"Pennar Industries Limited Q3 FY-19 Earnings Conference Call"

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

Moderator: Ladies and gentlemen, good day and welcome to the Pennar Industries Limited Q3 FY19 Earnings Conference Call hosted by PhillipCapital (India) Private Limited. 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 '*' then '0' on your touchtone telephone.

I would now like to hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital (India) Private Limited. Thank you and over to you sir.

Vikram Suryavanshi: Thank you Janice. Good afternoon and very warm welcome to everyone. Thank you for being on the call of Pennar Industries Limited. We are happy to have with us here today Mr. Aditya Rao – Vice Chairman and Managing Director, Mr. J. Krishna Prasad - Chief Financial Officer, Mr. Sunil Kuram – Vice President (Investor and Media relations) for question and answer session with the investment community. Before we start with the Q&A session, we will have some opening remarks from the management. Over to you sir.

Aditya Rao: Thank you Vikram. To all the stakeholders of Pennar Industries Ltd and its subsidiaries, welcome you on to the Q3 performance Investor Conference Call. We had a good quarter, a very strong quarter. We recorded net revenue of Rs. 397.1 crores which is up by 32% year-on-year and a net profit of Rs. 11.5 crores which is up by 34% year-on-year. Consolidated performance was also quite good with net revenue up 38% year-on-year to Rs. 575.2 crores and the PAT after minority interest growing to Rs. 15.3 crores. We are quite confident that the growth trajectory that the standalone entity and of course the combined entity will continue to persist. I think there has been deep structural systems we have put in place that ensures that we will deliver good growth quarter-on-quarter and year-on-year and we expect this to not change in the next few quarters. So as of now we are quite confident to guide you to double-digit growth for the company, standalone and for the consolidate entity in terms of sales and profitability for the Q4 and also for the next few quarters.

With that I would like to hand it over to the moderator for any questions on the company's operations, plans or future, and anything else that is relevant regarding Pennar Industries Limited. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We take the first mission from the line of Vaibhav Gogte from Ashmore. Please go ahead.

Ashwini: This is Ashwini here once again. A couple of questions, first as, could you share with us the revenue and EBITDA and maybe earnings after tax for the Pennar Enviro business, please?

Aditya Rao: Since we are not declaring subsidiary numbers, we will not be able to give those out right now. Now what we intend to do of course, as I had mentioned on the last conference call is to make

ourselves easier to understand. We are dividing the companies into the verticals which we have decided would be post-merger of course, assuming it goes through. But even if it doesn't, we will report these three verticals. The three verticals would be products, projects and services. So that will allow us to define a common working capital based on working capital days. The restrictions we made based on certain margin profile that we expect to have for each of those and I think that will help us add a lot more value. So Pennar Enviro we will not be able to give a breakup at this time. But you can work out a very good. So one thing I would suggest, you can do is you can take the PEBS numbers and subtract that from PIL to get very close to Pennar Enviro numbers, because…

Ashwini: No, so I did that, and I adjusted the intercompany sales which is mentioned in your report, so which shows me Q3 differential of Rs. 45 crores and year-to-date differential of Rs. 106 crores. So, the question I have in my mind is that, is there anything else or this should largely be Enviro?

Aditya Rao: No, I'm not sure. I am afraid it is not just that Ashwini, there is another company there. But a good chunk of that is, but I can't get into, since it has not been given out, I can't give you the numbers right now.

Ashwini: The second thing is that you said in your commentary for the Q3 you have given us vertical revenues for railways and for steel vertical and for tubes and ECD but you have given the gross numbers so I can't reconcile these with the next numbers. Can you give me the next numbers please?

Aditya Rao: We are not actually supposed to provide that breakup but I think it went through from our Board presentation. But what you can take is this, for railways the GST is 5%, for everything else it is 18%. Yes, so divide by 1.05 the gross sales to get the net sales, divide by 1.18 the gross sales to get net sales - for railways it is 1.05 and the other thing 1.18.

Ashwini: And the last question is that typically there is lumpiness that we see in the Q4 you know, if you look at the last 2-3 financials for Pennar, do we expect lumpiness this year as well?

Aditya Rao: You should not find any difference in that. I can definitely tell you that, you will not see a decrease in revenue percentage or profitability percentage in Q4 compared to the previous quarter for the standalone entity, for the subsidiaries. But please do keep in mind that we had for Pennar Enviro and Pennar Renewables, there were two special.

Ashwini: Extra ordinary items, yes.

Aditya Rao: Yes, those two extraordinary items you please do take care because we sold our subsidiary last year, that obviously will not be replicated this year and Pennar Enviro had a one-time significant

EBITDA of Rs. 7 crores which came in. So other than that, everything else absolutely we are certain of growth on all three metrics; revenue, EBITDA, PAT.

Ashwini: So, if I look at year-on-year growth for the first three quarters it was 14%, 33%, 10 and 32% and typically if I look at the four quarters, if I go back as long as I can, typically the Q4 has tended to be stronger than the Q3 in terms of year-on-year growth. Now you had very strong year-on-year growth in September 2018 and in December 2018. So, in my mind I'm just wondering that because you put in this new management control systems and you have kind of oiled the machine really well, if I look at the Q4 for this current financial year from the year-on-year growth perspective I mean, what should I take? I mean, you know you said double-digit, that is fair but double-digit could be anything from 11% to 99% I mean, you know. So, what do we…?

