"Pennar Industries Limited Q1FY16 Earning Conference Call"

August 13, 2015

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MODERATOR: MR. MANISH RAJ – DOLAT CAPITAL

Moderator: Ladies and gentlemen good day and welcome to the Pennar Industries Limited Q1FY16 earning conference call. We have with us on the call today Mr. Aditya Rao – Vice Chairman & Managing Director. As a remainder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing * and 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Manish Raj of Dolat Capital. Thank you and over to you sir.

Manish Raj: Thank you. Good morning all on behalf of Pennar Industries and Dolat Capital. I welcome you all to the Q1FY16 earnings call of Pennar Industries. With us we have Mr. Aditya Rao – Vice Chairman & Managing Director of Pennar Industries to discuss the Q1 results and the outlook going forward. I will hand over the call to Mr. Rao now for his opening remarks. Over to you sir

Aditya Rao: Thank you. Good morning and to all the stakeholders of Pennar Industries. it gives me a lot of pleasure to speak to you today on the investor conference call for the first quarter of the financial year 2016.

Q1FY16 has been characterized by volatility in steel prices. In spite of almost 25% decrease in steel prices, we have been able to not just sustain revenue but in several of our higher margin businesses expand revenue from a year-on-year performance basis that is from Q1 last financial year to Q1 this year. We believe the performance of the company has been very good considering the backdrop under which we function which is of a consistent and steady decline in steel prices over the last 5-6 months. More importantly I think we have positioned ourselves well to achieve our growth targets for this financial year and then all of our high margin businesses which includes our systems and projects business which is railways and solar. Our industrial components business and a CDW tubes business, we have recorded good growth in order book; good growth in margins and good growth in our forward looking revenue for the next few quarters as well. Our margins specifically have grown consistently and they are going well from a year-on-year basis. Our consolidated EBITDA margin has increased from 7.7% from the comparable quarter last year to 9.5% during Q1FY16. On a standalone basis too EBITDA margin has increased from 7.7% to 8.6%.

From a segmental performance point of view, our systems and projects business has performed very well in this quarter compared to Rs.16.2 crores in sales and Q1 of last year which recorded Rs.48.7 crores which is a growth of almost 201.1%. Do bear in mind that the EBITDA margin for this business is also quite high. So on an EBITDA basis, also there has been very consistent growth with EBITDA for the quarter for Q1 going from Rs. 3.1 Cr to Rs. 6.9 crores.

Our industrial components business has performed well as well. The last quarter saw significant expansion with our volumes from Yamaha going up and projected to grow up even consistently in the next few quarters as well. Our Wabco business has almost doubled. Most importantly we have now started a significant export business in our hydraulics division for a company called Bailey Hydraulics in the US. We believe this is a good opportunity for us and we will be doing capacity expansions to ensure that this revenue continues to go up during this financial year and in the next few years as well. From the tubes business the share of CDW tubes in the overall business of the company has expanded as it has consistently over the last few quarters. This has resulted in our margins increasing in the tubes business as well, from about 6.2% to 7%. As the share of the CDW Tubes expands, this margin expansion will creep up and in fact across all of our businesses we have grown in EBITDA expect for steel products business which is the commodity business of the company and because of the pressure on steel prices it has been impacted the most in a significant manner. We are down in terms of revenue and EBITDA in that business, but even for that business with our special grade alloy steel project coming up, we expect growth to come in. On an overall basis for the year, we project growth for that business division.

With that I would like to hand it over to the moderator to open the floor for questions on the performance of the business during the quarter.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. We have first question from the line of Pawan Kumar from Unifi Capital. Please go ahead.

Pawan Kumar: Mr. Aditya first of all I wanted to know about the performance of the subsidiaries in the sense how is the outlook going forward on PEBS and Pennar Enviro. I guess when you last talked about it, the order book was around Rs. 350 crores. So has it moved North. What is the overall sense we have on these two particular subsidiaries- Pennar Enviro and PEBS.

