not take, everything is either PSUs or private sector and PSUs comprise all these, for the railways sector, they are high, but overall the rest of the company the majority or most of our businesses, they are not even a very significant proportion. Another way for me to describe that is if you discount railways, less than 5% of our company's revenue is from governments or PSUs.

Rosham Shah: How was the company planning to optimally utilize this capacity going forward? You are saying we are exploring a lot of segments. How do you intend to keep focus and optimize all the divisions efficiently going forward?

Aditya N Rao: I think the idea is that we have to think of ourselves as an engineering company. And a lot of engineering companies have revenue streams. So, we have more than most, I would agree, I think, we have from discrete revenue streams point of view, we have anywhere between six and 10 at any point of time. So, I think the best way we have done that is that we have a very robust view structure, we have professionals head each revenue stream, and we make sure that they are directly accountable for profitability, for growth and for capitalization. So, that will allow us to take care of the financial parameters. From a strategy point of view, we only invest in businesses, which we think going to exist in the long term, which is they should exist five years from now, 10 years from now, we do not chase short term opportunities, we will only chase opportunities which allow us to build these assets capabilities, which will last for at least five years, 10 years, 12 years, with some improvements, some adjustments, some additions in capacity. So, that combination I feel will give us the operating structure and the org structure to be able to continue to manage this growth. So, if we have six discrete business units, and each of them has the potential to be Rs.1,000 crores, then we can more than double our size from where we are right now. And not worry about either from the bandwidth point of view or from a management point of view or from capital and assets point of view. So, I think that is the plan right now and we are confident that we will be able to achieve this.

Rosham Shah: If you could say anything on a debt reduction plan for the next one or two years? And also, is there any thinking of increasing the promoter stake by open market purchase or anything?

Aditya N Rao: From a debt reduction plan, I think we look at it as capital efficiency, I will also request after my comments the finance controllers to comment. But effectively the way we look at debt is in two ways; one, we monitor it in terms of interest cost as a percentage of sales, that is something that we monitor; and the second thing that we do is, we make sure that our ROCE is maintained at a high enough level. So, for ROCE, our target is above 20%, we intend to achieve that. Obviously, for the last financial year, it does not look good. But if you were to analyze the fourth quarter, third quarter, we are achieving that. And we are going to break it down to a BU level to make sure every business unit we have is, is profitable and capital efficient. So, that takes care of whatever capital we are using. On the interest cost percentage, our overall effort is to make sure that we are at 2.5% to 3% for most of our businesses, some business is less, but I think if we use that metric that allows us to make sure that we do not binge on debt. Our debt-equity also is at 0.7, we do not want it to increase, we want it to decrease. So, over the long-term, I think a safe level of debt-equity is about 0.5. So, as revenue grows, our profitability grows, I think that is what we intend to achieve. I would also request our finance controllers to comment on our debt reduction plans, post which I will speak about the promoter stake.

Krishna Prasad J S: Actually, it is something in relation with the turnover. So, debt reduction in relation to turnover whatever the ratio, that ratio as of now it is slightly higher, but we want to maintain that one. Once the turnover is increasing automatically working capital requirement also will increase. So, what Mr. Aditya is telling, the ratio what we want to have we control, and that control is going to be extended further. So, if there is a turnover increase, then only our debt will get decreased. To that extent we are controlling everything.

Shrikant Bhakkad: I do want to add at this point sir, the vast majority of our debt, 80%-plus perhaps is a short term debt.

Aditya N Rao: the next question you asked in terms of the promoter shareholding. As promoters over the last five years as you will see, even though there have been multiple rounds of dilution due to mergers, we have always maintained or even increased our shareholding, we will continue to do that. Less than about seven, eight months ago, I think we closed the buyback. So, we are prohibited from buying for a certain period of time, but I will clearly tell you that the promoters are very interested in increasing their stake on behalf of the promoters. Any rigorous plans that we have on this thing, I will communicate the next time we speak, but definitely we are very excited about this business. Our goal is to get from where we are right now, which is 35%, 36%, 37% to a higher level and we will communicate those in due course.

Moderator: Thank you. The next question is from the line of Amar Mourya from Alfaccurate Advisors. Please go ahead.

Amar Mourya: First thing is in terms of the commodity inflation; how much percentage of our overall order book is the fixed price order book?

