"Pennar Industries Limited Q1 FY14 Conference Call"
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MR. SUHAS BAXI – PRESIDENT & CEO
MR. RAVI RAJGOPAL – VICE PRESIDENT, FINANCE & COMPANY SECRETARY

Moderator Ladies and gentlemen good day and welcome to the Pennar Industries Q1 FY14 Earnings Call. Joining us on this call today are Mr. Aditya Rao – Executive Vice Chairman; Mr. Suhas Baxi – President and Chief Executive Officer and Mr. Ravi Rajgopal – Vice President, Finance & Company Secretary. As a reminder all participants' 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 '*' followed by '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Suhas Baxi. Thank you and over to you, sir.

Suhas Baxi Thank you very much Melissa and good morning everyone. My name is Suhas Baxi and I am the CEO of Pennar Industries. It is a pleasure to have you on the Pennar Industries Earnings Call for the quarter ending 30th June 2013. I have two of my colleagues with me on this call, Aditya Rao – Executive Vice Chairman of Pennar Group and Ravi Rajgopal – Vice President, Finance & Company Secretary for Pennar Industries.

Before I speak about this past quarter I would like to briefly touch upon the macro economic scenario which has a significant impact on key industries like automobile, engineering, capital goods and of course our company's operations.

Sliding economic growth, huge fiscal and external imbalances, high inflation, sticky interest rates and an uncertain global environment has made macroeconomic management difficult for the Government of India and of course the Reserve Bank of India.

The industrial growth dampened during the first quarter of 2013-14 primarily on account of a contraction in consumer durables demand by around 10.4% and also low growth of basic and capital goods market. We also saw a very small expansion in the intermediate goods at around 1.5%. All of this has definitely resulted in a muted industrial activity. What we have also witnessed is a muted tendering activity in engineering, capital goods and railway sector.

The slowing economic growth, the weakening investment sentiment has a significant adverse impact on commercial vehicles demand and as you all know the commercial vehicle segment does constitute an important element of Pennar's business.

While we expect the general economic situation to remain stressed in the coming quarters we do believe that some segments of the economy such as solar power segment hold promise for the business of Pennar industry.

Pennar's business as you know depends on combination of capital investment, industrial consumption and hence we are no exception to the generally dampened sentiments in this environment. Our sales to industries like automobiles, railways and white goods have seen a decline. What insulated us from a drastic drop in the sales to these segments was actually our calibrated strategy of launching higher margin new product, foray into new high margin segments and a conscious effort to do smaller ticket sizes with customers in our existing segment so that we are able to focus on expanding our customer base. For instance our steel products business unit alone added 54 new customers in Quarter 1 of FY2014. Efforts like this have cushioned us from a drop which may have been substantially more than what we witnessed in the first quarter. We do believe that the business of Pennar Industries has fundamental strengths to sustain reasonable level of profitability and positive cash flows. We have seen this in the first quarter and we are fairly confident of this in the coming quarters though the industrial activity is expected to remain tough. We focused on reducing process cost, ensuring highest level of product quality and better customer experience. For us it is important to retain the existing customers while we add new customers, new products and even new businesses. We are clearly looking at using the current phase of economic stress to get into new and related areas of business. During the year we plan to add two new product segments to our existing product portfolio. With this I would now request Aditya Rao to share with you the details of the earnings of the growth.

Aditya Rao Thank you Suhas. I will first present our earnings performance for the quarter ended June 30, 2013. For the quarter ended 30th June 2013 Pennar industry posted consolidated gross sales of Rs. 293 crores and net sales of Rs. 254 crores versus Rs. 329 crores of gross sales and Rs. 286 crores of net sales in the year ago period. Gross margins for the quarter stood at 38% versus 32% in the year ago quarter and 35% in the past sequential quarter.

Profit before tax is recorded at Rs. 9.6 crores for the quarter ended 30th June 2013 compared to Rs. 18.8 crores in previous quarter. Net profit post minority interest was Rs. 6.3 crores during the quarter versus 10.9 crores in the year ago quarter.

During the quarter Pennar Industry as a standalone company recorded gross sales of Rs. 223 crores and net revenues of Rs. 192 crores compared to Rs. 254 crores and Rs. 219 crores respectively in the quarter ended 30th June 2012. The standalone profit before tax for the quarter is Rs. 5.2 crores and profit after tax is Rs. 4.2 crores compared to Rs. 13.8 crores and Rs. 8.6 crores respectively for the year ago period. Our results clearly show that the impact of slow down in the industries in the sectors which is automobiles, railways, power and white goods is impacting our business. However, our business with infrastructure sector performed well. With this I would request Suhas to provide performance details of our business units during the quarter. Thank you.