Aditya Rao: It is not 11 nor it is 99. What I would say is I will promise you 20% Ashwini. I will promise you and beat that.

Moderator: Thank you. The next question is from the line of Rohit Koti from Marshmellow Capital. Please go ahead.

Rohit Koti: My only question is again on Pennar Enviro. So, you have given an annual report for a subsidiary in the website and what I notice there is that revenues of Pennar Enviro last financial year was around Rs. 100 crores, while the receivables there were around Rs. 88 crores, and this heavy receivable which is almost more than 50-60% of the sales has consistently remained the same for the last three years as well. And I think these forms around 20-30% of the consolidated Pennar Industries as well. And my understanding of the numbers also leads me to believe that the returns or the profitability of the business is not that great. So, is it possible for you to comment on this?

Aditya Rao: Yes, to the extent I can I will. So, the accounts receivables number is a reason for that numbers to be seen but the actual accounts receivables right now perhaps that would give a little more clarity on this, for the environment business is about 2.7 months of receivables of revenue is our accounts receivable. There is a reason for that which we will have to get into at a later point of time that is there. It effectively deals with one of our customers, the net dues to them and the net receipts not being grossed out. So that is something that we can get into at a later level, but we had to do what our auditor says, and it will be my effort. I know I'm not being very clear, we will try to get that clarity to you. But as of now which is the most relevant number our accounts receivable for Pennar Enviro is let's say 2.5-2.7 months and it is a range it changes every day. As far as the profitability is concerned, historical profitability margins that you have seen we believe those can be improved over time. Primarily that has to do with there being a substantial amount of fixed cost. It is a very technology heavy, engineering heavy industry, we have a fair number of collaborations in that business, but scale is there, and it is scaling quite quickly. So, I think we are quite happy with what Pennar Enviro has accomplished, especially what has happened in the last two quarters and we are not giving out order book details as such. But we

can certainly say that the ROCE, which is how I judge businesses and the growth rate, the combination of growth rate in EBITDA operating income and ROCE is quite good. It uses very little finance to generate the returns that it does.

Rohit Koti: So basically, this would be a cash generating business and the working capital cycle overall would be what, less than 100 days, less than 2-3 months. Would I be right in thinking that?

Aditya Rao: Absolutely right. Net working capital is definitely less than 3 months. And it is a cash generating business, post working capital changes also and there is no substantial CAPEX happened there.

Rohit Koti: You said it is cash flow generating post working capital as well, right?

Aditya Rao: Post working capital, post CAPEX. Yes, so it is our results to be clear, it is on cash results.

Moderator: Thank you. The next question is from the line of Lalaram Singh from Vibrant Securities. Please go ahead.

Lalaram Singh: My first question is that the revenue growth which we have seen in this quarter was pretty strong. Unfortunately, there was a similar growth in the expenses as well, so we did not see any sort of operating leverage to play out in this quarter. Can you explain that, why did that happen?

Aditya Rao: We have been putting our process in place, so one of the things we have put in place is obviously something that draws in growth in operating margin. No, it is not the revenue growth that we look at, we honestly don't care what our revenue is. We care about our operating profit growth which is we define as contribution growth so that has come down. But as you said and it is a good observation that our fixed cost has risen equally at by equal percentage, so the operating leverage has not presented itself in terms of I mean, there has been some slight margin improvement EBITDA wise, but it hasn't. So, there are a couple of reasons for this. I would actually like to tell you that I myself was a little surprised by it when for the last couple of quarters I have been surprised by how quickly our fixed cost is rising and our attempt, the last piece of the puzzle we are trying to put in place in the system was how to bring in fixed cost control so it has to grow at less than that. Since, we have put that in place and my CFO and HR head both assure that we will have less basically, my fixed cost growth will be a substantial fraction but only a fraction of the percentage growth of my operating margin. The problem came because of two reasons; one we are investing in substantial new capabilities. These include our entry into the aerospace markets, these include buildup of our retail assets, we are investing in 3-D printing, we have started a new defense subsidiary as well which has been doing quite well. So, all of these involve us investing in human capital and that has. We believe we had a cap on it, we were expecting the number closer to based on our system we thought we would output 15 or 17% numbers, but it went up all the way to (+30) because of this. But all of this is good news, I would encourage you to look at this more as an investment because these are people who are of very

high caliber that we bought in place. We have a strong new corporate team heading them as well and you will see results for this pretty soon. So, you will see the fixed cost increase which is (+30%) which is very high obviously. You will see that moderating it is a function of growth, it is the result of us trying to set our growth process in place. But it is not something that is not going to continue to be that high. We expect it, definitely over the next couple of quarters. You will see a decline in that. But you should expect about 20% or let me put it this way 67% of my operating profit growth should be my fixed cost growth that will more or less happen. It is an output of our model.