Aditya N Rao: So, on paper, our order book for railways does not have much commodity price in place, but the recent commodity price increases we have seen are very largely in the mild steel or the lower grade steel prices. Some of the BUs, alloys like IRS and stainless steel alloy. There has not been as I say 100% increase. So, there are no margin pressure in the order book if to anticipate your query. For our precision building line and other lines, we have now put in place price escalation clauses and all of our contracts are standard. So, we will not accept orders which do not incorporate a price escalation clause, because they have been forced to do it with the pace of raw material price increases. So, we are including them. And if there are customers who do not want to give us that, then we estimate the price as best as we can for when we are going to execute the order which is typically two, three months down the line and we give them that price. Either way, we make sure that our margins do not get hit because of the raw material price. Quite frankly, if we do get stuck at the wrong end of the stick, our goal is to go ahead and speak with our customers and renegotiate a contract so that we can make sure that we meet our target level of contribution. We will not execute orders at low margins if the low margin is a consequence of raw material price increase.

Amar Mourya: Secondly, sir, if you can update more about the US plan which we have talked about in the press release, when it will be commissioned, what is the kind of visibility we have in terms of the business over there?

Aditya N Rao: So, the US plant is Ascent Buildings Systems. That is the brand it works under in the US. It is in Tennessee, and it will be commencing operations from next month. It already has a very strong model book of about US$13 million. The operating profit for that are very healthy, much higher than what we get in India. The reason for that investment is for us to ground that it will be profitable in this financial year itself. In fact, next couple of quarters, we will be hitting not just profitable, but hitting a target from that plant. So, to summarize, the plant is starting commercial operations next month, the order book is very strong, the margins are very strong and in the months of November, December we will hit our target PBT.

Amar Mourya: Like you said, currently, the order book is around $13 million, in terms of the next two years, what kind of scale we can bring over there?

Aditya N Rao: So, as of right now, the capacity we have set up is for a single beam line which gives about 30,000 metric tons. So, at this capacity, we will execute about $25 million in revenue from that plant.

Amar Mourya: Profitability wise, is it going to be similar to the average company level profit or is it going to be higher?

Aditya N Rao: It would be higher than our current EBITDA, it would be higher than our current PBT as a percentage margin.

Moderator: Thank you very much. The next question is from the line of Dilip Sahu, an individual investor. Please go ahead.

Dilip Sahu: A couple of questions regarding the EBITDA. We have kind of reached a double-digit EBITDA in this quarter. Can you kind of tell me about the drivers for this EBITDA? Is it sustainable in the current financial year?

Aditya N Rao: Our EBITDA right now is at 13%. I think double-digit EBITDA can definitely be achieved and sustained. I think our goal is to achieve that. But you have to consider that this does include a significant one-time event of obviously the land sale. But over the course of the financial year, we will definitely have sustainable double-digit EBITDA which is above 10%. That is our goal.

Dilip Sahu: Railways happens to be the highest contributing in EBITDA. So, is it expected that this EBITDA will go up as well the business comes back?

Aditya N Rao: Regarding the railways business coming back, the timing and the quantity of it coming back is not something that I can project right now for the next few quarters. But the business is hard at work building, for example, we are investing a lot for other customers, GE, for example, in Loco, we have invested a fair amount of capital, that revenue stream is starting, we also are working with Bombardier and others as well. So, I can definitely assure you that once ICF, MCF open up, once these other investments come, the railways obviously will contribute in a very big way and the margins will jump up which is what I mean that over the next two, three years, definitely we will have that happen. Next one, two quarters until ICF opens up, articulates a plan of what they intend to achieve, it would be difficult for me to comment on the impact of railways margins on our current margins, but I definitely know that double-digit EBITDA is our target this financial year.

Dilip Sahu: One more question regarding the cash flow. In the consolidated cash flow, you have shown Rs.27.8 crores as a write-off and Rs.25.3 crores are the provisions in the year '19-20. On the higher side, just wanted to know what exactly were these two items?

Shrikant Bhakkad: It is more of a doubtful trade and receivables which we bagged in the last year which have been broadened and this was being done based on the expected credit loss method which was introduced last year. So, under the expected credit loss method, we are supposed to have a policy of planning and arriving at the numbers based on our past data. So, based on that past data, the last year provisions were higher which is moderated as we have collected more in the current year. So, we have a consistent policy of making a certain percentage of provision for each of our business unit heads while we earn the revenue itself. So, the current year is in line with that and last year being an exceptional due to the expected credit loss method.

