"Pennar Industries Limited Q1 FY-15 Earnings Conference Call"

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Moderator

Ladies and gentlemen good day and welcome to the Pennar Industries' Q1 FY15 Earnings Conference call. As a reminder all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your Touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Manish Raj of Dolat Capital. Thank you and over to you, sir.

Manish Raj

Good morning ladies and gentlemen. We welcome you all on behalf of Dolat Capital to the conference call with the management of Pennar Industries to discuss their Q1 FY15 results and future plans. Representing the management with us of Pennar Industries is Mr. Aditya Rao – Vice Chairman & Managing Director. We now handover the conference to Mr. Rao for his initial comments after which we could move on to Q&A session. Over to you, sir.

Aditya Rao

Thank you very much to all the investors and the stakeholders of Pennar Industries a very warm welcome to you to our quarter one investor conference call for Pennar Industries. I am glad th at you could join us today and to give you an overview of what has been happening at Pennar; developments at Pennar and our performance for the last quarter.

On a consolidated basis the company had gross sales of Rs. 316.41 crores in Q1 of this financial year. Net sales of Rs. 276.70 crores; EBITDA of Rs. 22.47 crores; profit after tax of Rs. 5.81 crores and a cash profit of Rs. 12.48 crores. There have been several changes in the company and our operating mechanism in the last quarter specifically we have been able to bring in a lot of improvement in our margins as compared to the last Fiscal which has essentially resulted in our profit and cash profit doubling from the corresponding period from Q4 of the last financial year.

For an individual business wise breakup our steel products division which comprises our Cold Rolled Steel Strips and our Cold Rolled Formed Sections business the sales for the quarter were at Rs. 101 crores. We received several repeat orders from companies such as VECV, Volvo, Eicher, Ashok Leyland, Prabha Engineers, Tata Group Companies, Tata Motors specifically Johnson Lifts and others. Some other major customers during the quarter were Larsen & Toubro, Lanco, Thermax, Simplex and BGR Energy. We have added several new customers as well specifically to name a few of them Neo Corp International, RKM Powergen, Shree Balaji Constructions, Future Net Security Solutions which is one of the first and a new round of export orders and we have also added a lot of new products specifically a 250 metric tons of production in the new Z Sheet Pile in the Z profile and a Wedge Barrier system which we are exporting. 40% of revenue in the quarter has come from new business and we have started adding new customers as I mentioned before in the US both for the manufacture of sheet piling and also for Wedge Barriers.

In the short and medium term our plan is to continue to add new customers specifically in the engineering and white good sectors and to potentially benefit from the revival of the Indian Infrastructure story over the next few months or the next few quarters.

The next business division which is our industrial components division had sales of about Rs. 14.7 crores. We have put a lot of effort in to developing this business further. We are in the process of extensive product development prototyping and vendor approvals from Yamaha, Xylem, Letrika Roots, FNSS, BEML and others. The white good industries slide has contributed a slight decrease in revenue in this business and we feel that over the next few quarters as the new customers which we have been trying to develop come in this business division should continue to grow further but in the quarter in question we have seen a decline in revenue.

We will focus on critical high performance components for brake, suspension and auto electrical applications. I think global sourcing is an important aspect of growth for this business and as an important opportunity for this business and with growth of our hydraulics business in which we had invested significant capital expenditure last year at about Rs. 13 crores we believe that this division has good days ahead.

The next business division which is our Tubes business was a division which we started off in a cohesive manner about two years ago. We have now been able to increase sales to Rs. 36.2 crores in Q1 which is up 12% year-on-year most encouragingly our CDW tube volume; our cold drawn welded tube volume which is a high margin product has grown by 37%. We are currently at around 100 customers in terms of our customer bank for this business and 60% of our business comes from repeat customers which is customers who are given us an order already and who want to work further with us and has given us further orders.

Some of these customers are Isgec, Thermax, ALF Engineering, Gabriel, Volvo, Eicher and others. Our sheet pile segment also has exhibited growth in this year. So the new products that we have added along with capital expenditure is going in to this business division will result in very significant growth by the second and third operating quarters in this financial year. So from a current run rate of about Rs. 13 crores a month we expect to reach about Rs. 17 crores per month in terms of revenue in this business division.

Our next business division Systems & Projects comprises of our railways and solar business. Railways has done very well for us exceedingly well from both from the point of view coaches and wagons. The quarter one sales have been at Rs. 16 crores for both coach and wagons and we feel that considering our order book Q2 and Q3 will be even better; vastly better in fact. So we have begun with an order book of Rs. 50 crores that has now grown to Rs. 90 crores and the integral coach factory has increased output and we feel that our coach business will do very well this year. These are also very high margin businesses so any improvement in revenue; any scales in revenue that comes in would have a very strong impact from the company's profitability and bottom line.