Lalaram Singh: Okay, well I think as you said that the investing in growth capabilities of course should be the priority for the company, so my question is, let me just reframe it again this is for the standalone business only, not for the consolidated. So standalone business we grew 31% revenues your employee cost also grew at say, around 40%-odd. However, the SG&A has grown at 72. So below employee cost whatever the expenses that is what stands really, so which used to be around Rs. 70 odd crores run rate has gone to Rs. 90 odd crores in this quarter. So can you give us a split of the number, below employee cost?

Aditya Rao: The increase is such that you have seen total split. We will not be able to give you in this forum. What I can guide you to is the total increase that you are seeing which would be not 40%, 34 or 35 was what I saw, bear with me on this if the numbers don't agree we will make sure that we explain what that difference is. But what we see the 35% approximate increase in the fixed cost, what we define as fixed cost, and out of that fixed cost half of it is literally 17% of that increase is new joinees, as they call it. A better breakup of that in turn we will endeavor to give you. If you can give us an idea what you are specifically looking at, we would love that you would come over, come meet us and we will give you the information and obviously put it up for all other shareholders as well so that we know exactly what is. But in this forum perhaps a thorough breakup right now may not be possible.

Lalaram Singh: Secondly, on the interest expense of Rs. 15.3 crores for the standalone business can you give me the split between the core finance cost and the bank charges?

Management: Bank charges as such will be very less. It is going to be either one of the instruments for financing whether it is LCs. It is overall and the cost is coming around 10.2%.

Lalaram Singh: 10.2 overall cost you mean to say including the bank charges or purely excluding that?

Management: No, including bank charges and everything.

Aditya Rao: Rs. 15.1 crores is our overall interest cost for the standalone entity. Consolidated we had Rs. 19.3 crores of interest. So Rs. 12 crores of that is cash plus debt and all of that and remaining is non-cash bank charges plus all of those.

Lalaram Singh: And can I get the key balance sheet figures as of December and for the standalone business; gross debt, may be inventory receivables and…

Aditya Rao: ` Sure, our long-term debt is for the standalone entity is about Rs. 100 crores, no other businesses have any debt. The consolidated debt is also around Rs. 100 crores. We keep repaying this, that is why little bit of variability, but it is a very accurate number, 95% accurate number. So, the short-term debt which is CC, which is typically used standalone is about Rs. 160 crores and PEBS was at Rs. 95 crores, the consolidated is at Rs. 265 crores.

Lalaram Singh: Got it.

Aditya Rao: The total amount of debt we are using is about Rs. 350 crores, approximate.

Lalaram Singh: Okay, and in the standalone business have we been positive with respect to the CFO from the operations over the last say, over the last 3-4 quarters on a quarterly basis?

Aditya Rao: We always generate net positive cash flows from operations. Now if you're growing at 30% and positive working capital cycle you will necessarily see changes which need to be 25% of which at least has to be funded through equity, will result in negative cash flow. But I see that as a healthy sign, because it is a natural thing. If I have a 2-month operating cycle, from a working capital finance point of view or working capital point of view and if I'm growing at 30% or 35% or plus that rate, it is not possible for us to generate positive cash flows after working capital unless my EBITDA margins of 30-32% of something.

Lalaram Singh: Which means that it should lead to a corresponding increase in the working capital, right?

Aditya Rao: In the working capital and the working capital days. What I would guide you, so the way everything that we do any risk factor has to be controlled for. So the way we control for this is we control our interest cost at 3%-3.3% of gross sales because all of our AR, all the numbers that we have given you are also gross based, they are not net based, except for the sales number but all of our accounts receivables, all of our inventory are gross. So since working capital finance is gross 3.3% of gross sales is the control we put. We tend to be below that usually but that is the limit. You won't see it crossing that.

Lalaram Singh: Okay, last question. If you can throw some commentary on each of your key segments in the standalone business; railways, industrial components, tubes what is leading to the growth you know, which say, geography which say, customer segments at the same time you know, what is the outlook for the next 1 or 2 years? If you can give that that will be helpful.

Aditya Rao: My attempt would be to give you that. It is important for us to give you a picture of how the addressable market size for each of our business verticals is evolving and I would like to give

you a lot of clarity on that. But the fact of the matter is I have now (+50) revenue verticals within the company. We have packaged them into obviously four business verticals with all the company and two subsidiaries. But the structure of our reporting will change over the next as I mentioned in the last conference call as well. We are frozen on that and we will post the merger or post the decision on merger which is imminent now. So, we will be reporting on the new structure which will basically divided into products, projects, services. So, we will give you addressable market for those but right now for the business units that you asked for which is railways, tubes, ICD and our steel business unit for all of them we are projecting growth. We believe the market for all of them is quite big. We are not #1 in any of them perhaps with the exception of railways. But even that we are increasing our addressable market size so very soon by certain capacity enhancements we will be making. So overall even in that business unit we will not be the #1 player. So accordingly, our market share in each of these businesses can grow further. The investments we are making will allow us to expand both our capacity and also our product profile. So, in none of those businesses do I see a decline and all of them will continue to grow at double-digit rates, I also answer the previous question, I can commit 20% in Q4.

