"Pennar Industries Limited Q2FY13 Earnings Conference Call"

November 13, 2012

MODERATORS **MR. NRUPENDER RAO – CHAIRMAN, PENNAR INDUSTRIES LIMITED**
MR. ADITYA RAO – EX. DIRECTOR, PROJECTS, PENNAR INDUSTRIES LIMITED
MR. RAVI RAJGOPAL – CFO & COMPANY SECRETARY, PENNAR INDUSTRIES LIMITED

Moderator Ladies and gentlemen, good day and welcome to the Q2FY13 Earnings Conference Call of Pennar Industries. We have with us today, Mr. Nrupender Rao – Chairman; Mr. Aditya Rao – Executive Director and Mr. Ravi Rajgopal – CFO & Company Secretary. As a reminder, for the duration of the conference, all participants' lines are in listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" and then"0" on your touchtone phone. At this time I would like to hand over the conference to Mr. Nrupender Rao. Thank you. And over to you, sir.

Nrupender Rao Good afternoon, everyone and thank you for joining us today and wish you all a very happy Diwali. The overall economic scenario in our country remains tough and continues to impact the key sectors of the economy. The industrial sector, the infrastructure sector and the capital goods sector have been definitely impacted. We have recently seen that things are improving and the index for industrial production was just about flat now. The Wholesale Price Index based inflation was increasing at the rate of about 7.8% due to recent hike in fuel prices. In recent quarters, we expanded our product offering and we have now developed them, perfected the products and we feel that these areas will have significant growth potential and even in tough market conditions we feel that we can ride over this condition. Our pre-engineered building subsidiary is performing very well and actually has been growing despite the difficult economic conditions. One of the main reasons for Pennar Industries overall top line coming down is due to railways not giving in enough orders. The first six months we found that the railways orders were not adequate for various reasons. The new product lines such as structural for solar industry and precision tubes are making increasing contributions to the overall growth of the Company.

Now, coming to the performance for the quarter that is Q2FY13 the consolidated gross sales has decreased by over 7%. This is primarily due to slow order inflow in the Infrastructure segment. Actually there have not been much reduction in the consolidated quantities but there has been a reduction in the total value because of low realizations from railways. The Infrastructure segment slowed down quite a bit, however our subsidiary has shown very good growth momentum and it contributed to 24.5% of the total consolidated net sales of our company which is up from 20% last year. My colleague, Aditya, will talk about PEBS performance in detail. Engineered Products division net sales was up 27.3% and EBITDA increased by around 8.1%. The Heavy Engineering segment shows marginal improvement and was relatively flat compared to last year and was about 8.3% up compared to last quarter.

We are pleased to also make important announcement that there has been a significant organizational change in the company and we have brought in a very professional gentleman called Mr. Suhas Baxi as the President and CEO of the company. He was previously the Managing Director of Demag India, earlier he worked for Thermax for over 14 years and overall he has 24 years exprieence in the industrial and engineering sector. We are confident that Suhas joining us will make significant contributions to the company's ambitious target for growth and diversification. So now I will ask Mr. Aditya to go ahead and talk to you about the Engineering Building subsidiary.

Aditya Rao Thank you sir. I would also like to thank everyone who is with us on this call today. In spite of difficult economic conditions, the PEBS division has continued to perform well in line with our expectations. Segmental revenue increased from Rs. 57.4 crores to 62.6 crores for the second quarter of the financial year. We received a number of good orders this quarter including IOT Infrastructure; a 43 crores order which is the largest we have ever received. Repeat orders from Larsen & Toubro and Kirloskar Pneumatic which reiterates the trust and confidence that our customers have on us. During the quarter we have also completed the execution of 100 metre clear span building for Ultratech Cements. This is the largest pre-engineered building in India made by a company and it continues our tradition of being the first to make several marquee buildings and projects in India. Our current order book is about 280 crores and we are confident of being able to achieve the target we have set for ourselves this financial year. With that I would like to hand it back to our Chairman, Mr. Rao.