Aditya Rao: Thank you for your question. On PEBS while I would like to say more unfortunately as you are aware we have filed a DRHP. The potential to taking the company public is an eminent possibility right now and very soon. So I will not be able to say anything right now considering we are under a quiet period on PEBS. Pennar Enviro will not be able to give revenue numbers for the quarter for the same reason because then it would be possible to work out the PEBS numbers. Pennar Enviro has gone through a rapid phase of order booking in Q1. So we are very bullish on Pennar Enviro's growth opportunities this fiscal. Compared to last year Rs. 30 crores we expect very high growth this year. For PEBS unfortunately I will not be able to say anything other than what is already present in a DRHP.

Sharat Reddy: Good morning Aditya. This is Sharat Reddy. I have a question. The steel business, can you give us some sense of how the business is modeled. It seems like there are two models. We see this across sectors. There are sectors like the chemical sectors, sector for example where raw material has declined dramatically, so many companies have announced a decline in topline but EBITDA has in fact been steady in some cases grown because they seem to work on a per unit conversions and the actual material is not relevant. In your case it looks like although you are a processor of steel you are working on some sort of ad valorem and there seems to be drop in raw material leading to a drop in EBITDA. Is that the way we and does that mean that in the future we will have to wait for a recovery in steel prices or for volumes to grow, so significantly that they will have to compensate for the drop in commodity price for you to show any growth?

Aditya Rao: That is in fact a very valid and very good question. All of our businesses with the exception of what we call cold rolled steel strips which is a large division, which is about Rs. 300 crores of the company's revenue derives from that, are non-commodity. In that sense they are specialized engineering and since we buy steel, add value to it and then sell it, essentially falling of raw material prices given the opportunity to expand margins in the medium term, in the short term to medium term. Over the long term, of course competition catches up and prices do renormalize at a level that is acceptable for our parties but essential falling in steel prices in the near term and medium term are good for those divisions from a profitability point of view. As you mentioned yes, have revenue shortfall because in these businesses across our verticals steel price as an expense varies from a lower 50% to a higher 70%. So in that sense some are exposed more strongly to the steel prices, some are less, but across most of our verticals and most of our divisions, the falling steel price essentially is a margin booster but a revenue depressor. The steel products business unit, the steel products business unit comprises two units. Our cold rolled steel sections and cold rolled formed sections business. The cold rolled formed section business is not dependent on falling steel prices for margins, effectively our margins the same story as other division margin tend to go up, not by a lot because the amount of margin we would had the value after, the margin after variable that we had for CRFS is only about 10%. So it is not a tremendous amount of gain that you get in it, but the cold rolled steel stripes business which I mentioned is about Rs.300 crores for us is very dependent on the raw material steel prices and any decrease in steel prices would traditionally mean that not only the revenue of that business goes down but also the margins themselves go down. Because the larger integrated steel players will get into this business and there is a market contraction.

This is the legacy business of the company; we have started off as a converter from hot rolled to cold rolled. Over the years we have branched away from the legacy business and a vast majority of our revenue and definitely our profitability is derived from the other divisions. As far as your question is concerned, with the addition of special grade alloy steels we will actually bypass this issue, and convert even the CRSS business to a much more value added business where the operating margin will be 15% plus. So that the EBITDA and the profitability of the company will be insulated from steel price volatility. However the revenue will always be subject to volatility in steel prices.

Sharat Reddy: When is your special grade alloy project expected to commence operation?

Aditya Rao: October will be the trial period. November we will be starting commercial production in that, of this financial year.

Sharat Reddy: What would be the capacity as well?

Aditya Rao: The capacity we are setting up will take us to about 2000 tonnes per month. Essentially we would look add close to Rs.200 crores in revenue run rate over a year, year and a half period.

Sharat Reddy: Last question, you guided for a growth overall for the year in this steel business notwithstanding the drop that we have seen in the first quarter. Can you help us understand how you are modeling growth?