Dilip Sahu: So, the write-offs will be in the same this year considering the size of the business, right, 14 or 15 crores…

Shrikant Bhakkad: This investment is what you take on an average.

Moderator: Thank you. The next question is from the line of Parin Jhaveri from JNJ Holdings. Please go ahead.

Parin Jhaveri: I have a couple of questions. First, the working capital days have increased from about 69-days to about 117-days year-on-year. If you can just highlight what is your target level going forward?

Shrikant Bhakkad: In terms of account receivable days, we have increased in terms of consolidated numbers if I have to see and correspondingly if you take accounts payable also it has substantially increased. So, the increase in accounts receivable and accounts payable more or less gets increased and the working capital number of days comes to around 96 working days. Maybe offline I can share your numbers how we arrive at this.

Parin Jhaveri: I was just picking up the data of the receivable two items and payable. I can take it offline.

Shrikant Bhakkad: But you have to add other current assets and other current liabilities as well.

Parin Jhaveri: I will take that offline. Sir, my next question is the debt is around Rs.540, 550 crores or increasing, right, short-term, long-term as well as current maturities?

Shrikant Bhakkad: Rs.584 crores in case you add the current maturities as well.

Parin Jhaveri: Sir, if I see your finance cost which is hovering at about Rs.80 crores, if you can just explain what would be the bank charges or any other charges which will be clubbed together?

Shrikant Bhakkad: Actually, we will explain to you in a little more detail because I think this is a confusion that you generally have in the investors. The finance cost also includes the interest charges that we pay on our long-term based limits which is letter of credit. While the LC limits and LC borrowing does not appear anywhere in the financial statements, but for procuring the raw materials we give this LC. We have mostly 15-days of credit free period or 30-days of credit period and after that it gets charged. So, that particular component of the borrowing does not straightaway appear in terms of borrowing while the interest does appear. So, it is not the bank's charges which are higher, it is the interest on those LCs are included in this finance cost. That is the reason the number in terms of percentage of borrowing when you do interest or finance cost divided by the total borrowing, the percentage appears to be little higher. While I can assure the overall rate we have in terms of working capital is between 9% and 10%. In terms of LCs, we have done a lot of breakthrough in terms of reducing our cost and that cost approximately is between 5.5% to 6.5% is what the interest cost that we pay on this LCs. So, that is in terms of finances. And what we have also done in the current year is we have started taking short-term borrowings from vendor discounting platforms that are available and which comes at a substantially lower rate of interest, approximately 100 to 150 basis points lower than the working capital interest. And those facilities are also unsecured facilities. So, we are increasing the component of this vendor discounting and reducing the working capital stress. So, overall if you see, the working capital number has come down from last Q4 to the current year Q4 by approximately from 18.28 is reduced to 18.1. So, we are constantly making the efforts to reduce the finance cost while reducing the interest rate and also reducing the working capital cycle.

Parin Jhaveri: What would be the number of this vendor credit or the LC discounting in terms of crores? So, your total debt is Rs.580 crores.

Shrikant Bhakkad: Vendor discounting is close to around Rs.136 crores as we speak, and the LCs will be close to around Rs.90 crores. Rs.30 crores a month is what LCs we will take on an average and we have Rs.90 crores for which does not appear in the borrowing.

Parin Jhaveri: So, if I get you right, we have a total debt of over Rs.580 crores which is reflected in the balance sheet in short-term, long-term, and current maturities and there is about Rs.222 crores of debt which is LC and vendor discounting, which does not appear in the balance sheet, but the interest is charged, right?

Shrikant Bhakkad: Rs.136 crores of DPD does appear in borrowing. Only Rs.90 crores does not appear.

Parin Jhaveri: What would be the levers for our EBITDA expansion from this 7.2% to 10% going forward?

Shrikant Bhakkad: I think there are a couple of things that we are doing. One, we are growing our new businesses and new CAPEX has been coming into a higher growth vertical margins which is BIW which is automobile and also Ascent Buildings. So, ascent will also have a little higher margins than the present margins as well as BIW component. Once the other businesses are back, railways will have better margins than our existing businesses. Another thing which will have the increase in EBITDA margins because with the same capacities we will be able to grow up much higher than the present. Due to the pandemic, certain portions we are not able to use the maximum capacity utilization. So, those will also be the area where we can increase. Aditya, if you want to add anything more to it.