Suhas Baxi Thanks Aditya and what I would want to draw your attention to is more of the analysis of what happened in the first quarter and how do we see the next quarter shaping up. For this I am going to be using the power point presentation which we have uploaded and has been made available to you. I am actually going to refer to the slide starting from Slide No. 6.

What we see as a combination of various businesses is our business unit. As you all know that Pennar has six business verticals and what we saw in the first quarter was two of the six business verticals actually grew especially on YOY basis.

Our tube business grew by 18% on YOY basis and 14% on quarter-on-quarter basis. This we do believe is a significant achievement on account of the fact that this growth happened despite of a dampened economic environment and dampened industrial environment. Our business of pre-engineered buildings grew 6% on YOY basis. This business has seasonality and hence we do see a drop on a quarter-on-quarter basis but once again both these businesses are performing in a robust manner and we expect them to perform in a robust manner going forward too.

Our business of industrial components more or less stayed stagnant. We did 2% less than what we did in the first quarter of last year. This has happened primarily on account of the fact that the business from the white goods segment which constitutes around 40% of our turnover in this segment has seen a definite dampened demand. We see our customers consuming their inventory in this sector rather than running production plants.

We have certain strategic initiatives taken here to mitigate what we see as a fall in demand and I will talk about it with you a little later. The two businesses where we saw definitely lower than expected results and lower than last year results, is the steel product business which is our largest business segment. This is where our business is dependent on automobiles and lower demand in automobiles was something that we were not able to mitigate completely though we added 54 new customers and a number of new products in this segment.

The biggest impact that we have seen in terms of lower than expected results or lower than last year's results is in our systems and project business where we have seen almost no demand from the railway wagon segment and once again I am going to talk a little more about this going forward about what's our strategy to take care of a clearly known fact that railway wagons as a business probably is going to take a long time to recover.

I would want to go to the next slide and the next slide primarily just talks about the fact that the industries which are significant to us are automobile industry, general engineering industry, railways and infrastructure. We need to make sure that the slowdown in these industries is something which we are able to tackle, which we are able to counter through introduction of new products and getting new customers on board and that is what our strategy is, that is what we are focusing on in the first quarter and also in the next quarter.

You would see on Slide No. 8 that we have added a large number of new customers. As a group we added 110 new customers to our portfolio during the first quarter. This I do believe is a very significant achievement for the group because we are, as an organization, not wanting to be cowed down by what's happening in the industry around us. We want to make sure that our strategy of growing our market is something which we continue to work on. At the same time some of these new customers are coming to us and to some of the existing customers we are giving new products because we are strengthening our product engineering and product development set up. Once again our customers have given a very good response to our initiatives and we have added, during the first quarter, 10% of revenue in PIL standalone business only through new customer acquisition and through new product introduction. We do believe that this trend and this initiative will help us gain approximately Rs.150 crores in top-line during the year. In the worst of the scenarios if the economy does not recover and if we continue to see a slowdown in our existing customer segments and in our existing customer demand we do believe this strategy is going to help us mitigate that slowdown. In a good situation, it will obviously contribute to growth.

The next four slides are essentially on performance of various business segments. Our steel product business unit has done approximately 10% lower revenues than what we did in the last year. As I said this has been primarily on account of slowdown in automobiles segment. And as I said a couple of minutes back, we are fairly confident that we will be able to recover from this dip in the second quarter because our new customers and our new products would help us address this dip.

The next slide is probably a slide on which I would want to spend a little more time which is Slide No. 10 and this is the slide on our systems and projects business. We have seen that as compared to the Quarter 1 of 2013 the business in Quarter 1 of 2014 shows a very different mix. The Quarter 1 of 2013 has a very large percentage of wagons business, 60% of the business coming from railway wagon.