Aditya Rao: One very important thing to understand is that while steel prices comprise a very important portion of our orders, the improvement in margins and also the investments that we are making and have made in the last few quarters have in fact set us up for rapid growth across all of our verticals. The one exception would be CRSS as I just mentioned but when we talk about revenue growth for this financial year, if you look at our railways from a year-on-year basis, Q1 to Q1 comparison we have grown massively. Our railways order books are stronger than ever in both coaches and wagons. We have over the last one month almost tripled our capacity to service ICF, integral coach factory where the number of side wall sets that we supply (and I can get into the detail of what that is if you need me to) has increased from 4 to 10 last month and this month we will be doing 20, in terms of sales. Do bear in mind that the operating margin in this in our ICF business is 40%. So we are effectively looking at very good revenue gains and very high margin gains as well in the systems and projects business driven primarily by our coach volumes and margins. Our wagon volumes with the margins will be close to 15% for that and also this solar module mounting systems business where for major grid connected photovoltaic power plants and all the major EPC developers in India we would be providing these module mounting systems on which the panel sits. Even that we believe is projected to grow at a very high rate in this financial year.

Coming to industrial components we have opened up a lot of orders. Our hydraulics business has a lot of growth potential. So from close to Rs.70 crores last year we are expecting us to reach triple digit revenue in this financial year and all of that will virtually come in from orders that your order book which already picked up from Wabco, from Yamaha and also from Bailey Hydraulics in the US.

In our tubes business a lot of capacity expansion has gone on. That is coming online now and you can see our volumes in CDW go up. So our tubes business all of last quarter was close to about Rs.170 crores and in this financial year we will look at substantial growth on top of that primarily because of the new capacity has been brought in and also the margins for this sector, for this business division rather, is also expected to go up because all other revenue is adding as I mentioned in my last conference call, every crore of revenue that we will add in this company will be at a margin after variable of +15%, so virtually it entirely drops down to EBITDA. So, that is why I am so confident about margin growth. Once as I mentioned the special grade alloy steel, 16 mm CR 5C60 (we make our wide variety of specialized grade steel which are not exposed to the raw material risk of the regular cold rolling business of the company is) comes online we are projecting a growth in the steel products business unit as well. So that is the way we are structuring it and these are not guidance. These are essentially what the CAPEX is set up for, the order book that we have will allow us to do in this financial year which is where our confidence and growth in these business units comes from. From Pennar Enviro's point of view, the large order book will ensure that this year will be a very high growth period for that division.

Sharat Reddy: The order book for the projects and systems, the railway and solar business?

Aditya Rao: The order book for railways is Rs.120 crores. It is forward looking as in the period of execution for that order book is only the next 7 months.

Sharat Reddy: Solar?

Aditya Rao: The solar business is currently at about Rs.75 crores and again as I said typically we take orders for 2-3 months ahead of time and longest lead time is about 6 months. So we will still book orders up to November which will impact this years' revenue but with our current order books itself we are looking at very high growth over last year. Last year railways entire business is 120. This year it will be way above that. Orders we have already booked are going to give us more than that in terms of revenue.

Moderator: Thank you. The next is from the line of Vikram Suryavanshi from PhillipCapital. Please go ahead.

Vikram Suryavanshi: Can you just highlight on what is the utilization rate for most of our segments and CAPEX plan?

Aditya Rao: You mean capacity utilization?

Vikram Suryavanshi: Right.

Aditya Rao: Capacity utilization for the tubes business was high at about 80%. For our railways business it is a little difficult to answer because we have been on a massive capacity expansion binge in our Chennai plant. So as I mentioned from a capability of executing four side wall sets we have gone up to 10 and now 20 and continue to add capacity, we think the peak is at 30. So I would say expanding that capacity at a very quick pace. We will expand to as I mentioned about double our existing capacity in the next 3 months. This will allow us to add, close to about Rs.10 crores of revenue in the coach business. That does not seem like much but as I mentioned these are very high margin businesses. So we are very bullish on this and we believe it is going to have a very disproportionate impact on the company's margin.

Industrial components we are stepping up a range of link motion presses. Our current capacity utilization in industrial components would be about 60%, we can take that up to 70% but the new capacity is coming online at the end of the year we are targeting close to about 70% capacity utilization. Steel products business is heavily underutilized. Our cold rolling capacity will be probably be at 20% or 30%. In our form section business again there is capacity expansion going on. We are currently at about 50%-55%. As an overall blend for the company across all of our businesses, excluding PEBS, I am must stress we are actually at about 50% capacity utilization right now for this quarter.

Vikram Suryavanshi: What would our CAPEX plan in almost like a total or a division wise?