Moderator: Thank you very much. The next question is from the line of Sachit Khera from Smart Equity. Please go ahead.

Sachit Khera: Sir, carrying forward on the previous discussion, you mentioned that the short-term debt on the standalone book is Rs. 165 crores or something there about? The short-term debt which is CC, our cash credit usage is about Rs. 160 crores for the standalone. Sir this was about Rs. 260 crores in September end, right?

Aditya Rao: You are correct. We have since swung a lot of it to LCs, you are absolutely right. Same number last quarter was Rs. 265 crores. But we have switched it to LC which doesn't mean our overall working capital exposure has come down by that much. It is just that we're not using rupee debt to finance it.

Sachit Khera: So, we can't really expect the finance cost to really go….

Aditya Rao: No, I do not mean that, as I had mentioned we have control over the finance cost, 3%-3.3% that is what it will be ranging on. Working capital part of it would be 2.8% and any long-term debt that we have, obviously is not very large. So it will contribute a little bit more, but we are promising 3.3% of gross sales is what our control is. We won't allow it to go beyond that but we obviously try to control it and reduce it and make it as low as possible but that is what we are promising it won't cross that.

Sachit Khera: And Sir I also noticed that there was in the standalone, there was an addition of about Rs. 28 crores in the inventory. So has the receivables position also increased in the last 3 months or I mean, can you comment on that, do you have a figure?

Aditya Rao: I can give you the number right now the standalone is about Rs. 276 crores.

Management: Number of days it is the same, what we have mentioned, what we are maintaining in Q2 and the number of days all that is same. But okay, because the turnover is anyhow increasing to that extent absolute number may change but as far as number of days to AR is concerned, it is about…

Aditya Rao: It is about 60 days. 276 is what I have right now which is not exactly comparable to December but…

Sachit Khera: I am really sorry sir I am going about this in an indirect way. My basic concern is that you know, gradually we have seen a reduction in the interest coverage ratio if I were to take a gross up of the finance cost including the LC and the non-LC cost. I mean, so effectively the question is when can we expect the margins specifically on the standalone books to start increasing? Where we can go back to that 3x cover historically instrumenting.

Aditya Rao: All of the newer investments we make, all of them, now target ROCE more, we target EBITDA to an extent but EBITDA as a value not EBITDA margin. We feel ROCE is a far more important number. So, from a DSCR part of view if ROCE is taken care of DSCR should be taken care of. So, what we are aiming for is a 30% ROCE, we are right now at 23-24%. We will need to bring that up to 30. So, my cost of capital is 10% for whatever finance I am using, and these things float, right. I mean, the debt that we use floats. So, it is not that they peak during certain periods of the month and the difference between the high and the low can be as high as Rs. 100 crores. So, what I can promise you is that we're trying to get ROCE of 30% and if my cost of capital is 10%, that is very healthy and the DSCR will take care of itself, when I do that.

Sachit Khera: My last questions sir, since that there has been a reasonable amount of liquidity strain in you know, the banking and in the NBFC sector over the last few months. Have you seen any of our customers face any liquidity issues wherein you could expect some more you know, write down on the receivables that we had earlier or not really?

Aditya Rao: We definitely do not, we monitor our accounts receivable for quality and it is more 180 days which is people have not paid us for 6 months which is a very serious number. That number has actually declined. What you mentioned there I think banks are very-very scared to lend to certain sectors. But the quality of the customers that we work with is quite good and we have enough risk management in house to do it, to know how much credit has to be given to someone. So, the moment we see payments getting to a stage where they're getting slow down, we cut off further credit. So overall, I think that the system will allow us to ensure that our more than 180 days or our write-offs so to speak will never be more than 0.3% of our revenue, which is what it is right now.

Moderator: Thank you. The next question is from the line of Rajat Sethiya from Vriddhi Capital. Please go ahead.

Rajat Sethiya: What is the cash balance on a consolidated basis at the moment?

Aditya Rao: About Rs. 120 crores.

Rajat Sethiya: Another question is on the receivables. So how do the total receivables I think you would also have some sort of performance guarantee stuck as part of the receivables, is that correct or no?

Aditya Rao: Yes, that typically comes in for PVS and Pennar Enviro. Basically, our project businesses projection the last 10% of revenue is typically covered by PBG which you give and then collect that money. So performance bank guarantees are substantial. I think we have over Rs. 100 crores out there right now. But none of these are addressed, I think we add value to our customers and we only go away from size once our customers are happy. So we have never had a BG come close to being encashed and we are quite confident in saying we won't have those issues. So they exist but not at a risk.

Rajat Sethiya: Okay, the last question is on the…I think solar we witnessing some sort of slow down. Is that correct?

Aditya Rao: Yes, I think in everything that we are doing, solar is the only revenue vertical that I have, which is not a business unit but a revenue vertical which we are not bullish about at all.

Rajat Sethiya: So the reason there is the execution is getting stuck or there is competition and hence despite volumes you are losing on margins?