What we see in Quarter 1 of 2014 is that railway wagons have just not contributed anything, just a small fraction. In Quarter 4 of 2013 we see the same thing. So we have kind of reached, I would say a conclusion that dependence on railway wagon for the business of Pennar Industries is not such a great idea and hence we are adding new businesses in this segment. This is what you see in the mix of business in Quarter 1 of 2013. We have got business from railway coaches at more or less the same level as last year. We have got business from solar segment, which is substantially higher than the last year. In fact last year it was almost zero. This year we are at Rs.7.5 crores in the first quarter there. We do believe that this change in mix of business and adding business into systems and projects business will help us recover from the drop that we have seen in the first quarter. In fact I will not be stretching the truth much by saying that almost the entire fall of revenues in Quarter 1 is on account of fall in the railway wagon business. But we now have a strategy in place. We now have products and team in place to make sure that in the next quarters the business of solar and the business of warehousing solutions which is what we have started for the purpose of countering the deficits arising out of wagons will start providing revenue to us.

Coming to Slide No. 11 this is probably one of the success stories of the group. We have seen an 18% growth year-on-year in tubes business. Our products have been accepted. We have now reached capacity utilization level which is substantially good and we do believe that we are now at a stage where we can start working on making this business more profitable. There are certain expansion plans that we have in this business and we would be increasing capacity of our precision tube segment to make sure that we are getting more high margin tubes business going forward.

The last slide that I have on the composition of our business unit is that of industrial components and the industrial components, our business unit performed more or less at a steady level. It also gave a profitability which is more or less what we experienced last year. So as far as our industrial component business is concerned we do not have performance worries in the first quarter and what we see as a very welcome sign in this business is that we have a wonderful pipeline belt of more than Rs.60 crores in size which will start yielding results from the next couple of quarters. So we do believe growth will come in the industrial component business too. That's the segmental commentary as far as the PIL standalone business is concerned. You may have a chance to refer to rest of the presentation either during this call or later on but what we have highlighted in the presentation, ladies and gentlemen is that we are focused working on basics such as cost reduction in our processes, working on basics such as quality of our products, working on our basics such as quality of our processes. We do believe that focus on these basics will help us, ensure that our customers are happy doing business with us because not only would they be happy with the quality of our product but they would also think that we have the right processes to deal with them. We think we would want to strengthen this advantage of Pennar during these difficult times while we are investing in new businesses, while we are focusing on getting new customer relationships and launching certain product extensions in the market. That is our strategy and we do believe that the first quarter results though at the level of the top-line and bottom-line does not show it, hidden in the result is a definite silver lining and that silver lining is the business that we are getting from new customers and new products and the likely growth that is going to happen in these businesses and we do have a strong sense of belief that this will happen in the coming quarters.

I would hand it over back to Aditya for the purpose of covering the performance of PEBS of the segment and also summarizing the performance of the company.

Aditya Rao

Thank you Suhas. I would now like to speak on the financials of PEBS. The gross sales were Rs. 83 crores and the net sales were Rs. 71 crores during this first quarter of FY2014 and that's compared to Rs. 77 crores and Rs. 67 crores in Quarter 1 of the financial year 2013. Gross margins for the quarter stood at 60% versus 48% in the year ago quarter and 50% in the past sequential quarter and net profit after tax was at Rs. 2.7 crores during this fiscals first quarter versus Rs. 3.2 crores in Quarter 1 of FY2013.

To give you a little more light on what happened in PEBS this last quarter: we have received a major order from Reliance. We started execution of our Solar projects. We have received repeat orders from Volvo, ACC, SS Developers and Abir Infra. We have initiated work on expansion to African markets and on another note the Managing Director of Pennar Engineering Building Systems, Mr. PV Rao, received the Manager of the Year Award from the Hyderabad Management of Association.

We have received 42 new orders in Quarter 1 increasing our order book to Rs. 330 crores which constitutes about 33,000 MT in shipment. We have received orders in PEBS, cold form orders, structural steel and also other sectors such as high-rise buildings. The majority of these orders will be executed in FY14 and an average order intake per month has been Rs. 70 crores in the first quarter. We have good spreads on these orders and we don't expect margin contraction this year so as per what our targets for this financial year where we would persist with what we felt was achieved at the beginning of the year and we will see very significant growth in PEBS this year.

As a summary I would like to re-emphasize the reason for the group companies' year-on-year drop is due to lower demand in auto and railway sector despite new customer and new market penetration. We see growth in the tube segment despite overall negative development. The drop in margins on account of lower sales and higher fixed cost which in turn is due to a clear strategic intent to expand our business in the next few quarters. We will continue to aim to focus our new customers and new products to compensate for lower demand from key segments and we will also attempt to expand in international markets.

This would help us mitigate the slowdown in the industry and in the macroeconomic environment right now. With this I would like to open the line up for questions.

