Pennar Industries Limited
Q2 FY17 Earnings Conference Call

November 11, 2016

MANAGEMENT:	**MR. ADITYA RAO – VICE CHAIRMAN & MANAGING DIRECTOR, PENNAR INDUSTRIES LIMITED** **MR. KRISHNA PRASAD – CHIEF FINANCIAL OFFICER, PENNAR INDUSTRIES LIMITED**
MODERATOR:	**MS. NIKHAR JAIN – EMKAY GLOBAL**

Moderator: Ladies and gentlemen, good day and welcome to the Q2-FY17 Results Call of Pennar Industries hosted by Emkay Global Financial Services. We have with us today Mr. Aditya Rao, Vice Chairman and Managing Director, and Mr. Krishna Prasad, Chief Financial Officer. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now hand the conference over to Miss Nikhar Jain of Emkay Global. Thank you and over to you Madam.

Nikhar Jain: Good morning everyone. I would like to welcome the management and thank them for giving us this opportunity. I would now hand over the call to the management for the opening remarks. Over to you Gentlemen.

Aditya Rao: Thanks to all the stakeholders of Pennar Industries. Thank you for joining us for the second quarter performance conference call. For the quarter in question, we had good growth in revenues; two out of the four business units in the standalone business and five out of the seven businesses in the consolidated entities recorded growth on revenue and EBITDA. We however, had challenges in two business units, which are our Steel products business unit and our Industrial components business unit. Our Railways business and our solar business did exceptionally well; our tubes business too scaled up very well in terms of both revenue and EBITDA. PEBS continue to have a good strong growth quarter along with material improvement in working capital cycles and our accounts receivables, more specifically. And our Environment business also continued to scale well with high double-digit growth, over a 100% growth, I would say.

In terms of the financial performance for the second quarter and for the half year, as opposed to the second quarter gross revenues last year of Rs. 389 crores, we have gross revenues of Rs. 420 crores for the consolidated company. EBITDA margin for the consolidated entity was at 11.1% compared with 10.1% in the same quarter last year.

One of the things we put a lot of focus and effort on is margin protection and more importantly growing margins. Well, this was something we were unable to achieve in this particular quarter completely due to the increase in steel prices. So, we had the imposition of a minimum input price (MIP), safeguarding duty, anti-dumping duty and the combination of these factors did not result in margin contraction for both PIL and PEBS, as our ability to pass through was good.

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But we were not able to pass through all that we need to retain margins, the raw material price increase plus our margin, which typically tends to be about between 10% and 12%.

A lot of our customers, especially in these two business units which underperformed, the steel business units and the industrial components business unit, are still absorbing these cost increases and these price increases. We believe in the next quarter we should have stability in prices and while there will be some increases, they will not be of the same nature as they were in the first half of this financial year. That said, we will continue to have growth in these verticals, even in the steel products business unit; the older commodity business underperformed but our Special Grade CR business did pick up; however, not enough to compensate for the fall in the commodity steel business and in the industrial components business. But there was good growth and in line with our expectations for the year.

Our systems and projects business recorded extremely high growth from Rs. 64 crores to Rs. 111 crores, our tubes business increased from Rs. 34 crores to Rs. 41 crores for the quarter; industrial components again saw a decline from Rs. 17 crores to Rs. 13 crores, primarily because of uncertainty over steel prices leading to our schedules being dropped. The steel products business unit, as I mentioned, also recorded a fall from Rs. 92 crores to Rs. 78 crores.

In terms of the subsidiary company's performance, I would mention that PEBS continue to do well with a strong order book. It is well in line to reach its targets for this financial year. And for the quarter in question there have been total sales of about Rs. 136 crores gross sales and then EBITDA of 13.3 crores at 11.11%.

Pennar Enviro had gross sales of Rs. 25 crores and an EBITDA of Rs. 1.16 crores. So, for most of this quarter, we have spent time on completing our Capex projects. We have a new plant coming up for Pennar Industries in Morinjapally. This is one of the most significant Capex events we have had in this company for a while because this plant will incorporate our hot-dip galvanizing capabilities, strip galvanizing capabilities, a new door and window section mills and very significant expansion in our solar roll forming capabilities. We are also expanding into stainless steel tubes at this facility and we are looking at improving and increasing our fabrication capabilities. So, this is a 100-acre land project that we have taken up and we are confident of finishing this by March; the vast majority of the projects will be completed and everything that is mentioned is projected to be completed by March and the impact on revenue would be very substantial.