In terms of wagons we have received a lot of new orders from HEI, from BESCO; from Texmaco and others and we feel that for a long period of glut wagon orders to wagon business for the company as well will do very well this year. Overall for the Railways business we feel we are very optimistic this year and we will definitely see high double digit grow this year compared to our performance last year.

In the solar business we have added most of major orders that we have received come from Harsha Abakus, Nuevesol and Sterling and Wilson. There are lot of orders we are quoting on right now but it has tended to be a lower margin business we are hoping to change that over the next few operating periods but as it stands right now what we make in solar or module mounting structures we also undertake the design engineering and project management and erection of these structures and we feel there will be vast market potential but operating margins scale are being improving operating margins will be our priority in the future.

That brings me to the subsidiaries. Pennar Engineered Building Systems and Pennar Enviro. Pennar Engineered Building Systems has had an excellent quarter with very good growth in terms of both top line and bottomline. The company has grown to Rs. 116 crores in revenue in gross sales as opposed to Rs. 80 crores in the corresponding period last year. An EBITDA of Rs. 8.5 crores has been recorded resulting in a profit after tax of Rs. 3.64 crores. The cash profit for the company was Rs. 5.16 crores. We believe that Pennar Engineered Building Systems will continue to scale well we think quarter two will also see very high double digit growth. The company has debt free; the subsidiary is debt free and continues to have an order book which is growing well. Our current order book is in excess of Rs. 330 crores and we expect this month to further augment that.

Our major customers for the quarter for PEBS were Reliance, Larsen & Toubro, Schindler, Sobha Developers, Gland Pharma and others. We have expanded capacity to 90,000 metric tons and our revenue from new product is over 50% of the revenue.

Environment Treatment business Pennar Enviro is one of our newest divisions, newest subsidiaries. It has grown very aggressively in this quarter. It has started out from a very low base but it has recorded sales of Rs. 7.71 crores and the corresponding sales last year were Rs. 1.5 crores. We have high hopes for this business the order book has grown to Rs. 40 crores and we are currently quoting on orders worth Rs. 190 crores and we are quite confident of being able to scale this business further.

So our hope and wishes that since we have an excellent team; since we have generated a good order book and we have several pre-qualifications and collaborations in place now we feel that this business we have high hopes for it we will follow in the lines of PEBS and grow to become one of the major drivers of growth and profitability at Pennar Industries.

Furthermore we are expanding at all of our plants, capacities at Chennai; capacity potential over Tarapur and Isnapur. We have also setup a 2.5 megawatt power plant for Pennar Industries and a 0.5 megawatt power plant for Pennar Engineered Building Systems. The intention was to get power security and we have completed these plants synchronized them to the grid and received open access permission. So it ensures us to very great degree from load shedding and other potential power cuts and it will ensure that we remain on the growth path that we have been on in for the past few months.

With that I give it back to the moderator. I will be glad to take questions specifically either each business division or each company or on a consolidated basis. Thank you.

Moderator Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from Giriraj Daga of Nirmal Bang. Please go ahead.

Giriraj Daga See the thing is there are a couple of questions to go by. First of all if I see like in the standalone business we are witnessing pressure and I will agree with that new business is doing good and that is why the consolidated numbers are looking okay with a 9% revenue growth. But we are lacking in all the divisions be it your steel products, industrial component systems so on a year-on-year wise like are we severally witnessing the slowdown in the sector and what is the current situation like say it was I can understand Q1 was a period when maybe not be much activity happening but whether the current situation is similar to that or has the condition improved from that quarter?

Aditya Rao The straight answer is every business division in Pennar Industries and all of its subsidiaries right now is growing with the exception of our industrial components division. So we expect Q2 be better across the board for the company except for industrial components division which might also show growth but for now we are not committing to that. In terms what has driven this growth if you would take a look at what happened in quarter one we have undertaken a process over the last few weeks to weed out low margin orders. So you would see a drop in revenue but you would see an increase in terms of profitability and we feel that the Indian infrastructure story the capital goods story that will take time to recover but we are not very far away.

I think they are already seeing increased enquiry banks, increased quote activity and order booking per se has not improved in comparison to if you were to compare it either to Q4 or Q1 of last year. So even taking cyclicality in to question we do not see an improvement as yet on order books but because of certain improvements we have made in a way we have some rear functioning because of certain improvements in terms of our customer base and the margin we are received from our customers we are seeing margin growth.

That being said in the next quarter Q2 compared to Q1 because of changes made in the company our CRSS division will see growth we expect that the company can grow from Rs. 25 crores to Rs. 30 crores per month in terms of billing revenue in that business division. Our Cold Rolled Forming Sections business we believe will grow from Rs. 14 crores to Rs. 20 crores that is definitely something we believe is possible and even beyond that.

We have a lot of solar orders and typically we trying to execute them once we believe that proper payment security is there because it is very easy to book orders in solar but to get your money is a little more difficult. So we have taken a decision that we will only provide our products and services to customers who we believe will be able to pay us. So keeping that in mind solar also I am confident will grow. Railways will do tremendously in terms of order book we did Rs. 16 crores for all of Q1.