Moderator Thank you. Ladies and gentlemen we will now begin with the question and answer session. We have the first question from the line of Ruchita Maheshwari from Nirmal Bang Securities. Please go ahead.

Ruchita Maheshwari Sir just wanted to know, we are very much emphasizing on the new products and new customers so can you give or can you throw some light on the new products which we have ventured into and what kind of margins will these new products command compared to the existing product.

Suhas Baxi Most certainly. Some of the new products that we have ventured into are in the area of press metal components for the automobile sector. We do believe that we have an ability to be a part of a larger value chain of auto components and most of the new products that we have ventured into in the first quarter belong to this segment.

The products belong to our industrial component business where our EBITDA margins have been upward of 15% in the past. So most of the new products that we are talking about are essentially coming from high margin areas of industrial component. Similarly some of the other new products that we have introduced are in the area of solar power.

In the past we have undertaken solar power projects by supplying structures for large capacity PV based solar power plants. What we did not do was we did not focus on the smaller capacity plants because smaller capacity plants are essentially coming out of smaller investment and it's not a big project business so we were not focused on it. When we looked at this market we said that the business of large plants is seasonal while the business of small plants is something which is a year round business. We need to have products in this area. We engineered these products and launched these products in the first quarter of this financial year. Again the margins on these products at gross profit level are upward of 27% - 28% and EBITDA is around 13% to 15%. So again products that we are talking about are high margin products in segments which are either growth segments or segments where we are under-represented in terms of the product portfolios.

Ruchita Maheshwari Sir these new products which we have launched in Q1 or will that be coming in Q2?

Suhas Baxi We have launched it in a time which is a little before Q1 so that we started getting revenues from it in Q1.

Ruchita Maheshwari What was the contribution of these new products into the overall business?

Suhas Baxi In Pennar Industries, out of the turnover of Rs.192 crores net the new products and new customers contributed around Rs. 20 crores of revenue.

Ruchita Maheshwari And during the current financial year, what’s your target of contribution from these new products?

Suhas Baxi The target is to grow this to Rs.150 crores for the year.

Ruchita Maheshwari And sir in this solar power how much revenue did we do during this current quarter?

Suhas Baxi During the current quarter, solar, we did a revenue of Rs.7.7 crores in PIL, Pennar Industries, and as you also know PEBS is in the business of solar EPC and they did a revenue of Rs.5.5 crores so as a group we did a combined revenue of approximately Rs.13.2 crores during the first quarter in solar. Once again the solar business is not a cyclical business but a seasonal business. What happens in solar business is typically projects during the year they open up in the first quarter of the year and get allocated in the second quarter of the year, so most of the action and business is in the last two quarters of the year. When we compare our solar business performance of Q1 to solar business performance of Q1 last year, last year we did less than one crore in solar business in the first quarter. This year we have done 13.2 crores. So we do believe that this is an indication of a much higher level of activity in the market. This is an indication of we doing more than what we were doing in the last year in terms of the product offering and the services offering and we do believe this together is going to help us achieve a good performance in solar business during the year.

Ruchita Maheshwari Sir what’s the margin in this business?

Suhas Baxi Well our margins if we look at our systems and project business of Pennar, systems and project business has done EBITDA margins which is high double digit level. So 15% to 16% margin is the margin that we do expect during this year. They are going to be quarters where you may see lower margins depending upon what is the turn over for that quarter which is to be typically Quarter 1 which is a small quarter for solar business but as we go forward in the year the average margins that we expect in solar business would be in the range of 15% to 16%.

Ruchita Maheshwari Sir when did we venture into this segment?

Suhas Baxi We started solar business in the year 2011-12. In 2011-12 the company did a turnover of Rs.77 crores in solar, 2012-13 the company did a turnover of Rs.85 crores in solar and this year we do expect a substantial growth in solar business.

Ruchita Maheshwari Sir how much we are expecting?

Suhas Baxi Well our target is to do Rs.200 crores of revenue through solar segment this year and we do believe that we are currently in line. If I have to probably answer you for a question that you may ask, what's the kind of sales pipeline that we see here? Typically the sales pipeline that you have visibility for is a three month sale pipeline in solar business so currently we have a visibility of around Rs.80 to 90 crores for the next quarter and our strike rate on these projects has been in the range of around 40%. So we do expect that in the coming quarter solar business will end up generating a good order book which will result in a good business from third quarter onwards.

Ruchita Maheshwari Which is the best quarter for the solar business; because we are targeting Rs.200 crores for FY14 that's why I am asking so many questions on this.