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We expect the total Capex for this project to be between Rs. 40 crores and Rs. 50 crores. And we are quite confident that whatever revenue we add, any CAPEX that we put in, the project goes into revenue generation which is at an EBITDA margin of higher than 10%. So, we are confident that we have capped off a good strong quarter and what I believe to be circumstances where we never expected prices to increase by this much but we did cover it very well and all the order books that we have are covered; whether that be our Railways business where we have an order book of a Rs. 100 plus crores, our solar business where we have a Rs. 150 crores plus order book or our PEL environment business, the entire raw material and procurement risk for all these businesses have been covered; correspondingly, we have seen an increase in interest cost as well but I think we are quite confident of closing over the year by achieving the targets we have set for ourselves and, with the new Capex project coming on line, we are well placed for strong double-digit growth in the next financial year as well.

With that, we would like to hand over to the moderator for any questions you may have, we also have our CFO, Mr. Krishna Prasad, here with us and Harsh from our Investor Relations team. So over to you for any questions you may have.

Moderator: Thank you, ladies and gentlemen, we will now begin with the question and answer session. We take the first question from the line of Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: I just missed the location of the new plant that you were talking of.

Aditya Rao: It is near Morinjapally, close to Hyderabad. It is about an hour and a half from Hyderabad. A lot of our plants are along the same road and this is the largest plant we have built in a long time.

Vikram Suryavanshi: So, land is already acquired or are we in the process of acquisition?

Aditya Rao: Land is acquired, entirety of land is acquired. We have started execution as well, the civil works are ongoing, the building orders have gone out, equipment has already been ordered for all the various business divisions which we are going to set up here and we are quite confident, the implementation is well in advance, I would say.

Vikram Suryavanshi: In Enviro business, our revenue what I heard was Rs. 35 crores and EBITDA was Rs. 1.2 crores, is that right?

Aditya Rao: No. The revenue was Rs. 25 crores and EBITDA was Rs. 1.16 crores.

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Vikram Suryavanshi: And how is the order book in Enviro?

Aditya Rao: Quite strong. In the quarter in question, we have received orders from L&T, from United Spirits which is a big repeat order that we have been looking at for a long time, from JSW energy for a Demineralization water plant and several others. So, the order book right now for Pennar Enviro is higher than Rs. 200 crores.

Vikram Suryavanshi: So, can we expect a substantial pick-up in execution because I think our order book has been substantially high for the past few quarters, so current run rate in terms of revenue probably I think?

Aditya Rao: The way to look at this is a ramp up, because Q2 is a monsoon quarter, so typically whatever implementation cycles we have, the best comparison would be quarter on quarter, we have Rs. 25 crores this year, the same number last year was Rs. 13 crores, so it is a growth of almost close to 86%. We believe this will continue, in the next quarter also; you will see a higher number in Q3 than you have seen in Q2 and Q3 is a higher number than Q3 last year. So, both QoQ and YoY high growth is continuing and that is the way we will bring in further growth. So, execution is improving and so long as in every quarter on quarter, we record a high double-digit growth, we will more-or-less achieve what we want to achieve.

Vikram Suryavanshi: And Sir, components business, was the impact mainly because of volatility in steel prices or is there any overall impact of business as well?

Aditya Rao: It is entirely because of volatility in the steel prices. Let us say, if we had a situation in the last six months where our prices went up, raw material prices shot up for the core HR raw material and for other value-added raw materials. We had prices shoot up from what was INR 29,000 to close to INR 35,000 which is a pretty massive increase of about 25%. Now when you run this across the product categories, the ones that are the most affected are white goods, engineering goods and of course the core commodity business, so that is something that we thought could happen but it is taken because once prices stabilize, we will expect to get that revenue back but as of right now, everyone is dropping schedules; typically, industrial components have customers such as IFB, Wabco, TVS and others and all have them have dropped schedules right now. So, the drop is pretty precipitous. Our hydraulic business has started picking up and these are modest numbers so to speak, we are only expecting Rs. 7 crores or Rs. 8 crores this year from hydraulics but it is compensating for the fall in others. We have also started working with other customers on trial orders. I cannot give their names right now but I think industrial components as of all, this year will grow but the last 3 to 4 months have been challenging in

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terms of running up revenue and advance business. It is the smallest business in the company right now but we do expect it to creep up, once price is stabilized.