Aditya Rao: I can give it you division wise, we will deploy, again excluding PEBS we will deploy close to about Rs.40 crores this year in capital expenditure. All of this will be through internal accruals; we will not be raising debt for this. Essentially, every business division we have is undergoing capital expenditure and expansion right now. I mentioned about special grade alloy steel project which will be about Rs.10 crores which will add substantially to our revenue and to the margins of the company but that you will start seeing that only from the end of Q3 and the starting of Q4 of this year onwards. Our tubes capacity expansion in CDW will come in about 2-3 months more. We are also expanding our commodity ERW tube business mainly for the reason that it needs to be expanded to service the downstream business for tubes Industrial component as I mentioned we are setting up of battery link motion presses to the expanding hydraulics capacity and we are also investing into specific opportunity, points of opportunity, investment opportunities which will allow us to optimize our margins Systems and Projects for solar also we are setting up some automation right now which will allow us to expand capacity for that business. We expect a huge boom in our solar business in Q3 and Q4 and judging by what we see this year, this year should be very good for solar as well. So overall as I mentioned about not including PEBS about Rs.40 crores, financed entirely through internal accruals, no debt expansion and all of this capacity expansions will be completed by in the Q3-Q4 period.

Vikram Suryavanshi: Can you just explain on working capital, how you are seeing compared to last year this year, the scenario for working capital and the way we are expanding even in Enviro how it will look like?

Aditya Rao: That is a very good question for Pennar Enviro and for standalone company working capital structure right now. We typically work at a two month working capital cycle. Our accounts receivables per se is a large majority of that because at time between us getting an order acquiring raw material, producing and shipping is very small (to the extent of, it can be as low as two weeks sometimes). But in general it is about a month. But the total working capital that the company will use is largely because of accounts receivable which ranges from 1.5 to 2 months right now. Over last few months, in some sectors we have seen a slight expansion to about our total account receivables right now will be about Rs. 170 Cr which puts us at about close to 2.5 months. So it gives a slight expansion of that. We see that moderating as growth comes in this quarter because typically the high turnaround businesses of the company which includes railways, which includes solar which is LC based essentially and others would essentially ensure, (the growth in those businesses would bring) the net working capital cycle down but we definitely are using more working capital in this quarter, Q1 of this year than we were in the same period last year. Not substantially a lot, I would say about 20%-25% more and this will correct itself over the next 3 months. There is also a little bit of holdover from Q4 where we had such a massive jump in revenues.. Some of those account receivables are yet to come back in because there is a 2-2.5 month and some cases that may push up a bit. But we are confident that by Q2 we will get back to an average working capital cycle of 2 months.

Vikram Suryavanshi: Last question sir what is be typical order duration for Enviro we target?

Aditya Rao: We typically would target lesser for Pennar Enviro it will be about 6 months. It is slightly larger.

Moderator: Thank you. The next question is from the line of Rajat Budiraja from Banyan Capital Advisors. Please go ahead.

Rajat Budiraja: My first question is on the solar power, give us a good idea what is the industry size in terms of the value of your product per MW. Second, how is the competitive scenario?

Aditya Rao: It varies a bit, the product we make can be module mounting systems for crystalline, for thin film, for optical tracking, single-axis tracking and also dual-axis. The vast majority is crystalline seasonal tilt or fixed tilt structures which typically come as per megawatt worth basis, it is about Rs. 40 lakhs, what we supply. It can be as high as Rs.70-80 lakh for some of the higher revenue business, mounting structures that we supply. So if we look at the market size it is about 4 GW is what is projected to be implemented this financial year. That seems aggressive the total installed capacity in India is 4 MW but based on what we have seen and the PPAs that have been signed at the state level and at the national level we are quite confident that we are going to have a very high fraction of that, may be 80% of that would definitely be executed. Consequently, the market size that we see would be anywhere between Rs.1500 to Rs.2000 crores.

Rajat Budiraja: How much of that size we are expecting to capture?