Suhas Baxi Yeah sure, third and fourth quarter. I mean the way I would say Ruchita is first quarter we did Rs.13 crores, the second quarter we do believe that it will be more than double of the first quarter and the third and fourth quarter is where we see there would be maximum action so I would say at the end of second quarter we would have reached around Rs.40 crores and the balance we would do in the third and fourth quarter.

Ruchita Maheshwari Sir just wanted to know, we have announced buyback at Rs. 40 on 10^{th} June and till date there is no excitement in the market and the stocks have not performed. In fact on 10^{th} June if I remember it was somewhere around Rs. 30 and despite of announcing Rs. 40 buyback the stock has not moved up and it has declined obviously the market has also fallen down and also the bad result in this Q1, don't you think Rs. 40 which you have announced is a pretty higher number or the investors are still not having confidence in the stock. What's your view on this?

Aditya Rao The share buyback offer price of Rs. 40 was based on our assessment of the intrinsic value of the share. We factored in the book value, replacement value of the business, our order books, the value of the subsidiaries and our future growth vectors. We consider it to be a reasonable and objective assessment of the value of the company in the near term. We are executing the buyback as per a schedule discussed internally and approved by SEBI. The market right now is not giving us this valuation. So we think that in the short-term it is difficult for us to comment on what the share prices is going to be. What we are going to do is we are going to continue with the buyback. We are steady buyers and the company will complete the buyback in time. We will also continue to focus on performance variables such as EPS and this combination should increase investor confidence and consequently increase the share price. We understand that the share price is moderated right now but we are working on turning this around

Ruchita Maheshwari How much shares have we bought till now?

Aditya Rao We have bought a total of 6.22 lakh shares over the last 40 trading days.

Ruchita Maheshwari And when is this buyback is getting closed?

Aditya Rao The buyback period is termed over a period of one year but we obviously reserve the right to do a quicker buyback.

Ruchita Maheshwari Just wanted to know, if you can provide the breakup of your other income because your other income has shot up a lot. So if you can provide the breakup of the other income?

Ravi Rajgopal Ruchita basically the other income consists of normal other income and sales tax benefit. We have made an investment in tube business in Isnapur and the sales tax benefit as per our AP Industrial policy – we have taken benefit under that one and we are taking that one.

Ruchita Maheshwari So this benefit is expected to continue in the coming quarters as well?

Ravi Rajgopal Yes. Those businesses are expected to grow and we are expanding the capacity there and we expect to get the benefit out of that.

Ruchita Maheshwari And if I talk about your other expenses, it constitutes 24% of the sales compared to the last year the same quarter was 16.8% and in the last two quarters was 19.3% so what was the reason for the sudden jump in the other expenses?

Aditya Rao Are you talking about the consolidated sales with the company?

Ruchita Maheshwari Consolidated, yeah.

Aditya Rao Pennar Engineered Building Systems has a very significant other expenses rise because the Company procures various bought out items for our cold form buildings and solar module mounting structures. There are a lot of components which are not being manufactured by the company which we are procured externally. So obviously in the consolidated sales this should show up as an increase in rise in other expenses. So these are variable procurement costs which have gone up because the product profile for PEBS has seen a significant change.

Ruchita Maheshwari If I talk about your PEBS, we currently have somewhere around Rs.330 crores of order book. Right?

Aditya Rao That's correct.

Ruchita Maheshwari So how much we have executed in the first two months of the current quarter which is Q2?

Aditya Rao We will not be giving a projection for this quarter but we expect there to be a very significant growth in this quarter on the performance last year as well this year. So that much I think we can safely say on the strength of our order book but specific quarter performance we would not comment right now.

Ruchita Maheshwari Sir what was the reason for the sudden decline in the performance of PEBS because I believe PEBS is one of the segments which is a high growth segment and which is overall improving the consolidated business of your company.

Aditya Rao We definitely have a perception here which is different from that so let me see if I can convince you of that. We have the P&L for PEBS out in front of you on the gross sales point we have grown, on our spread we have grown, on our gross margins what we call our contribution we have grown. So the spread we get from the market on our sales has increased and when it finally comes down to contribution we have actually seen more or less the same margins as we have seen last year 19.5% versus 20%. The reason for the drop in net profit as you would see is more of a fixed costs issue, where salaries are revised in the beginning of the year for the whole year. Over the next few quarters salaries are not going to move up but our margins will be staying the same. Our revenue right now for the Quarter 1 is at an average of almost the entire performance of last year. So even right now if you look at it if you were to scale this revenue up in Q3 and Q4 which will definitely be better quarters than Q1 and Q2 you will definitely see growth in our PAT. In fact based on the strength of our order book and the margins of the order book, we are reasonably confident that this year will be a good year for PEBS.