We did more than that we bought Rs. 16.7 crores was in the first month of the second quarter and we feel that is going to continue in for the rest of Q2 and Q3 as well. So we will see a lot of growth in the Railways business we will see a lot of growth in our legacy businesses and our Tubes business once the new capital expenditure that we have been making once the tube mill comes in we should be able to scale that business up by a factor of almost 40% from a run ate point of view.

In PEBS our order books clearly indicate a growth of about 40% to 50% compared to Q2 of last year to what we will do in Q2 of this year and Pennar Enviro of course has such a low base that it will obviously have growth. So my answer to you is that what you have seen in Q1 is a statement of intent we will make higher margins we will not compromise on margins and at the same time we will bring scalability in and everything that is growing is growing in high margin businesses.

Giriraj Daga My second question is like if I look at PEBS our order book has stagnant about Rs. 320 crores to Rs. 330 crores a number for quite long time now and now that we do not even cover the full revenue also like this quarter average was Rs. 101 crores for the revenue for the PEBS so we are not even covered for the full year. So have you become choosy in terms of the order in terms of margins because if I look at the margin also that were down both year-on-year and quarter-on-quarter as well. Quarter-on-quarter margin dip is very sharp?

Aditya Rao Let me answer in a different way. I think if you look at EBITDA margins for PEBS those are not kept I will get you those exact numbers right now but there has not been a dip in PEBS margins that is. On the operating margin we might have seen 1.5% but that is more of a revenue mix question rather than any object margin fall. In terms of your question on order book remaining stagnant the way we work on the PEBS business there has been a subtle change so PEBS's current services include pre-engineered buildings, high-rise structurals, steel structures, cold form buildings, and also engineering services. Whichis a new high margin division which has just started.

In fact we will have over million dollar of revenue in that it is essentially we undertake the engineering design and detailing and other IT enabled services for customers in the US and we have added about five customers and five different companies right now. We believe this vertical is very scalable so since our focus has gone in to these different verticals we do not typically present an order book for that we do not also present an order book for solar. They have got this faster conversion cycle we get clarity only in a month before. It is just like we do not report in order book for some businesses in PIL we will not be able to report the complete order book but the growth for this year remains quite strong and remains quite capable.

The reason is we do not actually book for the whole year we are not comfortable taking exposure over a certain amount because of the inherent risk in the PEBS industry. One of the major risks in the PEBS industry is raw material price variability. So we end up taking a large order book and that gives you revenue foreseeability yes, but raw material prices are consistently in flux and we do not have the ability in PEBS to pass on raw material variations. So if we can get ourselves in to a situation where we have a larger order book and if you do not have the ability to hedge raw materials which we do not no company would have that considering the variations that in steel prices. And on an annual basis we can say 16% to 20% variation that is not unusual.

So we prefer not to hedge, so it looks like our order book may be declining in proportion to our revenue but if we look at our quarterly output so to speak that is steady and strong the outflow has been strong. In terms of EBITDA margins for the year compared to this year and last year.

Giriraj Daga My last question is related to the debt and CAPEX like what is our gross and net debt and what is the CAPEX for FY15 and FY16?

Aditya Rao Our gross debt remains consolidated and standalone like that?

Giriraj Daga Yeah console mean?

Aditya Rao So we have no long term debt across the group except for Pennar Industries we funded solar power plant which was about Rs. 25 crores. That is for solar power plant that is discreetly for that business. The total debt including working capital, non-cash LCs and BGs for the group is about Rs. 182 crores. Standalone PIL is about Rs. 160 crores and PEBS did about Rs. 39 crores. Pennar Enviro has a small credit limit so it is about Rs. 2 crores.

Giriraj Daga And what is the CAPEX number for FY15 and FY16?

Aditya Rao For the FY15 and FY16 year we will be taking opportune CAPEX and we estimate the total CAPEX for the year to be about Rs. 40 crores but the individual break up I will provide you at a little time. At this point we are not ready to disclose the exact numbers before board approval is given.

Giriraj Daga Okay but are you looking to like to get the debt for that or you will be doing from internal accruals only?

Aditya Rao No, we will only completely do it through internal accruals. We will not be increasing the debt profile of the company. And the only increase in the debt profile of our company has been for the solar power plant for that discrete project. For no other purpose has there been any debt increase in the last year-and-half, two years quite the contrary because of the strong cash flow generations especially in our subsidiary PEBS the company is virtually debt free on all accounts. It has debt yes, but it also has cash reserves well in excess of that which we are currently using treasury operations for.

Giriraj Daga And what is the cash book cash that we have?

Aditya Rao About Rs. 30 crores.

Giriraj Daga And just a clarification. Did you say the Pennar Environment order book somewhere in the opening remark?

Aditya Rao Yes, Pennar Enviro's order book is currently around Rs. 40 crores.

Moderator Thank you. Our next question is from Amit Sharma of Wallfort Financial Services. Please go ahead.