Aditya N Rao: I think that is a good explanation. I think our growth in higher margin businesses and moderation in our working capital usage together will boost our margins, I mean, working capital days might not boost EBITDA but it will boost PBT.

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

Venkat Subramanian: I had a couple of questions. On our Engineering Services business which is highly value added. Will it come into play quite meaningfully in our American business – will we probably start doing more design out of here which is probably what is going to be a big margin kicker?

Aditya N Rao: In this current financial year, to give you a perspective, the total size for Engineering Services which is our structure engineering plus our automotive engineering is about Rs.40 crores, Rs.10 crores breakup, a combination of about Rs.50 crores. So, that Rs.50 crores gives us something of 30% in terms of PBT. So, obviously, the more we scale up that, the better it is. Long-term steady state sustainable PBT we expect to be about 25% for that vertical. So, we had it and we were trying grow it, but I think for it to start contributing to more than as I had said 15% of PBT as it is right now, I think would require us to dramatically improve our customer presence in the US which we are attempting to do. So, this is a medium-term project. It is not going to happen in the next couple of years but over the next two years I think growing that Rs.50 crores to a larger size will automatically increase because of its high PBT percentage will increase its profit share percentage from now, from 15% to 20%, 25%, that is what we intend to achieve. So, if 50 goes to 100, that gets achieved over the next year, year and a half.

Venkat Subramanian: Fifty will need to go to a little higher number, right, Aditya, for this to become let us say about 25%?

Aditya N Rao: Right now, if you look at 30%, we are about Rs.15 crores. I think if we were to double that, then I think for it to be 25% doubling basically mean that 15 goes to about 30, right, 30 becomes 25%.

Venkat Subramanian: You see visibility for that you think that is workable, right?

Aditya N Rao: The business is headed by a very compelling team of people who understand how to grow this vertical business. They all come from very strong engineering background. So, I think we have mapped out our addressable markets quite well. We can body in white where we have got very good orders and some of the largest companies in structured engineering are our customers but mostly yes, the US would be a big market, Europe would be a big market, but we have the run rate to achieve that. We definitely have the addressable market to scale to that, but it will take us some amount of time.

Venkat Subramanian: The second interesting is very high margin business for you will probably be your Hydraulic Cylinder Services. Is that shaping well and what kind of visibility do you have there?

Aditya N Rao: On paper, it is great. One thing we failed in Hydraulics is not scaling it. Shiva, who heads our Industrial Components division, his priority is to ensure that he scales up Hydraulics. I think he has a larger order book when he delivers right now. I think with the improvements we are making in industrial components and the capacity expansions already met, this business will do very well. I think Hydraulics is as you said another business which is exports, high entry barriers, high value added and can scale. So, we should focus on growing that vertical.

Venkat Subramanian: Where are we just now, Aditya and where we think we can get there and what do you need to do to kind of strengthen Shiva's hands there?

Aditya N Rao: We are again at a similar level at Rs.4.5 crores right now versus little over Rs.50 crores in revenue per year. So, the market is huge. Our competitors are Wipro the 1,000 crores and several other companies which are around Rs.200 crores. So, our intermediate target is to get to Rs.100 crores and for Shiva to achieve that, it would mean some amount of moderate capacity expansion which we have undertaken. It should not be too difficult for us to get it. It will involve massive amount of capital. I think we have our customer base as well. It is all US for hydraulics. So, I think the best thing we can do to make sure Shiva is that he is to ensure he has the capital he needs and that we are able to give him the other factors of production in terms of raw material and others and he is committed to doing that. I am quite confident he will achieve these numbers. To give you a perspective, just two and a half years ago, this Rs.50 crores was Rs.25 crores. He has managed to double in two years…. small numbers obviously, but I do not believe the market will prevent him from growing. I do not believe his order book will prevent him from growing consequently. I think if he continues the path we are on, he will achieve that very soon.

Venkat Subramanian: Secondly, we had a broad goal of getting to about a billion dollars maybe and something in about four, five years' time. That is almost about four-fold growth. What are the building blocks that we will require, what will be the drivers? And halfway when we get there, which businesses you think will be where and how do we need to retool ourselves?