Ruchita Maheshwari If you can give the target revenue for the full year in PEBS?

Aditya Rao I am not sure if I can give you full year guidance but we have an internal target of Rs.440 crores as opposed to Rs.325 crores which was the revenue last year. And our current unaddressed order book is Rs.330 and as you have already seen in the first quarter we have already done Rs.83 so we are reasonably comfortable on meeting these targets.

Ruchita Maheshwari If you can give me the current debt position?

Aditya Rao For the entire company, correct?

Ruchita Maheshwari Sir because the interest has declined a lot so is it because of…

Aditya Rao PEBS or for the company?

Ruchita Maheshwari For the overall company, consolidated business.

Suhas Baxi The interest has declined also on account of the fact that our cost of interest has come down.

Ravi Rajgopal We have been able to get about 1% reduction in the overall rate of interest and used less working capital due to reduction in business volume . Hence interest as an absolute number has come down.

Ruchita Maheshwari Sir what is the current interest rate?

Ravi Rajgopal Around 11%. It is a combination of various factors.

Ruchita Maheshwari And if you can give me the full year target for the overall company in revenue terms and in your PAT terms?

Suhas Baxi The revenue targets that the company had set itself at the beginning of the year PEBS and standalone PIL has two major constitutes. Pennar Industry standalone had a net revenue target of Rs.1,000 crores and gross revenue target of Rs.1,150 crores and PEBS had a gross revenue target of Rs.440 crores. I think at this moment we are again, as Aditya said, not really giving a guidance but clearly pursuing the targets that we had set at the beginning of the year.

Ruchita Maheshwari And some thoughts on PAT?

Suhas Baxi At EBITDA level we were looking at the company doing an EBITDA of approximately Rs.150 crores at the group level and at the PAT level, Aditya what was the….

Aditya Rao Our projection was about Rs.62 for consolidated group entity and as I said, I mean the market conditions are such that we are confident of the efforts we are going to put in. We are sure that this company will grow to those levels. You should probably not put us in a position where I can give you the yearly guidance right now but we are committed to these targets and we are going to ensure that all the efforts that are necessary to achieve these are put in.

Ruchita Maheshwari So we should be assured that the coming quarters will be better than Q1 which was a sluggish quarter for you.

Aditya Rao That's correct.

Moderator Thank you. The next question is from the line of Abhijit Vohra from Unifi Capital. Please go ahead.

Abhijit Vohra My first question is what the previous analyst asked about other expenses. Why the other expenses are high and you answered that there were certain bought outs which have been included. Shouldn't these bought outs be clubbed with cost of goods sold, just a clarification?

Suhas Baxi That's a good question and our auditors felt that since these are bought out items specifically which are bought and then invoiced to the customer they belonged in that categorization so you can definitely put it in there. It's an addition and it doesn't affect contribution or EBITDA or any other treatments so yeah we can consider them as cost of goods sold as well.

Abhijit Vohra Any other significant components in other expenses apart from these bought outs? Last time I believe you indicated that there was certain cost of zinc for solar mountings which were being included apart from these any other significant components?

Suhas Baxi The other expenses do include all consumables which go into manufacturing process, cost of power, cost of freight, and selling expenses. As you would know typically in the first quarter of the year which is the summer months the cost of power, if you are buying power depending upon how your power sources are stacked up, the cost of power is typically higher. So, Pennar Industries typically gets a higher cost of power in the first quarter. We also see increase in diesel price which is one of the consumables that we have in some of our processes. Now all of this is something which has started from the last quarter of the last financial year and as compared to the last quarter of the last financial year, our other expenses have come down and that's also one of the significant targets that we have that we would be working on reducing our process cost. I do not know whether you were there on the last call but in the last call we briefed on the fact that we are investing in a solar power project. We would be shifting a substantial part of the company's power requirement through sources which are going to have a much lower cost of power generation. So actions of some of these activities has already started and going forward we would see that we would be able to get the other expenses down for areas other than consumables substantially because that's what is in our hands right now. Consumables are clearly driven by what's your product mix and what really get's consumed for the purpose of production.