Amit Sharma A bit of understanding first. When did we acquire the hydraulics business company?

Aditya Rao So the hydraulics business has actually been an asset purchased so there is a company in Chennai called Wayne-Burt Systems which was in the business of hydraulics we have acquired their assets.

Amit Sharma When was it?

Aditya Rao This was in the third quarter of last year.

Amit Sharma So what is our view on this business per se because when we acquired it maybe the bottoming out process was in the process for that the related industry if I am correct or rather correct me if I am wrong. And how do we perceive it to be progressing now?

Aditya Rao So the hydraulics business is very important to us we have invested significant CAPEX but the asset purchase we have made was not for while it looks like as a growing concern that was not essentially the intent we wanted that to be piece of a larger hydraulics growth strategy. So we have capabilities in hydraulics cylinder manufacturing

That being said with the existing capital that we have spent existing assets that we have purchased we have started building activities so we are picked by DML as a customer and there are companies in the US we are currently doing product development and also Indian companies. We have well over 20 trials and in progress right now. As we move forward we will be able to get more of these get become on the approved vendor to sell of these companies and scale hydraulics revenue. Our outlook on this is that we believe that hydraulics division by itself can grow to Rs. 500 crores but it will need continual investments and time, manpower people and of course with further more CAPEX as well.

There is some multiyear venture and it is a thorough engineered product and we feel that we have a lot of core capabilities in it. The market leader in this business is Wipro with about Rs. 1,000 crores of sales in just in hydraulic cylinders. There are several other strong players as well such as Dantal Hydraulics and others. Our intention over the next few quarters or the next few years really will be to continue to gain market share from them. We are a small player right now but potential is vast and we are positioning this business accordingly.

Amit Sharma So what are the kinds of industries you are targeting in this business?

Aditya Rao Mostly construction equipment, material handling; it is just pretty diverse but primarily the construction industry will be consumer off. So earthmoving equipment, cranes, lifters, back holes, loaders those are the kind of equipment which typically use this. And obviously we want to target other opportunities for example in one of our export orders for FNSS where you make security systems wedge barriers it is an integrated solution which also includes hydraulics. If you have been to a hotel, if you have been to mostly in five star hotels you typically stop there and there is a barrier that goes up so those are some of the systems we will be getting into. So even those are potential end users for hydraulic cylinders.

Amit Sharma And what is the kind of margins that we expect to earn from this business and what are the margins currently and what do we expect from this business segment?

Aditya Rao one of the things across our business verticals is, we will not compromise on variable contribution we expect about 20% the industry average is about 25% but since this is early days for us we would take these orders around 20% and we feel that is sustainable.

Amit Sharma In a way you want to break the market? It is a strategy to gaining market share if I am not wrong?

Aditya Rao That is correct, yes.

Amit Sharma You said you are targeting a revenue of around Rs. 500 crores from this business in how many years?

Aditya Rao It will take us time for 5 years.

Amit Sharma You have given us a fair bit of idea about the order book situation currently but with all these capacities which is currently undergoing what would be our capacity by the end of this year or as soon as this capacity expansion is over?

Aditya Rao Our total capacity across product verticals quoted as a tonnage which may not be the best way to do it but I will answer your question. It would be about 250,000 metric tons. By the end of the year we will probably increase that to 260,000 to 270,000 metric tons. But there are lot of discrete capabilities we are building in product development in ancillary services such as short blasting, painting, galvanizing which could not be quoted on a tonnage basis but most of our CAPEX will now go in to providing value added services and not just plant, machinery expansion.

Amit Sharma I do understand this because your website quotes around 300, 000 metric tons of capacity that you have currently so that is what I was confused about because you said 250,000 metric tons?

Aditya Rao I think if you include PEBS and others then it gets up to about that.

Amit Sharma So that was the gap. Now after everything is over this capacity building exercise or asset building exercise is over how do we expect our or strategize our order book percentage to look and what kind of revenue composition would we like to be there in next two years, 3 years' time?

Aditya Rao We typically would not have order books for all of our businesses we have it for some of our businesses but some others we actually have long term contracts which typically would not be able to quote in order book number for.

Amit Sharma What is the percentage of those kinds of contracts?

Aditya Rao I would say about 50% of our revenue is order book based and the remaining is a combination of annuity revenues, engineering services, and steady revenue flow which is repeat orders.

Amit Sharma And what is the kind of growth that we see in the second kind of a segment?

Aditya Rao You mean in the non-order book quoted businesses?

Amit Sharma Right.

Aditya Rao We will definitely see double digit growth as an average across all verticals for this financial year on terms of what topline and our stated intention is to double the profit we had last year as a standalone company and for the subsidiaries also to have high double digit growth and profitability this year. But this is in guidance which has broad statement of intention so to speak. But we feel that we have the ability to do that and as you said in quarter two itself is looking so much better than quarter one that we are confident that we should be able to achieve these numbers.