Aditya Rao: I would say it is under siege from every possible metric. It is frankly a sector we want to vacate. What is there is there, if orders come to us at a good margin, we will take them, but we will not be deploying any further capital into solar. The situation right now is that for the MMS business, we have solar MMS, we have solar T&D, and we have solar rooftop also. With the exception of rooftop solar which is still quite good, the other businesses aren't really you know, the ROCE is still okay but scalability is a problem. We had for example, our operating profits last year from our solar vertical to now there is a decline frankly of 20%. So, we're not very happy with the business. No entry barriers, anyone can come in. Even though there is design, typically when you had design plus manufacturing margins are resilient but in this case the design has also become to an extent customized and it has become a commodity. So, once it becomes commodity, once it becomes difficult for us to compete. So, there are players such as Purushotam Profiles who are out there, who are effectively job working it out. So, we do not want to be present in those verticals. I don't see a realistic way for us to improve our value addition enough

for us to get our ROCE back up to what it needs to be. So, I don't think we don't like what we see and solar will continue to decline in terms of revenue and profitability obviously for us.

Rajat Sethiya: In terms of revenues can you give the numbers? What was it for FY 18 and what is it for 9 months FY 19?

Aditya Rao: So divisional we have not given out, but it is flattish I can tell you. Yes, I mean, we did give out last year, we can tell you it is flattish but we're not giving out exact numbers because it is still our steel BU and we're not breaking it up.

Rajat Sethiya: On 9-month basis of this flat in terms of sales?

Aditya Rao: Yes, for the year also it will be flat. Slight growth may be but it's just more of an impact of raw material price perhaps being higher in the last 9 months. I don't think the tonnage part of it is more or less flattish.

Moderator: Thank you very much. The next question is from the line of Dikshit Mittal from Shubhkam Ventures. Please go ahead.

Dikshit Mittal: Sir, my question is on other income. We have seen big jump in other income in 9 months as well as in this quarter. So can you break it up sir?

Management: Other income on consolidated basis is Rs. 7.3 crores and most of this includes whatever salary funds are there and on that interest what we have.

Dikshit Mittal: Okay, so sir if I adjust for this in spite of more than 30% topline growth our profit has been flat or declining. So any particular reason for that?

Aditya Rao: So the reason for that, are you talking about consolidated?

Dikshit Mittal: Yes, both sir consolidated as well as standalone also like if I adjust for this other income operationally our profits are down in spite of good topline growth.

Aditya Rao: Let me look into that I'm not sure why that would be, and I need to look at the breakup of other income quickly to understand it. One reason for the consolidated being a little flattish would be that our renewables used to come in strongly which used to add about Rs. 6-7 crores. But flatting on standalone but I have to look into. But allow me to get back to you on that.

Moderator: Thank you. The next question is from the line of Lalaram Singh from Vibrant Securities. Please go ahead.

Lalaram Singh: My question is on the pre-tax, on ROCE which you said is 30% is the target for the company. As of now if you look at the past data, it has hovered around between 16-17 to 20 odd percent at a pre-tax ROCE level.

Aditya Rao: Yes, you are defining it as EBITDA divided by capital employed, sir, or are you looking at PBDT divided by capital employed or EBIT or…?

Lalaram Singh: EBIT.

Aditya Rao: Okay, we tend to do EBITDA but fair enough, go ahead sir. I think the actual thing, your definition is the correct one but since we don't have, the depreciation is all really just you know, we don't end up spending that amount on upkeep but please go ahead sir.

Lalaram Singh: So you mean to say that the depreciation run rate is actually higher than what you actually need in the business, the CAPEX regular, that is what you mean to say?

Aditya Rao: No, other way round. We don't need to spend that much, depreciation we spend, we don't spend all the amount that we have in depreciation for keeping up our gross block. So, what I am trying to say we run our ROCE on EBITDA divided by capital employed not on EBIT, which is a different definition I agree. So that number is what I want to be 30%.

Lalaram Singh: So your depreciation annually is around Rs. 27-29-28 crores, right? Rs. 30 odd crores say, in the standalone business. So what is the actual CAPEX required to keep up the business at current run rate? Is it say, 22?

Aditya Rao: We sanctioned Rs. 3 or 4 crores this year.

Lalaram Singh: This is for which business, standalone business?

Aditya Rao: No, our maintenance CAPEX.

Lalaram Singh: So your maintenance CAPEX is like is less than $ 1 million a year, Rs. 6-7 crores, Rs. 5 crores that is what it is?

Aditya Rao: It is definitely less than Rs. 7 crores a year.

Lalaram Singh: Okay, that said however in this definition you're missing out a big cost of doing your business which is the cost of you know all the bank charges and all that. You know, finance cost is eating a lot so your ROCE might look say 20-25-30 using your EBITDA approach sorry EBIT approach. By the end of the day what I'm left after accounting for all the other cost at ROE level it is hardly 10%, correct?

Aditya Rao: You are correct.

Lalaram Singh: So definitely this is not the derived the level of returns which I would I mean, you would want as a business owner. So first question, do you think that this is the right ROE level or this should go up. #2, if it should go up then what would lead to this change?