Vikram Suryavanshi: Yes and the last question on this Special Grade Steel, how is the production on monthly basis and what kind of revenue are we able to generate now?

Aditya Rao: Special Grade CR has scaled up; right now we are at 800 tons. We will reach 1,000 tons this month, I am quite certain of that. The ultimate goal is for us to reach 2,000 tons. I think it will take us about 6-7 months more to reach that number, by the year end we are quite confident of reaching 1,500 tons. For reference purpose, a 1,000 tons add close to about Rs. 60-70 crores in revenue and 1,500 would add close to Rs. 130-140 crores in revenue annually.

Moderator: Thank you. We take the next question from the line of Rita Tahilramani from Edelweiss. Please go ahead.

Rita Tahilramani: From the Railway, what is the current order book? As you mentioned, it is somewhere around Rs. 100 crores but, as on Q1, it stood at around Rs. 180 crores, so am I getting the numbers right or wrong somewhere?

Aditya Rao: Rs. 190 crores would probably be our revenue projection for this financial year for Railways; that is the one number that dovetails well for expectation from Railways but the order book as of right now is as high as it has ever been for coaches and for wagons too it is coming in strongly. So, we have recently picked up orders not just from ICF which is traditionally where we get our coach orders, but also picked up from Modern Coach Factory. So, order book is only going up right now, it is not going down.

Rita Tahilramani: So currently, how much is the order book?

Aditya Rao: For coaches, it would be close to about a Rs. 100 crores, for wagons it would be close to about between Rs. 30 crores and Rs. 40 crores depth; we are expecting some more orders from Texmaco and other companies,

Rita Tahilramani: And the revenue currently is?

Aditya Rao: As of right now, for the first half of the year, railways would have done close to about Rs. 90-95 crores, I will tell you the exact number.

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Rita Tahilramani: And with this new order for the Shatabdi and the Rajdhani trains coming up for the side walls, are we picking up the orders from that end also, are you getting orders from there?

Aditya Rao: So, what we do in Railways primarily is, for a wide variety of coaches, we actually provide the end walls, side walls, the trough floor and some under pavements and the components. So, these can be demo coaches, MU to EP coaches and others. Right now, for MCF, we have started supplying these components, entire system will get into a little later but, as of right now, it is RCF direct cleaner whether they are using them for Rajdhani or others; I do not have foresight on that but I will look into it.

Rita Tahilramani: Currently we do not do it, okay. How much of the side walls do we actually manufacture per month, is it somewhere around 21, 22?

Aditya Rao: That is accurate for, what we call our ICF side walls, 21 is our current run rate. From our capacity point of view, we can probably increase that by about 20%, for MCF orders which it is much higher, so it is about 40 right now is what we are building up and we also have plans for Capex on that business generate to cater to Raebareli as well, so right now it is at 40 to a month's side.

Rita Tahilramani: And what would be our market share for each of these coaches and wagons and who are our competitors in this business?

Aditya Rao: In terms of supply, our market share would be close to about 30% in coaches for ICF and MCF I think it is slightly higher. The other players in this field are TI, Indra and one other company.

Moderator: Thank you. We take the next question from the line of Annirudh Agarwal from AAA Investments. Please go ahead.

Annirudh Agarwal: My question was about the systems and projects side, where we have seen the margin kind of drop from 14% to 12%. So, is this mainly due to the change in on execution mix or how should I look at it?

Aditya Rao: I think what you should look at is that the solar has gone up, now Railways tend to be at a very EBITDA, solar tends to be with range bond between 10 and 12, the orders have picked up, as we have increased scale, proportion of solar has gone up which has brought EBITDA down slightly but the individual business units such as railways and solar are pretty at or near their margins. So I would not read too much into the systems and projects EBITDA drop, I think. It

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is a healthy business and I think, going forward, once the raw material prices also stabilize, you can expect margins to return, if not growing.

Annirudh Agarwal: And what is the kind of competitive intensity we are seeing in the solar business?

Aditya Rao: As of right now, I think all of our major competitors are pretty full, we ourselves are full; frankly if we execute the order book we have in solar itself, it would be no easy task but we are still continuing to book orders for past Q4, we are now booking for Q1 of next year and the competitive intensity so to speak continues to be quite good. I think a lot of players are adding capacity. We ourselves are adding significant capacity as well. So I would say, as of right now, we are not struggling to book solar orders. In fact, we have 2 or 3 order closes today itself and I am quite confident that we have a good chance of closing those orders.