Amit Sharma And what kind of margins do we earn on an average from the non-order book kind of business?

Aditya Rao They are a big blend actually but on average we get about 10% to 12% in terms variable contributions.

Amit Sharma And we do plan to add value addition into this, right?

Aditya Rao Yes absolutely.

Amit Sharma So what kind of incremental margins do we see?

Aditya Rao I think you aware we are trying to target 200 basis points improvement in margin this year some of it has already been achieved but we should be able to achieve that by the end of this year.

Amit Sharma And on the order book segment which is another 50% so what kind of revenue target do we see I mean we are trying to double the revenue this year and what kind of targets do we strategize in next two, three years' time for the revenue topline?

Aditya Rao Well, we may not turning revenue but our goal is to double profit in revenue not so much but let me just tell you regarding the order book business let me just take it up individually because let me be more thankful. So railways business our order book is about Rs. 90 crores which has grown by about 70% to 80% compared to what it was in Q1. Our PEBS order book is about Rs. 330 crores which has more or less been the same as when we started off in Q1 but that does not reflect the fact that we have additional business divisions that we have and a lot of non-order book revenue generating aspects in PEBS. But the Pre-Engineered Building Systems division itself has actually grown by high double digits. I do not have a percentage for you but I will get back to you but it has grown. Our other order book businesses are solar which stands to increase by a lot this quarter because typically for us very cyclical Q4 tends to be high and Q1 tends to be a little bit of a lull but in this year with the number of new projects that are coming up we are actually going to pick and chose our orders in this business. So orders we have a large order in coming from L&T; we have a large order that is coming from Azure Power and several others. So we will stick to fewer customers, better margins but inspite of that we will see order book growing aggressively in solar.

Amit Sharma So in the solar we are only in to component manufacturing, right?

Aditya Rao We also do design engineering we also do project management as in erect the structure at the site.

Amit Sharma But on in to the EPC part?

Aditya Rao I would not call it EPC because we make everything so I would call it engineering, manufacturing, and project management.

Amit Sharma So what is this kind of cycle that we typically would like to be in the solar business?

Aditya Rao Three months from getting order we have to be out of that.

Amit Sharma Okay, within three months the entire the liaison must take place?

Aditya Rao Yes, and that is true of all of our order book businesses; PEBS, Pennar Enviro, and everything we will work on that. If it is much more than 3 months we typically would not be involved in those businesses success.

Amit Sharma So what is the kind of target that we used to have for a longer period of duration for the revenue to grow may 2-3 years' time?

Aditya Rao Considering at our base strength and there has been the cash to generate one of the things that comes out in the P&L is that we have a very strong cash flow generation. Our receivables and our debtors have come down markedly since the beginning of the quarter by almost close 20% and our cash flows are strong right now. We have the ability now to invest without raising any debt in to opportunities we see in the market so considering growth opportunities we feel that a continuous investment of about Rs. 50 crores from our own cash flow generation every year should get us to the point where we should be able to see definitely about a $1 billion in turn over; over the next three, four years. And that is something that again that is not guidance it is our vision and we hope to reach that number over the next few years.

Amit Sharma And what is our current overall margin you said because there was some calculation difference. So the overall margin on the EBITDA from as per the management is?

Aditya Rao So the total EBITDA for the quarter was 22.47 on net sales of 276.7 which puts us at something approaching 9%.

Amit Sharma And for FY15 where do we plan to take it to 200 basis point improvement?

Aditya Rao Yes that is correct.

Amit Sharma And the revenue growth of around 30% on the topline?

Aditya Rao Yeah, we will not be able to give guidance but we are expecting high double growth,

Moderator Thank you. Our next question is from Manish Bhandari of Vallum Capital. Please go ahead.

Manish Bhandari I have few questions regarding few of the durations of our company. My first question is regarding the CDW and as I understand that Munjals have set up the key customer has set up their own plants or not their own plants but may be that because of some kind of long term tie ups they have. There is an expansion which has been done by the Tube Investment for Rs. 250 crores. So what is your outlook on this division from the future customer acquisition point of view as well as from the point of view of value addition what it will do to gain value addition of the business?

Aditya Rao So our CDW tube business will only about Rs. 50 crores this year. Its high margin profitable business and the market leaders here is Tube Investments. So we are stealing market share. Tube Investment does about 7,000 tons every month in just CDW Tubes. We are nowhere near there we have about 500 tons. So we are about one-tenth their size less than that really one-eight their size in CDW. Our goal will be to chase them. We are waiting there are lot of opportunities in the market our goal right now is to go to several of our customers to whom we already supply a lot of engineered products trying to get them to accept this product as well. It is a process that has worked well. We are actually now add capacity for CDW and a lot of the new capital expenditures are going in to Tubes. We will be going in to expanding our capabilities in CDW or the input raw material such as mother hollows for CDW Tubes.