Aditya N Rao: Getting to a billion is one of the factors of our growth plan definitely. So, 32 billion right now means about Rs.7,000 crores. Right now, we are a little more than 40% of that income we assume. We are at a run rate which is around Rs.200, 220 crores and reach Rs.250, we reach Rs.3,000 crores, Rs.200, 220 crores per month. So, getting to a billion means that we encourage businesses with very high scale potential. I think buildings, plants can do that. I think they can go to scale in revenue and profitability. I think as you mentioned our inventory is good. For hydraulics, for industrial components as a whole, has a lot of potential. Even our tube CDW vertical, we currently have 10% of the market share, but we have 10% of the revenue of the highest market share player. So, there are multiple avenues where many of our businesses we are at low market share and just by expanding our capacities, expanding our capabilities, making sure that the working capital is efficient will ensure that those businesses can continue to grow that they have sustainable revenue streams in them. So, that is the plan we have. So, our plan is not Rs.7,500 crores or a billion. It is a process by which we achieve that. Our plan is to boost PBT. So, let us say we are at something like 60, 70 crores per annum, if we can get that to 100 crores which seems to be definitely on the card very soon, then getting that 100 crores to 200 crores, 200 crores to 300 crores and ultimately when we reach a billion, we would obviously want a number assuming 5-10% profitability would be 500 crores PAT. So, Rs.500 crores PAT plan is actually for us the way to think about. That is how we are working on this. But it will take us obviously a fair amount of time to achieve those numbers.

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

Arvind Joshi: Just a quick clarification. Is cess totally out now or pulled out entirely?

Aditya N Rao: I am not fully aware sir. I will have to check and get back to you. I know that…

Arvind Joshi: I was just following the releases to the exchanges. I was just wondering what the status is. Anyway fine. I also would appreciate if you could give us a little bit clarity, this GE business is largely shell parts. What are you doing for GE?

Aditya N Rao: Truck frame sir, shell part we can say the load bearing parts effectively.

Arvind Joshi: This BIW is a fairly large, complicated product for us to start. Are we having the right kind of domain expertise, and these would be what, European and American customers in the American domain that you are planning to work?

Aditya N Rao: It is high margin and all of it is export. The plant is not but we have done a lot of tool development internal out of R&D. We have tied up with some of the largest companies in the world. I cannot -- they have explicitly asked…

Arvind Joshi: I can understand. Why I was wondering was this is not a business which can be run at very small scale. Eventually once they become your serious customers, we will have to scale it up maybe 10x, 20x from here for them to take you seriously for you to stay on the horizon. So, do you feel that kind of a scalability and outlook exist from the kind of stuff that you are doing?

Aditya N Rao: Absolutely. Starting of small is the most important part sir. Once we start of small, our scaling will be dependent on how much capital we can deploy and how well we can manage our operations. All of those are things that we can definitely follow, I mean, 10, 20-years is the journey I guess sir, I mean, obviously, JBM and others larger than that but we are starting off now, we are just looking at Rs.100 crores in revenue for the first year. So, we will absolutely make the investments we need. Right now, we have a strong order book or multi order book. So, revenue is not under hit. We have to make sure these are safety critical parts we have to make sure that quality is improved. But one thing is we never had quality issues. I think our focus has always been make great products. So, we never had a situation where we supply products, and they fail totally or something. So, we take care of that first. That combined with our expertise, I am quite sure we can achieve this.

Arvind Joshi: So, you are comfortable with the kind of learning curve you have undergone aid you do not feel there will be any unpleasant surprises at least from the delivery front on quality?

Aditya N Rao: I believe that we are well geared up to understand the challenges this industry represents. We understand our safety critical it can be. We are also for example in the aerospace business, very small, but we know how critical it is that we have micron level precision. So, we…

Arvind Joshi: It should be some aluminum alloys and all or it will be a conventional steel business?

Aditya N Rao: You're absolutely right. It is aluminum machining, mostly…

Arvind Joshi: We have some expertise in that also, it is a new vertical that we are looking at?