Abhijit Vohra My next question was about your power requirement. Last year you were running on diesel gensets, right? Now this year I believe that is not the case. Despite this you are seeing higher power cost?

Suhas Baxi Well if you see last year our cost of power was generally averaged out through the year. This sluggishness in power availability started in the quarters after the first quarter of the last financial year. That's where the maximum demand which was provided for by the APSEB started getting curtailed, etc., so we had to depend heavily on what would be called as diesel power or alternative sources of power which were primarily standby sources of power and that's how our cost of power started going up during the quarters subsequent to the first quarter. What we see in the first quarter of this year is our dependence on diesel has gone away completely because we started buying power from the exchange. Exchange power in our experience is substantially cheaper and also more reliable as compared to other sources of power. So that's what constitutes a substantially large percentage of what we have as power source right now. What I was explaining was exchange power is typically higher in cost during the first quarter of the year because these are summer months. In the next month the cost of exchange power is going to be lower than what it was in the summer months so that cost will naturally come down. During the third quarter the solar sources will replace the exchange sources and we would have further reduction in cost of power. This is a gradual process. This is not going to happen in a day just because we decided to move to solar because we have to set up the solar power plant. We have started work on it and we do expect start of operations sometime in November and once that is operational you would definitely see further reduction in cost of power. One of the other things which happened is we have also entered into a long-term power purchase agreement with another solar power plant which started supplying power to us from 21st of June so we enjoyed it only for 9 days in the last quarter. The impact of that power cost reduction is going to be seen probably in the second quarter. So I think this is one work in progress which will have to be tracked over a period of time rather than just in one quarter.

Abhijit Vohra Second question is on PEBS. Just wanted to understand the entire reduction in margin in PAT level is because of higher wage revision or is there something else?

Aditya Rao No that's it. Higher fixed cost is the reason. Our interest costs have gone down. There is no significant depreciation. If you look at the variable cost it is very nearly in parity in terms of our margins last year and this year. The reason is fixed cost only, salaries and slightly higher administration cost and these will be tempered with higher revenue growth. So if you want revenue growth you need to get people so that will mean fixed cost increases. You need to obviously also motivate and empower people who are already there in the organization who have been with us for last 3 to 4 years and they will bring in the revenue growth. We had our best quarter in terms of order booking in Q1. In Q1 we have booked close to Rs. 220 crores so we think what we are doing at PEBS is paying off and we have confidence when we say we are going to meet our yearly targets that we have set for ourselves.

Abhijit Vohra Some of these costs will also be because you are setting up the foreign…

Aditya Rao That's also true. Yes, correct but a minority. It is not that we are spending crores on setting up our international operations but yes there is some cost increase because of the increased marketing activity there and other things we are trying as well. We are trying to improve international sales. We are also trying to open up other avenues of business internationally such as outsourced design services and other engineering services. So yes the fixed cost increase is the reason for the moderated profit.

Abhijit Vohra And how is the working capital behaving currently?

Aditya Rao Our working capital usage is stable. Our receivables are stable. We have hardly any receivables which are more than over a year and more importantly our net working capital utilization has just decreased because of couple of reasons – strong cash flows from our cold form business and Reliance order and also because of the investment from Zephyr Peacock which has come into the company so the net debt for the company as it stands right now which includes term loan and working capital is only Rs.15 crores on cash basis.

Abhijit Vohra Rs.15 crores is PEBS you are saying.

Aditya Rao That's correct.

Abhijit Vohra And for group level, consolidated. It is Rs.160 crores which is included in the presentation. Can you give me the breakup between term loan and working capital?

Aditya Rao Term loan is Rs.12 crores for Pennar Industries, for PEBS the term loan is currently about Rs.16 crores. The working capital for Pennar Industries is Rs.160 crores, Rs.60 crores is our own capital sources and Rs.100 crores is funded and for PEBS it is about Rs.50 crores. And in addition to that of course PEBS currently has about Rs.42 to 50 crores so that would be removed and that has been deployed into working capital now so that will bring down the total debt utilization of the company by a lot.

Abhijit Vohra Next question is on the road map you have drawn in your annual report. Just wanted to get a sense. You are saying 10% of your additional revenue contribution every year will be from new products. This year most likely whatever you are guiding is on track. Rs.150 crores you want to achieve from new products but these new products that you are trying to bring in you also mentioned that this might be from entirely new businesses and new businesses might be looked at. What will be the capital commitment from your end and resource commitment? What might be the additional debt or cash requirement that you may have? What will the planning be like? Then obviously for next year for the capital expenditure to take place you might take some time before the revenues start in so are those things also worked out?