Aditya Rao: We have this scale to capture lot more. I think we would target about 20% of that as the order book, but how much of that actually converts into revenue this financial year is to be seen. I am a little constrained in terms of telling you this because PEBS also makes module mounting structures with a design engineer manufacture, they do not just manufacture, and they also design and share the entire system. So I cannot give you a fully straight answer on that, but I can tell you for the standalone company itself we are looking at solar revenues this year or close to about Rs.150 crores plus. Whatever PEBS does will be obviously an addition to that.

Rajat Budiraja: In terms of competitiveness who are the other guys bidding for the same project?

Aditya Rao: From the design engineering manufacturing and from let us call it solar module mounting structures turnkey, the large players are ourselves, a company called Nuevosol who would probably be the market leader and a company called Ganges International and Tata International. So four of us are among the large players in this business and they are the ones we compete with on almost all the orders.

Rajat Budiraja: Is it fair to say that most of the market is captured by these 4 players, like around 80%-90% or is it 50%?

Aditya Rao: I would say closer to 60%-70% is these four players. The remaining is unstructured but essentially it is all moving to the structure side. Essential the scope of what we deliver now has become design engineering, manufacturing, site erection of module mounting structures, table alignment, module placement, wiring, AC, all the way to the DC side. These are, as I said the CAPEX for MW for this entire value scope I just mentioned is only about Rs.70-75 lakhs. It is not very different from what you would normally see, the Rs.40 to 50 lakhs which I mentioned but seems to be what is happening and only good established players with very good engineering capabilities will be able to serve these markets. So for the next year we see the unstructured market actually declining a lot and there will be good market share gains for the established players like us and our competitors.

Rajat Budiraja: Second question is realization we can see that the rate has gone down, so what about the volumes, how it has been?

Aditya Rao: Volumes have grown in every business unit except for CRFS in our steel products business and ERW tube, those two volumes have declined. ERW tube we were making about 2000 tonnes a month, we are at 1,700 tonnes a month now. In the steel products business we used to do about Rs.30 crores a month, we are at Rs.17 or Rs.20 crores a month. These are the lowest margin businesses in the company, in a sense we are happy that the revenue share is coming down. I am not going so far as to saying that this is a planned withdrawal and what I am trying to say is that, the products that we have which are subject to raw material price variations in terms of recording revenue and margins are only these two businesses and they have reacted to falling raw material prices with less sales. The other business divisions have all grown in terms of margins and a lot of them are actually grown in terms of revenue too specifically this year System and Projects business there has been a 200% growth in terms of our revenue. So we expect this trend to continue. We would actually say that the revenue will continue to go up in spite of steel price fall for the remaining companies because we do not say it is bottomed out but we have reached a stage where we do not see much of an impact of these on our topline any more. The exceptions would be CRFS and ERW tubes, with the exception of those two businesses we are not looking at our revenue decreasing and margins across the board we are looking at increases in this financial year.

Moderator: Thank you. The next question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: My question again on margin improvement. You said most of the division will see some margin improvement this year. So could you highlight, one is the margin improvement driving from the better operating leverage or some of the odd input benefits what we are getting. So what you attribute to the margin improvement and secondly what kind of, if you quantify the improvement over the consolidated level it will be helpful. Thank you.

Aditya Rao: So margin improvements because of operating leverage are actually a consistent part of our strategy. It is something that we definitely see going on. I will however not be able to comment too much on that right now because it is a multi-year strategy right now. However, in Q1 all the margin gains which you are seeing, the vast majority of them have to do with the revenue proportion changing. If you look at what has happened in terms of where our revenue has come from in Q1 of this financial year, the higher margin business is such as railways, solar have dominated. That is the reason why even though revenue itself are fallen you are seeing margins expand at a very substantial level. Over the next few quarters what we have planned is that (one other things that we have discussed and we have taken as one of our boundary conditions is to ensure) that every crores of revenue that we add to this company will be added at an operating margin of 15% and above. Those choices or any CAPEX decisions that we make, any decision to expand capacity will be based on that thought. So essentially over the financial year what you would see happening is expansions in our high margin business specifically our ICF revenue, our solar revenue, our CDW tube revenue and our industrial components revenue and also our environment business revenue. All of these are at higher operating margin business. So on a consolidated basis when you look at a margin as a blend with each of these business growing and look at it in terms of revenue new revenue that is coming in or what margin is coming in, so you have last happened last year, our revenue last year, we are looking to add let us say x Rs.100croresfor this financial year and if you add that x Rs.100 crores at an operating margin of 15% and above all of that falls down to EBITDA, lead into EBITDA margin growth. I would not give you an EBITDA target for this financial year but last year we were at an overall EBITDA of about 10% slightly less than 10% I think. This year our consistent goal year-on-year will be to expand at our stated goal quite frankly is expanded by at least a 100 basis points every year and we think that these targets are achievable this year.