Aditya N Rao: We've been present in it for a long time, sir, almost two and a half to three years. But it is a small business; we do Rs.3, 4 crores a year and it is something we do, it is part of our rail business. Yeah, I guess I should have brought it up. But what does that illustrate is we understand that there are industries out there specifically in BIW, which demand output, which demand quality, and any failure on our part has big impacts on our customers' ability to perform. And we are well geared up, we have understood with our customers exactly what needs to be done. We will invest the capital, the people skills, and most importantly the time that we need to succeed on this.

Moderator: Thank you. The next question is from the line of Digant from SVIP Capital. Please go ahead.

Digant: A couple of questions. So, the debt has been increasing with the vision of us improving our working capital cycle. So, I just wanted to understand why was the buyback done? That is the first one. So, the second question was that we had guided for Q4 to be better than the Q3. So, kudos to that. And you have also guided that the Q1 would be better than Q4 of this quarter. So, are we on track for that?

Aditya N Rao: Let me take the buyback part first. The rationale for a buyback is that we ensure that the funds of the company are used in order to reduce equity when the PE multiple is low, or we believe that PE multiple to be low considering historical values. That is a different discussion compared to our debt-equity for the company. The nature of our business is that we will always have some debt, it could be non-cash there, it would be cash. The idea for us how we intend to run the company is to maintain a certain debt-equity, make sure it does not go out of control. And then make sure that the actions that we want to take whether there are buybacks or dividends or others. It is a board driven decision. And we believe we have spent our money wisely. We have retired some equity and retired equity at a low PE multiple. So, it is seen in that perspective. That is our explanation for why we did a buyback even though we have substantial debt. That is point number one. The second point you raised, which is Q1 versus Q4, Q4 as you know has several extraordinary items. So, I cannot say that Q1 will be better than Q4. But once the extraordinary items are removed, it will be more or less in line with that. So, we are not going to slip back to very low profitability levels, but we are going to be able to sustain a certain level of profitability. So, that is what I have guided to. I am not guiding that Q1 is going to be higher than Q4 considering the sale of land asset and the items where it is coming. What I can definitely assure you is that quarter-on-quarter from now on, we will only be improving. There is certain cyclicality in some businesses, but this is the level of performance we are seeing with one of our hands still tied behind our back Really not all of our business has reached back to their peak potential. I have no doubt that over the next few quarters, that will happen, more and more of our businesses will start hitting peak. And when that happens that will naturally increase our PBT. And that is our target. We are a profit-focused, liquidity working capital-focused company. So, consistent improvements in profitability as I had promised and delivered over the last three quarters and consistent improvements in working capital efficiency as defined as number of days of working capital, our cash outflow to cash inflow cycle that I can definitely commit to, we will keep improving and keep getting better over the next few quarters. Were there extraordinary items? Obviously, we cannot say that it will be. But you can absolutely count on us for consistent improvements.

Digant: Extraordinary items are for our profits, but would the revenue increase? And the other question was that how much component of railway revenue was in this Q4?

Aditya N Rao: Shrikant, correct me if I am wrong. We had gross sales of about Rs.45 crores which corresponds to net sales of about Rs.38 crores.

Shrikant Bhakkad: Numbers are not there presently, we get back on that number, but I have yearly numbers only.

Aditya N Rao: Those are the ballpark numbers.

Digant: The other question I asked previously, the extraordinary items were in profits, right, so the revenue would be better than Q4 or how would that go?

Aditya N Rao: I will come back to the revenue projection, because a lot of it depends on the raw material prices than versus now for some rates, that revenue composition, how much of that is high grade steel, low grade steel, but I will come back to you on this. But you are not going to see a massive drop in revenue, that I can definitely promise.

Moderator: Thank you very much. The next question is from the line of Rosham Shah from RS Capital Services. Please go ahead.

Rosham Shah: Just want to confirm, are there still more unused land bank or any other assets that we plan to dispose of in the next one or two years to generate quick cash?

Aditya N Rao: The company has substantial land assets. This was freehold land. We did not have a factory on top of it or we did not really have any COVID there. There are other such land assets we have in the company, but no decision has been taken as yet on them. As and when the board takes those decisions, we will communicate. But we have land assets on our books, we sold five acres, for example and we have 50 acres, and we also have a land in Chennai plant, we have plans to have in Hyderabad, near Bombay and others, but there are currently no rigid plans to liquidate. This was a very easy thing to sell because it was not generating revenue and it was not being used for anything else. So, we sold them. But we will finalize the plans for that, and we will communicate. But right now, we do not have any plans.