Nrupender Rao Thanks Aditya, Looking forward, we expect some stress in the economy in the near term but the recent reforms the government has announced are expected to improve the Infrastructure investments. The setting up of the National Investment Board under the Prime Minister for a single window clearance for large Infrastructure projects is expected to ensure fast tracking of the clearance process and management remains optimistic on the long-term growth of the Indian economy. We are quite optimistic that the slowdown is over in the Indian economy and now onwards we will see growth. Already we are seeing movement in the automobile sector which is one of our major customer segments and I think we will see more of these segments moving forward in the next couple of months. I would like to pass on to the moderator for an interactive Q&A session.

Moderator Thank you. We will now begin the question and answer session. We are going to take a first question from the line of Giriraj Daga from Nirmal Bang Securities. Please go ahead.

Giriraj Daga Which segment of the Infrastructure has seen severe stress? Because Infrastructure revenue has also gone down like 48% YoY. What I understand is Cold Rolled largely we supply to Automobile. But Automobile, which segment, particularly, CV segment or which segment we are witnessing a good amount of stress

Nrupender Rao On the Automobile side our main customers are in the LCV segment, that is a Light Commercial Vehicle segment. Tata, Ashok Leyland, Eicher, these are our main customers and now the things are moving towards the better and we are already start getting orders from all three of them, so we expect things to improve further. In addition, we make a lot of auto components that goes into the auto sector, the Tier II and Tier III companies. As the auto has picked up we expect results to be much better on that side. Your question was on the Infrastructure side. We make a lot of building products for roofing systems, for purlins which are for roofing, side cladding and deck plates; deck plates are used in power plants. The power plants activity also has come down. So the activity in the Infrastructure area has not been as we planned earlier. So it is coming down and we expect it to move forward, it may take another month or two.

Giriraj Daga About the Heavy Engineering, it is largely Railways I guess, right?

Nrupender Rao Heavy Engineering is largely Railways and we had a little slow down in the Railways because enough wagons and coaches were not ordered but we are now seeing a lot of activity on that front.

Giriraj Daga With respect of revenue from railways, ordering may have started, but whether it will reflect in revenue from this quarter or next quarter or starting from April '14 onward?

Nrupender Rao No, what happens is for example, wagons, the moment the Railways board decides they will place the wagon orders on Titagarh, Texmaco and they immediately place the orders on us and all that will happen within a month's time. So we are expecting movement within this month, next month for sure.

Giriraj Daga So largely expect second half to be quite better compared to the first half?

Nrupender Rao Definitely.

Giriraj Daga Would you have any target in mind and you like to share what kind of revenue basically you are looking?

Nrupender Rao We cannot exactly put a number on that we are still working it out and that will become more like guidance and we are not ready yet for that.

Giriraj Daga But anyway, whether we will be able to match the last year number because first half we are not able to?

Nrupender Rao No, it will be better than the first half and our endeavor is to make a good improvement and we are hoping to match last year's second half, that is our thinking anyway.

Giriraj Daga As we are witnessing slowdown, so what is happening towards the Capex side, are we continuing with the Capex in the…?

Nrupender Rao Capex, we had put for production of special quality tubes and that is already implemented and the tubes production has started. We have already started supplying special tubes for automobiles and trial lots are already going. So no further big Capex is planned for the second half. So we think we want to wait for the second half and then only in the next year look at it. So to answer your question, there will not be any significant amounts of Capex in the second half.

Giriraj Daga And last question is related on dividend and the cash. Like first of all, dividend will be maintained at the current level of last year and the remaining cash will be used in debt paying or whether we will use the debt paying as a first measure and may cut down a dividend also looking at the market conditions?

Nrupender Rao As far as dividend is concerned, that is for the board to decide and board will decide at the appropriate time, which is probably at the end of the year. As far as other things are concerned we are basically focused on managing cash and improving the situation. So as you can see our borrowings are actually little less than what it was earlier.

Giriraj Daga Inventory has also come down?

Nrupender Rao Yes, we are managing very tightly considering the situation, but overall we have no plans to borrow more money or to do anything further like this in the second half.

Giriraj Daga One question for Aditya. About the expansion in what we had been discussing or talking planning about the North India expansion, is it on track, what is the status there?

Aditya Rao The expansion that we have been contemplating is very much in play, we now have a pretty strong order book built in PEBS. So by the end of this financial year certainly we would want to get capacity in the north of India up and running.