Manish Ostwal: Secondly I may be repetitive, but you gave some comment on the working capital reduction, so what we have achieved working capital reduction last one year and what is going ahead situation?

Aditya Rao: Working capital would break up into two ways, working capital, and working capital finance. So when we talk of reduction in working capital we are talking about the total working capital that is being used by the company such as the current assets that they would use to record our growth. So that would come in the way of inventory, it would come in the way of accounts and receivables. So in proportion to our revenue we will see those numbers coming down. So if our revenue grows up by 10% we will see working capital not increased by that much that is what will result in working capital depreciation. That is what we mean when we say they are going to see consistent declines in working capital. How that would happen essentially is, the numbers we watch and the number we monitor most closely is accounts receivables. So account receivable at the end of Q4 was about Rs.200 crores plus, right now it currently had Rs.170 crores. We would as I mentioned on little earlier look at a two months account receivable cycle, that will make sure that as a proportion of our revenue to total working capital will be at a lower level that it is right now.

Moderator: Thank you. The next question is from the line of Amish Kanani from JM Financial. Please go ahead.

Amish Kanani: One observation is that, despite the steel products declining our standalone sales growth was about 2.7% whereas our consol sales has declined by 6%, be it gross or net. So directionally some subsidiaries have declined one point. Second point is but on a margin side the first quarter last year was 7.7 at both the standalone and consol level, whereas on the EBITDA consol level is 9.5 and standalone is 8.6. So the point there is an increase in the margin but decline in the turnover in subsidiary level. If you can directionally tell us what has happened there? I know PEBS is under DRHP so you may not be able to quantify things, but if you can directionally tell us something.

Aditya Rao: I guess I would have to be very careful what I say on this. Here is what I am allowed. In the parent company as you mentioned what has happened is volatility in steel prices have resulted in steel price is falling for the good part of our expense falling. Across the blend in our Penner Industries standalone company raw material expense accounts for about 70% of our total revenue. So when you have that falling, 70% and it has fallen by about 25% you will see revenue falls but you will not see margin falls unless you pass on the amount of percentage of reduction you have gotten**.** We have not done that. We have not passed on that price reduction and so we are retaining our margins and growing our margins across several of our divisions. As far as subsidiary is concerned, since I will not be able to say anything on PEBS but from the consolidated level what you have seen is the same picture where the revenue of the company on a standalone and consolidated basis as they have declared has decreased but the margins that we have increased across the board except for our steel products business unit. So essentially I guess what I am trying to say is that if you notice in our DRHP PEBS also we have mentioned it, one of the risk factors we have mentioned in the DRHP is that raw material price fall can negatively impact revenue. So that is the risk factor we have mentioned. I will not be able to say anything else but I can say for the standalone and consolidated sales of the company, we are not concerned on growth in this financial year in terms of our topline or in terms of our bottom-line.

Amish Kanani: And sir more observation was there was few railway coaches and wagon companies which have mentioned that there were issues regarding the tenders and they were not given the tenders, so they were not kind of executed their orders from their side, but surprisingly we are doing well may be because of the ICF orders. But if you can just tell us whether we are at a risk of that uncertainty where railways have been actually been very aggressive in expecting the price cuts and hence in turn we getting impacted?

Aditya Rao: I think what you are referring to is what happened last quarter where one of the major wagon manufactures have under quoted very heavily at below operating margin. So that kind of resulted in a very bearish picture we had given for our wagon business. You are right in assuming that the majority of the growth that has happened in our company in the railways division has been because of ICF and that is going to persist, but even for wagons now what has happened is a lot of renegotiations has happened and the customers that we would supply such as Texmaco and Wexco and other they have come back to us with prices which are in fact at almost the same or higher margins that what we had last year. So in Q2 and Q3 the coach revenue and the wagon revenue are likely to go up. So the concern was there in last quarter but I am happy to say that they have found a way to address it.