Suhas Baxi They are all worked out and I will be happy to share with you some details of it. When we made this plan of getting 10% revenue every year from new products we clearly knew that this is going to require capital expenditure. This year we drew up a plan and to invest approximately 60 crores in capital expenditure. Our idea is to fund it through combination of internal accruals and debt. Currently our plan is to have it being refunded in the ratio of 1:2. So as you know that the company has a positive cash flow generation and we will always have an ability to fund approximately Rs.20 crores of this Rs.60 crores for internal cash accruals and we would be raising a debt for the balance Rs.40 crores. Some of these plans are already underway and a substantial progress has happened on these plans. We would be talking about some milestones in the next month in terms of where we are but at this stage I would like to say that the plans are in place. The plans remain unchanged so we would spend these Rs.60 crores that we have planned and we have an ability to fund them through this year's cash flow for the internal accruals and we also have an ability to supplement it with a debt of approximately Rs.40 crores.

Abhijit Vohra Okay my concern was obviously you are looking at threefold increase in revenues in the next 5 years and a significant portion will be coming from new customers. This will entail not just capital expenditure for manufacturing facilities but also marketing channels and developing customer relationship. Significant capital commitment will be required. In that sense will the capital structure as in your borrowing will they go up and how will the profitability look? Obviously the EBITDA margin might improve because these are higher value added products but how will the profitability look like and ROCE which is what we are concerned about. How will it look like?

Suhas Baxi Well I would definitely want to answer this question one step at a time. The type of businesses that we want to get into are primarily driven by value addition through engineering and less driven by capital investment in manufacturing infrastructure so most of the new products and new businesses that we are getting into would require investment in engineering, product development, marketing and services on one side which is a combination of revenue expenditure and R&D expenditure. And second portion would be for what I would call as investment in manufacturing assets. The investment in manufacturing assets will not be as heavy as the investments have been in the manufacturing assets in the past. So one of the questions that you had and which Aditya answered in terms of, we have invested in growth for the future is actually not a new thing. If you look at PEBS performance, PEBS invested in an 80 people engineering team when the business was less than 100 crores size and this team was larger than the team which a 500 crores company had at that time because they went long on engineering which resulted in an aggressive growth fructifying. We think we as a company have seen this success story as the benchmark and the new businesses that we are getting into that's precisely what we are doing. We are investing in technology. We are investing in home grown intellectual property. We are investing in human capital on one side which is where probably there are going to be quarters like PEBS saw in the first quarter that your fixed costs have gone up and your revenue is probably not in line. We may have a couple of quarters through the next years like this but I think our capital expenditure will be moderated because we are not going to be talking about 100 of crores of capital expenditure coming in for generating smaller revenues. We would be talking about tens of crores of capital expenditure and this combination is what we believe will drive the growth of this company. And I think I will be very happy to meet you personally next time when I am in Mumbai and explain to you the strategy in larger details so that we are in sync and if there are any inputs which are available from analysts and investors we would be happy to take them on Board.

Moderator Thank you. The next question is a follow-up from the line of Abhijit Vohra from Unify Capital. Please go ahead.

Abhijit Vohra Just one book keeping question. There was this statement that replacement costs of Pennar is Rs.700 crores versus gross block of Rs.360 crores. Just wanted to know how this was arrived at and was it an independent consultant who gave this estimate?

Aditya Rao The estimate is an internal valuation that was arrived at taking into account the capex that would be necessary to set up 200,000MT of cold rolling, roll forming, pressed components and fabrication capacities. It is also inclusive of our brand and IP that allows us to provide over 2000 different products to our customers. We are reasonably confident that this number if accurate and we don't see a necessity to validate this externally currently. If we need an objective valuation of the company we will pursue external valuation options.

Moderator Thank you. As we have no further questions I would like to hand the floor back to the management for closing comments. Please go ahead sir.

Suhas Baxi Well I would want to thank everybody who came on to the call today and I do believe that the interaction was able to provide a good insight to people on the call and we will be very happy to take this conversation further if anyone of you have questions going forward in the future. You can get in touch with the management or you could get in touch with our investment relation advisors and we will be very happy to answer them. Thank you once again for being on the call and have a great day. Thank you so much

Moderator Thank you gentlemen and the management. Ladies and gentlemen on behalf of Pennar Industries that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.

This document has been edited for readability.