Giriraj Daga Have you already started marketing of this capacity?

Aditya Rao Yes, as I mentioned, we have received a pretty large order from IOT Infra, Indian Oil Tubular, which is a joint venture between Indian Oil and Oiltanking of Germany. A significant portion of their order can be shipped out from that plant.

Moderator Thank you. The next question is from the line of Nishar Gotharia from Lucky Securities. Please go ahead.

Sachin Kasera This is Sachin Kasera here. Just want to get some sense from you on the Tubes and the Solar division. I believe we were pretty optimistic on those. So how are things progressing on those fronts?

Aditya Rao Let me answer you have on the Solar division. Solar has been something of a new division for us and it picked up very quickly last year. So we closed last year around 92 crores in the Solar division. This year we expect it to be better, at least a 20% top line improvement. More importantly, we have just received orders from ABB and several others including Neosol, Azure Power and others. We are trying for some orders from L&T and other companies. We are pretty hopeful that this year Solar will be a very significant contributor like last year to our revenue. Most of this will be built in H2 of this year which is one reason why our projections for the second half of the year are that optimistic. But essentially, what we are also providing is a very PEBS model where we are actually looking at doing a design engineering, manufacturing and project management of solar, structural frame existence.

Sachin Kasera How have we done in the first half on the Solar side?

Aditya Rao Solar is a very cyclical industry. Most execution happens from March the financial year, so the first half would be a very low number, it would probably be around 10 crores or so. If you look at last year as a benchmark for example and the orders that we have right now for this year the benchmark from this month onwards is when the solar shipment start going out, so we think it is a realistic figure. As far as Tubes division is concerned, Pennar industries foray into CDW Tubes, it is picking up steam, and we had about 61 crores in terms of top line in Tubes, mostly ERW last year. This year with the combination of CDW Tubes, we expect to do about 125 crores. As a division stabilizes, our margins are improving. In the month we just finished we had better margins than the last month and the last to last month before that.

Sachin Kasera Is it against 61 crores last year?

Aditya Rao Yes.

Sachin Kasera If I got right, the Chairman mentioned that we expect the full year with H2 to be better compared to H2 of last year and are we looking forward to, with the full year being same as last year, or are we just expecting the H2 to be same as H2 of last year?

Aditya Rao I think we would pretty much have parity of H2 last year and H2 of this year. Maybe a little more, maybe a little less. We are not going to be giving guidance but one thing we do know is that H2 is going to be better than H1 of this year.

Sachin Kasera Which would mean that considering H1 has been much lower than H1 of last year, we could end up with FY13 as a year being much lower in terms of profitability over FY12 that is a possibility as of now the way things are looking?

Aditya Rao As we are not giving guidance, I would not be able to give you a firm figure in terms of profitability but I think we are going to say that this year is a one of sustenance for us. So we are looking to replicate last year. That might be a bit of challenge, but we are geared up for it, we have the orders for it, PEBS is doing well, Tubes are scaling up very well, solar continues to do well and I think if we are able to get all of these orders out, push them out in the next five months we have for this financial year, we might end up with the good year.

Sachin Kasera On the Heavy Engineering side, how do you see second half? Chairman did mention we started to see some orders and all. If you could throw some more light on this?

Nrupender Rao Yes, Railways have basically two segments, one is wagons and one is coaches. In Coaches segment, we supply to Integral Coach Factory in Perambur, which is our main customer, and of course also to BEML and a few other customers, but more importantly, Integral Coach

Factory. As far as the wagon profiles are concerned, they mostly go to wagon manufacturers, who manufacture the entire wagon, like for example Titagarh or Texmaco who are two of our major customers. It could be Braithwaite and Standard and a number of other people, but basically these two, three customers are very major. Last year, I think our Texmaco itself gave more than 100 crores worth of orders to us. So, these two people and one or two other people are expecting good orders now that there will be a change in guard in Delhi and obviously they have asked us to be ready so that they will give us the orders correspondingly. So we are expecting that in third and fourth quarters, there should be a pick up on the Railways.

Sachin Kasera I believe sometime back you were also looking at certain new initiatives in the areas like Defense, Aerospace. Could you give us some progress on that?