Regards to the CAPEX is going on and capacity expansion among our competitors certainly I think the Rs. 250 crores capacity expansion that you are talking about from TI is gear towards a different kind of product it is a Tube it is a CDW Tube but it is I think intended more for hydraulic cylinders. So I think that is a different segment there are various CDW Tube itself can be broken up in to a wide variety of segments and the customers we are targeting are primarily in the automotive sector. Our future for this division also it involve a fair amount of integrated products so we would not just make the tube we will make the tube manipulated products things which has seating systems are possible; things which has a hydraulic cylinders also our won captor capabilities and that will be very useful.

So our goal going forward is to be engineering company we will not look at it like a commodity company and the combination of taking market share from our competitors and getting in to value added engineering services we will make sure that our CDW and our Tube division overall continues to grow.

Manish Bhandari How bigger it will be the import substitution market in CDW if there any because that is what my understanding was there was huge import substitution which could be done by the Indian players?

Aditya Rao Yes, there is a fair amount of that I think close to 2,000 tons to 3,000 tons of the overall monthly CDW output is from that and there were several companies which had actually developed capabilities in CDW and DOM, Drawn-over-Mandrel Tubes as well which had done this. There are some companies have done that but vary degrees of success but the potential still exists. CDW Tube will do as long as the industry continues to do well grow exists for that matter. And our goal will be to ensure that we build up capabilities, build up scale and ensure that we can the customers that we do have we are solely able to increase volume and solely the definition here would be double digit growth definitely.

But we will keep investing CAPEX we will keep increasing production output and we will use the cash flows in that business division to reinvest back in to the business. Tubes business is self-funded from Rs. 40 crores per year it has now grown to Rs. 180 crores what we expect this year to be and that has completely been through to from the profitable business division itself we have grown that.

Manish Bhandari Would you be in to CDW as well as CDS or only in CDW?

Aditya Rao Mostly only CDW.

Manish Bhandari So is the CDS is a higher margin business?

Aditya Rao Yeah, seamless tubes we are not present in.

Manish Bhandari My second question is on the PEBS business. What is your strategy followed by Zamils and Kirbys and Tata Bluescope and Everest of the world and is there any margin pressure going forward because apart from the engineering side of it there is not much competitive barrier and at least these four or five people are well turns in to the system now. So what is the challenge what you can see coming in our PEBS business which is the industry which is growing at 10% to 15%? If you can throw some light on that challenges.

Aditya Rao There is something called the PEBS sector which is defined in India and that is you are right continues to grow at a CAGR of about 15%. The market size for that business was about $1 billion about Rs. 500 crores to Rs. 600 crores every year. Major players that are present there are some of them are you mentioned the market leader is Kirby which have Rs. 1,000 crores in turn over in this. Our positioning in this is either more powerful engineering company than as a sheer volume pusher.

There are companies which are bigger than us in the PEB but our capabilities in precision engineering design and custom fabrication and custom manufacturing roll forming gives us ability to actually do a lot of interesting projects. So though we may not be a largest we make the largest building in India at 10 million square feet building for IOT in Dahej. We have made a 250 metric ton crane carrying capacity building in Chennai for L&T. We made a building which is a kilo meter in length; we have made the first gold rated green factory in India. We have also made high rise structures which are lot of our competitors do not do. In fact 16 floor building built up in three months. So there are lots of advantages to having these capabilities which allow us to tap sectors which most PEB companies generally do that. So our addressable markets in this include the PEB market; the cold form building market; the high-rise buildings market. Engineering services as a big piece as I have mentioned earlier we have picked up a lot of customers in that and we believe that is a scalable and a highly profitable vertical for PEBS to be present and overall for us we will be presented businesses which give us good variable contribution of about 18% to 20% is our boundary condition and also has very quick cash conversion cycles. Consequently PEBS we have no debt we have cash reserves in fact and we expect going forward that we will be able to continue to grow this business or based purely on our assets. Other PEB companies may face challenges, may not be a challenge based on their product profile being restricted to one particular sector but I think our diversity gives us the ability to multiple sectors advance and accordingly ensure that we can demand our margin from our customers.

Manish Bhandari Is the PEBS Solution viable for the affordable housing also?

Aditya Rao In fact it is, yes. In fact over the last year that is why the cold form buildings technology comes in. Specifically PEBS consists of hot rolls form sections, tapered built sections those will not be useful for affordable housing but cold form buildings the new line that we have started is possible and under service structure we have been done many buildings about 5,000 buildings last year small buildings and we have done Anganwadi centers; we are looking at police stations; we are looking at other kinds of end users for these buildings as well. But yes, even low cost housing is certainly an opportunity for us.

Manish Bhandari My another question is regarding the railways/defense. Railways became non-existent for last two years before you have gone a full run in the railways and now if I understand from our conversation is that there is an order book in railway which has started coming back. And also I wanted to know your thoughts on the defense side; is there any play which we do any work we do from our product profile which would finally get in to the defense business which is likely to be a sizeable business going forward and the revenue the government regime and also what are the margins of the company can change dramatically because the railway which was non-existent and which was in contribution to the margin as admitted by you would change significantly over the next two years. So all you are planning which you did for two years back was excluding the railway or you are looking for revival in the railway and there is an additional defense which has come up now, which you were not expecting?