Aditya Rao: So here is my thing, one thing we had to make very clear to ourselves really over the last one year really is what kind of company we wanted to be. So, my goal is for us to grow at, I have a certain internal growth rate which we won't tell you, but we want to grow at a sustained rate of certain X% every year, no matter what. Now some would consider that unrealistic, some would say that it is a very dumb thing to do. But I think we worked out a system which allows us to do that. But the cost of doing that is continual investment from a capital, gross fixed capital formation that we need to, and I need to keep increasing my gross block, to increase capacity and to enter new verticals which allow us to do that. The consequence of that is interest cost eating away a substantial amount of my profitability. In fact, as it stands right now, my cash profit is the equivalent to my interest cost which is ridiculous. But it is something I made peace with. Now at some point of time high growth rates tend to moderate, that is the fundamental law. So, at that time that when it happens obviously our investments will decrease, our leverage immediately declines and our ROE also absolutely shoots up. So, the reason why, the one way for me to answer your question is when do an EBITDA substantial amount of it dropped down to PAT. It drops down to PAT when interest goes down, and interest goes down when two things go down, your working capital and term debt or long-term debt. So, both of those are something which we are trying to address in a certain way. I think working capital efficiency will as a percentage will bring it down a bit, but we are hard at and we are trying to get that under way. But as long as we continue to grow. I suggest that you let us get away with 3.3% interest cost and absolutely will deliver less sometime but don't allow us to cross it but hold us accountable for that is what I would suggest because we are in a low margin business I am aware of that. I mean, some of our ROCEs are good but very few of my, half of my revenues above 15% EBITDA, half of it is below and what we are adding is above that so over time it will catch up but there is no denying that I use a tremendous amount of working capital to deliver my revenue and my EBITDA. So, this condition will be here to stay. We will continue to have substantial decreases when that 3% drops to 1.5-2% that is when you will see everything flowing down to PAT.

Lalaram Singh: So that leads to you know, two more questions which are very linked to that. So one is that at what scale of the business do you think that you believe it is the time to around to focus more on these terms and cash flows and you know, lowering the interest expense at what scale? #2 is that if things are going right for you in this growth pace of course you will not face any issue but for example, there is a case where suddenly the growth rate drops in your say, business because it is not that secular from a business, they are driven by projects you know, linked to economy. So in this scenario you are basically saying that if things go well that is good. But if there is an issue

then our company could be in trouble, right, with all your working capital debt and the liabilities and if you know there is an issue collection of receivables. So in a way you are basically trying to achieve the goal with you know taking more risk also. Is it correct?

Aditya Rao: That is a very good question. Let me answer, if let's say the market moderates by 10% where we present in, we are not able to collect it. Let us also assume in terms of receivables we are not able to collect all of those are risks and most risk are cash related that we may not get orders, we may get orders and not be able to execute them and just bill our customer; we may execute our order, we may get orders, execute them, bill our customer but our customer may not be us; we may get our orders, execute them, get revenue recorded, the customer pays us but we still don't make the margins that we make because our costs are higher than they are supposed to be. So, these 4-5 standard cash stories are what we monitor. Every one of our businesses is mat for what we call quintessence or death. So, every one of our business has a death rate, my revenue verticals not my BU verticals wise. So, what we do is this we keep…nothing drops off the radar and falls. So solar this we saw coming, 2.5 years ago, so any one of our businesses which sees that will need to be replaced. So, this growth rate that I'm promising is in conjunction with a lot of other businesses being killed. Some of them deliberately, frankly. We will just starve businesses which we believe are going to die of capital. So that is how we address some of those risks. In terms of what would happen if there is a sudden fall as such. We have something called as quick assets. So we take everything we owe to our banks, everything we owe to our vendors, accounts payable so we get put all of that in and then we put all of our quick assets we don't consider our fixed assets and that, all the cash that we have, all of our collectable accounts receivable everything that is as an inventory that can go out and become and we net all of those off. Our goal is to make sure that number keeps growing year-on-year, day-on-day frankly, I monitor it on a daily basis. So as long as that number which we call net quick assets it is not…others may use it differently but the definition I use is what I use, as long as that number is going up, as time goes by my risk actually goes down because my revenue diversity increases, not all market decline at the same point of time and the ones that are dying are being removed, being replaced with fresh avenue. So, I would say that is what our risk management calls for. Can something bad still happened? Absolutely, anything can happen, but we are doing the best we can to plan for every possible scenario which includes substantial revenue contraction in some verticals, margin drops in some verticals, collection cash flow issues in some verticals. Each one of those is a risk and I have a big risk team looking and monitoring all of that because as you said we are making big promises so obviously we need to make sure our systems are air tight otherwise we will make mistakes. So far it has worked out and hopefully it will but if we see it not working out, we obviously can course correct very quickly as well because I don't have hundreds of crores or Rs. 400-500 crores. My debt equity is still 0.6 and my cash plus my current assets itself will be more than enough to remove all long-term debt, all short-term debts and all payables. So, if I don't have too much debt nothing can kill me.