Amish Kanani: If you can explain why a margins in coaches are very decent, so what kind of value addition are we doing so that we are getting so and in the expansion you mentioned from 10 to 20s happening in next 3 months is what you have said?

Aditya Rao: Yes, coach revenue in terms of 10-20s essentially refers to the side walls that is not revenue, those figures we will give later but from making four side wall sets we have to 10 side wall sets, from 10 side wall sets we are doing 20 this month and we expect to go to 30, that was what I mentioned. But your question was about…?

Amish Kanani: Little better margins, you know.

Aditya Rao: So what we do in ICF essentially is we provide components, subcomponents and subassemblies, so end was subassembly, side wall subassembly sort of troughfloor, so if you walked in a coach you probably walked in our trough floor because we have a very large market share on that. So we give these assemblies and also underpin assemblies to ICF where they will integrate and manufacture the entire coach. The reason we derive a good margin on this is the number of players in India, (Internationally there are lot) who have the capability to deliver precision stainless steel and move from a wagons from CorTen steel to stainless steel has been the driver for the railway business for a very long time for our railway business at least and we anticipate this expanding. I see us stated goals were to expand revenue by 30% every year and there are other disproportionate impact in terms of the procurements. So we are quite frankly not curtailed by our capacity in this as I have said earlier in the call as well. So because of lot of these factors the complexity and skill required to provide these subassemblies, the amount of engineering talent that is necessary for product development, the time investment that needs to be made in, contribute to tremendous entry barriers for this business. So that is the reason why more than the other suppliers have good coach revenue growth.

Amish Kanani: So one related question sir. When we are expanding is it that in turn ICF is also needing that much extra, or it is that we are able to have higher market share and the place where we have the factory are we the only sole supplier and who are the other suppliers in India to the ICF?

Aditya Rao: There are other suppliers, we probably are the largest but it is a little fluid I think the others are also doing quite well. TI for example is a good supplier as well, Tube Investments. So in terms of the ICF ability to pull I think if you were to ask ICF, they would tell you that we are slow, that we are not giving them what they need. So as I mentioned we cannot build capacity fast enough in this business.

Amish Kanani: So are we saying that the increase of 10-20s in turn because of the increase requirement from ICF right now?

Aditya Rao: Absolutely.

Amish Kanani: Is there any number that you can share which is our market share to ICF and stuff like that?

Aditya Rao: I will check and get back to you on this. I am not sure if they are okay with me giving out the number, but I will check and get back to you.

Moderator: Thank you. The next question is from the line of Pritesh Chedda from Emkay Global. Please go ahead.

Pritesh Chedda: Just a clarification from your opening comments which you made, in the industrial components space did you say that you would reach 3 digit revenue this year, that is how it was mentioned?

Aditya Rao: That is our target, yes sir.

Pritesh Chedda: On the railway side just wanted to know what was the quantum of business last year that we did in railways?

Aditya Rao: Rs. 120 crores in gross sales.

Pritesh Chedda: The backlog that you mention was about Rs. 140 crores this time, right?

Aditya Rao: It is about Rs. 120 in coach.

Pritesh Chedda: And wagons is additional?

Aditya Rao: Wagons is additional, it would be about Re. 40 crores.

Pritesh Chedda: So Rs.120 plus Rs. 40, Rs. 160 Crores.

Aditya Rao: Yes.

Pritesh Chedda: And last year you said you did Rs. 170?

Aditya Rao: Rs. 120 cr. Out of which Rs. 90 Cr was coach and Rs.30-Rs.40 Cr was wagons.

Pritesh Chedda: Is it fair to assume that this is an order which is executable in the current year itself actually?

Aditya Rao: We would want it to be, it is actually executable. It depends a lot on what capacity we bring to the table, but yes.My answer is yet it is possible for us to deliver this in this financial year and it depend on the variables are our ability to build up capacity, produce the product, get it cleared by Rights inspectors and ship to them once they have approved but of course.