Aditya Rao Well, actually it is an excellent question so yes, Railways remains very important part of Pennar Industries it has not been for the last two years but the revival obviously shows us the potential that we have for our products and services for both the coach business and the wagon business. We feel that this business will continue to grow and I think the last two years there is more of an aberration . But we definitely have strong order books now we feel that there are lot more potential and expansion of our capabilities in that as well. So we are having a lot of discussions with ICF we are trying to see if we can become much more important part of the supply chain we believe they are already a very significant payer but there are certain other activities we can add. We can add under frame assemblies; we can look at body bolsters; we can look at end part, fronts parts. So I think where we are present right now is that we have lot of capabilities which can be used by the Railways and we think going forward the Railways will continue to be an important part and hopefully what happened two years ago will not recur that definitely something that we feel will not recur. In the defense industry we are starting to build up core capabilities. We have started defense revenue in PEBS we are an MES supplier, Military Engineering Services certified supplier we built a heavy vehicle factory near Avadi, from Central Government Departments also we received a lot of orders. There a lot more that can be done in this field and we are actually putting the team together to chase down opportunities in this field but as of right now it will be a little premature for me to comment but it is certainly is a very strong area of interest for us right now.

Manish Bhandari Just Railways and Defense and I was keen on knowing that is there any other product specifics or project specific engagement you would have with the defense of that product? I wanted to know.

Aditya Rao Yeah, I think mostly PEBS and Pennar Enviro but Pennar Industries we are now putting the team together to explore opportunities in the defense sector. Railway is of course a very important part of performance.

Manish Bhandari I have one question regarding the water desalination some kind of work what you do in there which is the water chemical treatment. So what is the scope of that work and how big that work would be?

Aditya Rao We actually have very strong capabilities in water desalination we provide yes, some additive treatment, specialty chemicals, and treatment packages as well which can treat water but we also do full-fledged desalination plants. In fact we are one of few companies in India which have actually completed desalination plants so we have Hetero Drugs example we have just completed a 2 million liter per day desalination plant in Andhra and we are working on several other plants right now. There is a large desalination plant order which we expect to get in the next year that is in the next quarter and that one order itself is over Rs. 100 crores. So feel there is a lot of opportunity in this sector and we derive this from our technical tie ups with the company in the UK we have an exclusive tie-up with them and they have been in to this business for well over 30 years and we have access to their pre-qualifications their engineering know how their technologies in order to cater to the Indian market. We feel de-sal will be a very big space to play in the water treatment industry in the next few years.

Manish Bhandari And usually this is sponsored by the municipalities and the state government or you have a private sector play in this?

Aditya Rao Desalination is used by a lot of process industries like power plants, steel plants, and cement plants. It can also be used for municipalities such as Chennai for example has built a 100 MLD de-sal plant I think IDEL has done that and the market is there in both and typically we have been present mostly in the industrial side and the private sector we do not do too much with municipal bodies but that is not to say what was these opportunities but as of right now we do not do BOOT projects we are more of a technology provider.

Manish Bhandari So my last question is regarding all the conversation we had and all your observation finally we should see a company which would have a 500 basis improvement in the margin over the next three years assuming we have a significant revival in the IIP in which we all are expecting and return on capital employed of 25% is that what the shape of the company would be?

Aditya Rao Correct I think ROC is a very important number for us. We are targeting (+20%). A lot of our businesses are plus the Railways and PEBS are both more than (+35%) in terms of ROCE. Going forward I agree with you we would not stop at 5 basis points. Pennar Industry is used to make a few years ago an EBITDA margin of 12-13% as well we are 14% world standing. We are obviously we have gone on a long way since then but that is not going to be allowed any further.

Everything that we add will be high margin businesses revenue is less important to us than cash flow and margins and everything that we add will be high margin business which will result in as we go forward as a share the high margin businesses expands further as PEBS grows as with a 20% variable contribution, as railways grows further, and as Enviro grows further with a 15% variable contribution we will see EBITDA moving up and that should happen soon. We definitely feel that margin expansion would be a key metric to monitor.

Moderator Thank you. Our next question is from Dixit Mittal of Shubhkam Ventures. Please go ahead.

Dixit Mittal Sir, just wanted to know this Enviro is a 100% subsidiary or there is some other industries also there in this?

Aditya Rao Look they are majority owned is by Pennar Industries but with an existing business that was that Pennar Industries invested in to so 51% is owned by Pennar Industries the remainder is owned by others.

Dixit Mittal Okay 51% is owned by a listed company?

Aditya Rao Yes correct.

Dixit Mittal And sir, in PEBS how much stake do we hold?

Aditya Rao Currently the stake is 75%.