Lalaram Singh: You are trying to see which businesses you know if they are not meeting your criteria you will kill them, and new businesses will emerge. Now this statement is basically telling us that as a company we are equipped to identify new opportunities and capitalize on them and do it on a consistent basis which is I think one of the most difficult things to do in business, right. Every company has a core competence, has a particular line of business which it understands and where it will create the need for itself. But for us it is actually a bit opposite where we're saying that they will do you know, whatever things which meets those numerical criteria which is say, margins are 15% or ROCE of 25%, of course in theory it looks pretty correct. But there is also the element of execution, right? I mean, it is difficult for someone to do all the things, right as a business man. So how do you see that I mean, what enables us to you know, enter these diverse businesses or where you see we have 50 lines of businesses, right which is a huge number. So just you know the thought process about your company's architecture which allows it do so because many new companies are actually able to do what you are doing, entering very new businesses every year and you know scaling them up also. If you can throw some light on that?

Aditya Rao: Again, something that a lot of the questions you are asking us are things that have come up when we are doing a modeling, when we are doing a risk management and of course when we are building a ROC structure. So, in order to answer the first part of your question, yes identifying opportunities is typically seen as difficult and I think we have a system that does it and I have enough for the next 3 years of growth. I have enough projects as you call them. For us a project is defined as anything that increases my operating profit. So, to increase my operating profit by say X% everywhere, that being our goal, we absolutely have enough to take us through for the next 3 years. And that is after they have passed through certain element of risk management first, project owner looks at it, then our finance person looks at it, then our risk management head looks at it, then there has to be a personal sign off. Committed I mean, credible people making us commitments is what we use. That brings me to the second part of the question, how do you manage those growth? What kind of ROC structure do you need in order to manage these many kinds of verticals, these many kinds of revenue streams, ensure each of them are growing, ensure that something we have worked out is pretty unique. We have business 50 unit heads but effectively in this company in I have each one of the revenue verticals the 50 that I mentioned are people, professionals who do a lot of work to make sure they are credible and we make sure we support them and we tie in their compensation, their growth everything as per the performance of the company. Risk management is something we pay a lot of attention to make sure we are very clear to them how much capital is allocated to them. I measure working capital daily, business unit and vertical wise, we measure Accounts Receivable every day. So, if anyone goes above and we tell them immediately. So, the combination of that risk management measuring what each thing needs to be plus a unified base on which we treat all of our revenue heads the same way has allowed us to mass produce revenue generating heads. So that has allowed us to sustain this growth rate and everything we invest into, we don't invest in Rs. 10 crore or Rs. 20 crore revenue heads for example. Each time we invest into can become 100, 200, 300, some of them can become thousands of crores. So, the combination of nurturing these guys and making

sure your addressable market is high for each one of those verticals will ensure that current level where we are grossing 2500, 2600 gross sales in the year plus taking 2x, 3x, 4x and we can do that without substantially increasing organizational complexity or reporting structure. I believe our management structure to be robust enough to manage this.

Moderator: Thank you very much. We take the next question from the line of Vijay Kumar an individual investor. Please go ahead.

Vijay Kumar: My question is regarding the forthcoming corporate action. We are looking for an amalgamation. Can you give us any heads up about for the revaluation of the fixed assets that can happen as a part of this amalgamation?

Aditya Rao: No revaluation of any fixed assets. I mean, we have, we sit on reasonably large land banks, but I don't think we have any plan

Vijay Kumar: So both are listed entities and they will continue to have the same book value after amalgamation?

Aditya Rao: That is correct, we would see the same book value.

Moderator: Thank you. We take the next question from the line of Lokesh Bahl from Pennar Industries Limited. Please go ahead.

Lokesh Bahl: Actually, my question is every time whenever I go through the result I don't find anything you know what we had promised that we will have the organization of Rs. 6,000 crores in the next 2-3 years. So those symptoms are missing. Can you assure me that we are still on target, we are going for those targets?

Aditya Rao: So, what I will differentiate is the things that, I assume that you are a shareholder sir, so I work for you so I owe you two things, aspirational statements and commitments. I'm committing to you that I will grow at double-digit rates for the foreseeable future and if that business model calls up a possibility of me not doing that, I will make sure that I tell you at least a quarter or two in advance, that is as far as my commitment to you. Aspirational statements, Yes, I mean I don't target revenue I target EPS and profitability and growth specifically operating profit growth and Yes, I want to be as big as I possibly can. My goal is to maximize the amount of capital that I have employed in at making sure that I generate a certain effective and accurate return in the engineering and technology industries. So, I know it is not a very nice thing to say for, that is not well received and a lot of things but that is what we have decided to do and that is what we're going to do. So, will I reach a billion at some point of time? Yes. I don't see why we won't but these are aspirational statements. As of right now, what…so if you since I have been talking on these calls so at least I think my commitment to you is I have and I will continue to deliver growth in revenue, profit, EPS, and I will make sure we take no company killer risks though that is my

commitment to you I can go ahead with that. Anything beyond that is aspirational and I want my son to become the President of India may be but that doesn't mean that it will happen. These are aspirational so treat them as such, not commitments.