Annirudh Agarwal: So any kind of timeframe you could give me on when could we expect to see Rs. 150 crores order book executed?

Aditya Rao: It has to be executed almost entirely in this financial year probably.

Annirudh Agarwal: And in the environment business, the Rs. 200 crores order book that we have, what kind of timeframe do we expect?

Aditya Rao: It is a little more open, so our customers are across a broad range of industries, each with their own implementation timelines. So some are much quicker; definitely the water projects will go a lot quicker, some instrumentation orders that we have and others will take a little longer, I mean they could be as long as one year but the vast majority of the Rs. 200 crore order book will get implemented within the next nine months.

Annirudh Agarwal: And what about the margins in the environment business; should we see an uptake or basic kind of a steady state margin that we expect, going forward?

Aditya Rao: You will definitely see an uptake; I think we are also being very sure and very conservative when we estimate these margins; in actual fact the operating margins that we get from our customers, which is margin after variable trends to be about 15%, so you bring in more and more of that revenue into the company you will see margins creep up, I am very confident of that. So I think the steady state margins will constitute of Pennar Enviro and are in line with our other businesses, you should consider 10% up as a target but it is still early days for Enviro, we are still in ramping up the revenue, we have over a 100 engineers in the company and the mean cost we have is manpower cost, so like any engineering company I think as you

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have been scale in that is when you start seeing the better margins but it is good ROCE, it is good return on capital employed, there is hardly any debt in the company. So I think it should be taken on the basis of what the company will look like as we go down a few more quarters, a in few more years it is a good generator of profits and even this financial year it is a net cash flow positive business.

Annirudh Agarwal: And any kind of medium term targets you have for the company as a whole, say a three-year time frame, in terms of revenue, etc.? Consolidated Pennar industry?

Aditya Rao: We have our internal targets and internal budgets and our goal is to achieve those and I think we are well in line to achieve those, I do not see more than a variation, (+/-5%) I am sure we will end up where we wanted to be in this financial year, from a revenue, EBITDA and PAT basis. No surprises this year so far.

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

Vikram Suryavanshi: Apart from this Rs. 40-50 crores Capex on the new plant, is there any other Capex we are envisaging and how will this Capex be funded?

Aditya Rao: Other than this Morinjapally plant, we have our regular tube expansion in Isnapur, again a lot of these would be funded entirely through our own terms, so we have steady state Capex for growth and each business invests in its own; so we have regular Capex expansions in Chennai, Isnapur and others. The total for all these projects, together, will not be more than Rs. 10-15 crores.

Vikram Suryavanshi: And this Rs. 40 crores which we have for this plant, are we raising any debt for that?

Aditya Rao: We would be doing it; 50% will be financed by us and 50% through debt.

Moderator: Thank you. We take the next question from the line of Anirudh Agarwal from AAA Investments. Please go ahead.

Anirudh Agarwal: What is the outlook on the tubes business?

Aditya Rao: Tubes has done well this quarter and with high double-digit growth. I can mostly talk of what has happened this quarter where we have seen sales growth of about 20% and EBITDA growth of close to 30%. I think you will continue to see as CDW sales go up, I think you will continue

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to see revenue expansion and margin expansion more importantly. So, in tubes, our targets this financial year are current 2000, 2200 tons to get to 2500, 2600 tons by the end of the financial year. Next year I think you are going to see a much more rapid growth as well because you will have stainless steel tube mill up, we will have our regular tubes, ERW tubes Capex increasing and we are also adding a lot of draw benches for CDW, so the combination of all of that puts tubes in a place where it will continue to see high growth for the next few quarters. In fact, it actually has time limits and from a revenue point of view, though margins have expanded, now I think we are confident of both revenue and margin growth in the next few quarters.

Moderator: Thank you. Since that was the last question, I now hand the conference over to the management for their closing comments. Over to you.

Aditya Rao: Thank you for your time. I am not sure we have another caller but we will continue to focus on scaling revenue and profitability and I think commodity price increase notwithstanding, all business units are in a good place to scale up and we thank you for your support in all of this. And we welcome any questions you may have afterwards as well.

Moderator: Thank you. On behalf of Emkay Global Financial Services, this concludes the conference. Thank you for joining us, you may now disconnect your lines.

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