Dixit Mittal Sir, any possibility of diluting it further or it will remain at 75%?

Aditya Rao We have brought in a private equity player about a year-and-half ago and so the current structure PEBS is 75% is owned by Pennar Industries and the remaining 25% is owned by the promoters of Pennar Industries. The reason that has happened was the company was initially supposed to be a joint venture between Pennar and NCI, in the last minute NCI converted in to a technical collaboration from a joint venture so balance had to be made up. At that time we had no guarantees on performance.

So the promoters stepped in and funded the remainder. Over the last one-and-half years the company has done quite well and have raised private equity so a company called Zephyr Peacock which is a very well regarded fund based out of New York has invested money they have not yet converted it but we expect that conversion would happen at some point of time. After conversion Pennar Industries' holding will be close to 62%.

Dixit Mittal Sir, can you share the valuations at which the stake will get converted?

Aditya Rao Post money the valuation of PEBS one-and-half years ago was Rs. 210 crores. We believe it will be higher than that.

Dixit Mittal And sir secondly, out of your total yearly revenues of around Rs. 1,500 crores sir, how much are from the value added engineering business and how much is from the commodity like business?

Aditya Rao Only 20% remains from the core commodity business but if you compare from low margin versus the higher margin business roughly about 50% to 60% of the company remains less than 10% margin and the remainder is more than that and then margin have been variable contribution without fixed cost being removed. So essentially removal of raw material, labor cost and other variable costs electricity, power and all of those production costs. Once those were removed we typically get 50% to 60% of our revenue we get less than 10% and for others we get more than 10% such as Railways and PEB and others.

Dixit Mittal And sir, you have shared your order book from railways and PEBS and sir, if you can share for other businesses as well like cold rolling and tubes these sort of businesses?

Aditya Rao So I will give you the numbers first. So PEBS order book is about Rs. 330 crores; our Railways order book is currently Rs. 90 crores but we see that growing again both I think we actually see that growing in the next few months. For cold rolling we typically do not maintain an order book it is a different kind of business and we typically have about 1.5 months worth of orders at any time so cold rolling this year will be close to over Rs. 300 crores in revenue.

Dixit Mittal And sir, in tubes also we do not have any like order book right now?

Aditya Rao Tubes is also very similar. There is a massive market out there really it is a question of us building capabilities and supplying but we do not maintain an order book for tubes . But yeah, we have foreseeability for the next two, three months that we do have it is not quite an order book it is not orders placed on us, it is an expression of requirement from our customers.

Dixit Mittal And sir finally, you mentioned that you will be spending the capacity in tubes. So how much is the expansion in that segment?

Aditya Rao Currently we have 2,000 metric tons capacity per month in ERW and about 500 metric tons capacity in CDW. After expansion we will go to about 3,000 tons ERW capacity and about 1,000 tons CDW capacity.

Dixit Mittal And sir, how much is the CAPEX that you have invested for this expansion?

Aditya Rao Overall it has been done in phases. The 1st Phase is Rs. 3 crores will take us up to intermediate 750 level in CDW and about 2,400 in ERW. The total CAPEX will be about Rs. 6 crores that is it. But that is not inclusive of the working capital margin requirement and other things.

Dixit Mittal And sir, finally currently if you see our gross block is around Rs. 500 crores and we are doing around 3x asset turnover. So going forward like you have mentioned that you will be spending around Rs. 40-50 crores per annum kind of a CAPEX. So can we say that this three times let us say turnover will be prevail or it can increase further?

Aditya Rao They will actually increase further because we will not be incurring our asset base as much as for every Rs. 50 crores they add we will add more than Rs. 150 crores revenue definitely. So we would actually expect at least Rs. 200 crores to Rs. 220 crores. So the ratio will increase.

Dixit Mittal So you will be targeting Rs. 40 crores to Rs. 50 crores per annum kind of CAPEX and generating around Rs. 200 crores of incremental revenues from that every year?

Aditya Rao That is correct. It is rather more than that in some cases but overall yes, that is you can take that picture.

Moderator Thank you. As there are no further questions from the participants, I now hand the floor back to the management for closing comments.

Aditya Rao Thank you so much. Thank you firstly for your participation, for the questions you have asked. As stakeholders we would love for you to be further informed about the company so I would like to invite all of you who are present to visit us in Hyderabad take a look at our manufacturing capabilities and our engineering capabilities at our other facilities in another cities as well. Our goal here is to increase the profitability of the company and improve the cash position of the company. Over the next few quarters for this financial year that is what we will be focusing on.

We are confident that over the next few operating periods we will be able to bring in large changes in the operating margins and the EBITDA margins in which the company has and with corresponding cash our cash levels also being maintained at a strong level we believe that we can do quite well in the next few operating periods in the next fiscal where we are optimistic about the future we are optimistic about this year for growth of revenue and profitability and look forward to your support as we try to implement our plans. Thank you very much.

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

(This document has been edited for readability purposes)