Pritesh Chedda: The gross margin number in this part of this business is how much?

Aditya Rao: For wagons it is about 15%, for ICF it is between 35%-45% across all including trough floor and all assemblies. The side wall sets which I mentioned 40%, that is the highest margin we have right now.

Pritesh Chedda: When you refer to gross margin, it means revenue minus raw materials?

Aditya Rao: Revenue minus all variable expenses, raw material, labor, electricity, power, interest cost, inventory carrying cost and all variable costs.

Moderator: Thank you. We have next question from the line of Pawan Kumar from Unifi Capital. Please go ahead.

Pawan Kumar: How big is this opportunity with the Bailey Hydraulic Cylinders and especially towards the export in the industrial component?

Aditya Rao: Hydraulics itself is a massive opportunity because the market leader we are chasing is Wipro which is about a Rs.1000 crores plus in hydraulics and there are other large players as well, Dantal Hydraulics and other who are above 3 digit crores revenue. From our side it is a small business right now because we are looking to actually gain customers, large B-Grade customers right now, with Bailey itself it can be a customer who gives us about Rs. 50-100 crores per year. As if right now this financial year we are targeting certain proportion of that, that has Rs. 30 crores.

Pawan Kumar: Regarding tubes businesswhat kind of growth do you anticipate going forward; relatively the business has been almost flat for the last four quarters?

Aditya Rao: That is actually an important question; it is something which I should have addressed. What essentially is happening in tubes business is we are essentially cannibalizing our own revenues. So ERW sales are going down partly in response to raw material price fall or large raw material levels falls, but CDW revenue and tonnage is going up substantially and what we essentially want to do, what we want to model us is after the company like TI, so TI does about 7000 tonnes CDW tubes and that is every month. So that is the market for us. That is the market we are targeting. Our plan for tubes is to reach Rs. 500 crores business and the majority of it would be the CDW tube revenue. The time frame we are setting ourselves to achieve is the next four years and the capacity expansion we would need to in order to make all of this happen are under way. This year we are looking at about Rs. 200 crores. Last year was Rs. 160-170 crores.

Pawan Kumar: FY16, Rs. 200 crores okay. I wanted to understand what would be the capacity constraint regarding, I mean what would be our present capacity and how much is being utilized especially in the railways business regarding coaches and the wagon separately?

Aditya Rao: As I have mentioned coaches I can give you only broader picture. The capacity in coaches would be mentioned in our capacity to manufacture side wall frames, trough floors and underframe assembly such as, we call them end construction, end part. So that is what we call them. So if we look at our capacities in that we have the ability to output close to about Rs.13-14 crores per month right now in terms of finished product. We are currently at about Rs.9 or 10 Crores. We expect to ramp this us both capacity and the revenue in a very significant manner over the next few months. So by the time we meet you in the next quarter I am confident we would be giving you a very good growth number in railways.

Pawan Kumar: We can expect more than 20% revenue growth in railways, this year also?

Aditya Rao: Definitely. As I said entire unit is Rs. 120 crores last year. 20% puts us at Rs.150 Cr. We are definitely targeting a larger number than that.

Moderator: Thank you. As there are no further questions from the participants I would now like to handover the floor to the management for their closing comments. Over to you sir.

Aditya Rao: Thank you for your time to all the stakeholders. We are glad you could join us. We attempt to give you the best picture possible in the time that we are present but if any of you would want to visit us, meet with our core management team, visit our manufacturing facilities, (presently pan India we are manufacturing plants in Hyderabad, Chennai, near Bombay, and Bangalore) we would love to have you and give you a better picture of this company. Going forward we expect the volatility in steel prices will persist. We believe that will have an impact of reducing revenue yes, but based on the CAPEX we have the capacity that we have and the targets for the financial year and what we see in terms of order book right, we will continue to see margin expansions we believe. We will also continue to see over the course of next few quarters' revenue growth as well across most of our business divisions. So we are positioned well to achieve our targets for this financial year and I thank you for time and thank you for your questions.

Moderator: Thank you very much sir. Ladies and gentlemen on behalf of Pennar Industries that concludes this conference call. Thank you for joining us, you may now disconnect your lines.

(*This document has been edited for readability purposes*)