Rosham Shah: I was just seeing your press release. During the IPO, we had generated funds in '15-16. And there are some 4-odd crores which is still unused towards some infrastructure financing for design and engineering. Still it has not been used. What is the reason and when do you plan to use it?

Shrikant Bhakkad: That has to be used for the purposes which is mentioned in the IPO document. And we intend to use it gradually and wisely. So, only monies which can be used for the purpose and the project that has been specified in the IPO can be used out of those proceeds. So, remaining all the amounts have been used except this amount. Over a period of two years this will be completely used.

Moderator: Thank you very much. We will take the last question from the line of Keshav Garg, an individual investor. Please go ahead.

Keshav Garg: Sir, I wanted to understand that our operating profit in FY'21 it was Rs.157 crores whereas in FY'20 it was Rs.169 crores, so almost flat and this is nominal. If we add inflation and actually the profit will be actually one-third of what it used to be, let us say 10-years back. Our margins have kept on coming down. So, have we turned the corner, or we still have to go somewhere?

Aditya N Rao: I think that is a great question. If you were to compare Pennar from a 10-year, 15-year basis, 15 years, it looks good, 10 years it looks very bad. The reason for that is in FY'2011, we had a massive influx of wag in revenue. That business almost disappeared overnight. And that was the reason why we then went into a lull and our profitability came down. And over the last seven years, they have gradually ramped up. If you look at FY'2019, our profitability has increased by about 500% from the lulls in about 2013, 2014. Now, what I would like to say is that we do consider it our responsibility as the management of this firm to ensure shareholder returns. Shareholder returns means market cap growth, market cap growth means obviously PE multiple, which is in the hands of a supply/demand equation, but more importantly, EPS growth. We have not delivered EPS growth over the last 10 years. We have over the last five or six years. What we intend to do going forward is stabilize the revenue streams and only invest in revenue streams which are stable, which are not one year, two year, three year opportunities, but literally five year, 10 year, 15 year opportunities. So, the revenue base of the company stands on right now is extremely sustainable. I do not imagine any of these businesses disappearing. We used a variety of metrics to ensure that our profitability will continue to grow from this point on. So, our EPS will continue to grow which can only happen if your EBITDA grows, which can only happen if your margins grow, or your revenue grows. So, a consistent improvement in our revenue from high quality, high margin businesses, will ensure that both EBITDA and EPS grow, definitely more than as you said, if you link it to inflation 5% or more than 5% EPS growth has to be there, not much more than that. And our focus will be to ensure that. If we do our job well, I am certain that over the next similar period of time, let us say 10-years from now, we should definitely not put ourselves in a situation where we are saying that we have not adequate growth in our EBITDA. But it is a very good point that you brought up. And it is important for us to take note of the fact that we look flat and even if we do not adjust for inflation also we look flat over the last 10 years, which is not good.

Keshav Garg: Also, you can consider that the market is giving us a tremendous opportunity by offering the shares at a throw away price, at the same level where the shares were in 2013 and '14 back, where all the reinvested profits are not being accounted for in the share price. So, if you can do a really significant buyback at this price, then it can permanently extinguish a large portion of a share capital which is a permanent liability and all the future growth will get divided on a smaller base of shares so basically EPS will grow faster than profits and that will be a permanent thing, so that you can consider.

Aditya N Rao: I have a personal view on this. It is not appropriate for me to express it in this view. But the board is considering all corporate actions and when a decision is taken, we will communicate.

But yes, I do believe buybacks are a great way to grow shareholder wealth, and I believe buybacks are a great way to grow EPS especially when your company is in growth path, especially when your capitalization.

Moderator: Thank you very much. Ladies and gentlemen, that was the last question for today. And I will hand the conference over to the management for closing comments.

Aditya N Rao: Thank you very much for your time to have joined us. Thank you for a great set of questions. We will take our learnings back from this, we have not made a note of every question, all the commitments are made to you. My focus will be to make sure that whatever commitments we make have to be honored, which is why we will be very careful when we commit things to you. But I can assure you on that basis that we will continue to work on growing our profitability, we will continue to be growing the capital efficiency. Thank you again and thank you for all of your support.

Moderator: Thank you very much. On behalf of PhillipCapital (India) Private Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.