Lokesh Bahl: And one more question, like, how do you think about you know, there are a lot of talk is going on regarding revival of capital cycle and all. So how do you see like, what will be the scenario for Pennar in this present future, next 2-3 years? If we take for example say in 2021 like what scenario you find that which will be there for the Pennar Industries as amalgamated concern?

Aditya Rao: Well the way I see it sir, is addressable market, markets tend to go up or down, they have good years-bad years, some markets are cyclical and some of those cycles last many years. The way I see it is for each one of our verticals what is the addressable market size. If the addressable market size is growing, I can grow. So, we have plans to continually increase the addressable market size. Majority of our revenue comes from India, only 5% of our revenue is outside India and we are intending to increase that to 14% over the next few years. But India itself I think, I am a big believer in the India growth story, and I think it will do well and irrespective of whether it does well or not I think we want to grow, and we will identify opportunities in the market that will allow us to grow. So, the increase in addressable market size thereby increasing our quota activity, thereby increasing our orders, thereby increasing our revenue, thereby hopefully increasing our operating profit, thereby increasing our EBITDA and profitability and the EPS. We take that EPS deployed back with a certain amount of leverage into increasing our addressable market further by building more revenue generating assets that is our business model and I'm quite confident we will get to where we need to be, 3-4 years, I'm sure it will be good for India and it will be good for us, but aspirational sir.

Lokesh Bahl: And are we generating cash at operating levels?

Aditya Rao: Yes, we are prior to working capital changes which is how I define it. All of our businesses are generating cash on operations. Unfortunately, when you have a very high growth rate it does tend to mean that you have to, you fund 25% of working capital through our cash so it does tend to decline that a fair bit. But our focus is growth, so at our current margin profile and our current working capital cycle we will not have positive working capital sorry positive cash flow after working capital changes.

Lokesh Bahl: And do we expect it to turn positive in future?

Aditya Rao: I honestly don't target that. I think it is a very poor measure of whether a company is doing well or not because if I take a piece of paper down and tell me how a company with a two-month operating cycle and the 10% EBITDA margins will ever make positive cash flow after working capital. I don't believe that to be possible because of our increase of revenue by 20-25%, it already growing, if you're not growing absolutely. But if you're growing by 20-25-30% then with a two-

month operating cycle you're going to have to put in close to 12% of that or something so Rs. 4-5-6 crores will go into working capital anyway. So how will you ever generate that much cash if your EBITDA margins are 10%, 8%, 9%. Your net cash is going to be five or six so you will be negative. So, I don't think that is a metric you should judge us by.

Moderator: Thank you. We take an excursion from the line of Vikram Suryavanshi from PhillipCapital. Please go ahead.

Vikram Suryavanshi: What was scrap sale for this quarter, just to reconcile the number?

Aditya Rao: Scrap sale would have been around Rs. 21 crores.

Vikram Suryavanshi: And can you give the details about how is the retail business progressing and are we in the range of Rs. 100 crores target, what we are looking for this full year?

Aditya Rao: So, we are Rs. 100 crores, we won't give a breakup but retail business is picking up, we're adding new stores continually, but I can tell you we will not reach a 100. We will reach a good fraction of it, but we will not reach a Rs. 100 crores. But next year I think we will be able to reach well beyond that. But our ROCE is quite good in that business. We wanted it to be (+25%), and we are definitely doing that, and we are doing (+) 30. So, it is good news in the sense that that our expectations in the market we are getting what we need to but our ramp up of stores have been a little lower than what we thought it would be. So, we will our target of a Rs. 100 crores this year we will not achieve. But a good fraction of it we will.

Vikram Suryavanshi: And just last question, in tubes business if you look at, on quarter-on-quarter compared to last quarter we have seen some slowdown so can you just give some outlook on the tubes business as well?

Aditya Rao: So significant part of the tubes business specifically our CWD tube goes to the US and our ERW goes to automotive and our remaining CWD also goes to….so the automotive sector has been doing badly. So that has resulted in a temporary decline on a sequential quarter-on-quarter basis, year-on-year it is still higher and that will persist, year-on-year will continue as well. So we believe that the US market is back, the automotive market may take a month or 2 to come back but even if it doesn't we have diversified our customer base enough now to divert that volume elsewhere. So I don't think you have to worry about tubes on a quarter-on-quarter that is Q4 to Q4, Q1 to Q1 sequential quarters right now you will not see a decline in revenue. You will see growth, you will see double-digit growth.

Moderator: Thank you. Ladies and gentlemen that was the last question for today. I would now like to hand the conference back to the management for closing comments.

Aditya Rao: Thanks to all of you who have attended the call, excellent questions, thank you. Please continue to give us your thoughts. To those whom we have promised to get back we will get back to you and whatever information is given to you obviously will be in the public domain on our web site and exchanges as well. But thanks again to all of you for your support and we intend to continue growing this company over the next few quarters. Thank you.

Moderator: Thank you very much. Ladies and gentlemen on behalf of PhillipCapital (India) Private Limited, we conclude today's conference. Thank you for joining you may disconnect your lines now.