Nrupender Rao Because of the general softness in the economy, the new segments also are not moving that much. So we have given samples and prepared the ground, but we have not broken ground in terms of developing new markets, we expect that to happen in the Q4 and later.

Aditya Rao We have put manpower into the value-added defense sector. We have gotten registered with an MES, Military Engineering Services. This is the time-borne process, but we can probably have more on this for you by the end of the financial year. We have also got MES orders from a heavy vehicle factory and several others for buildings but we will be giving you more color more detail on this by the end of this year.

Nrupender Rao The order supplies are made in the form of two buildings that are going to defense workshops that we have been registered with and we have also started supplies to them.

Sachin Kasera And just one last question, a bit on the medium term what we understand that we have a challenging FY12 and even a little bit of challenge even in FY13 wherein we had impact both in terms of top-line as well as on the margins. Going forward what is the company internally working in terms of how do we see we are getting loft on over FY14 & 15. Do we see the margins coming back to good old days and how do we see the growth reviving in FY14 and FY15?

Aditya Rao Thank you, that’s actually pretty important question for us. We have made several changes to the way we are working, Mr. Rao has mentioned that there is a new CEO and he comes with a significant engineering experience. What we have managed in PEBS is to add design capabilities to what we have always been good at, thus speaking of system integration company. That business model has worked very well for PEB, it has worked very well for solar and we are very well structured to be able to add these engineering design capabilities and float whole new verticals. So we are taking a very good look at material handling, we are taking a look at the engineering designs and I think if we can replicate what has been done at PEBS, what has been done at solar, in auto components and in other sectors that we have in the ESP and others. We will create scalable business models which can put us in universe as much larger than we are right now. So right now for the next two years for us it will be about scalability, getting back on the growth part. So we are in the process with the new incoming CEO, of drafting our financial year '14 business plan, which will include of course, not just the budgeting of top-line and bottom line, but also the sectors and product developments which is going to happen next year. So we are pretty optimistic whether the market comes back or not, because of our ability to enter these new sectors, I am quite hopeful that we will very soon be going back into the growth path. I think since end of quarter 2 has been really been when Pennar Industries has found it difficult to put program and growth but I think that time is now at an end and I think for the next couple of quarters at least we are putting in place measures to ensure that we get back on the growth path. These will be new divisions, new products, new verticals, but they will be based on the fundamental strengths that we have in product development so we are pretty hopeful for what's going to happen in FY14.

Sachin Kasera So we are basically looking at much better FY14 and 15 over 12 and 13?

Aditya Rao Absolutely. Yes I would definitely say that's a yes.

Moderator Thank you. Next question is from the line of Theo Daniel from Unifi Capital, please go ahead.

Theo Daniel We see that the interest rate is higher in this quarter can you substantiate that please?

Ravi Rajgopal Interest rate actually is the function of bank interest rate also, but we are holding around 12.75 to 13 considering this market which is pretty descent number for us.

Theo Daniel On quarter-on-quarter basis also it has been high that's why I was wondering if there is something that we took in this quarter and then paid back or something …

Ravi Rajgopal For the year end, it will be around 13 crores. Last year around we took some loan and we are repaying it. It will be flat at around 13 crores like last year, not raised any additional loan

Theo Daniel In terms of margins, how are we going to be seeing the next two quarters because it has almost been flat in last two quarters, but how is it going to be in the coming quarters, if somebody could throw a light on that?

Aditya Rao Margins are essentially an output of products mix that we have. We have our cold rolling commodity product slightly higher margin products which are the engineered products and of course the highest margin products which are railways and the engineered components and deck sheeting. So in this product mix, the sectors that we are focusing on and we see growth coming in over the next two quarters are primarily in the solar industry, in the pre-engineered building industry and CDW tubes which are all high margins businesses. If I want to give an amalgam of these that we are adding business mostly in the 10 to 20% margin range. We have intent to pick up a lot of customers in the engineered components division which has done very well this year. And if these plans fructify and we strongly believe they will, we will see margin expansion in Q3 and Q4.

Theo Daniel Okay. Could you please share with us the margins that you have been seeing in last month at least like you said it has been better than the earlier months and so on, if you could tell us what the margin was in the last month and if you could at least give us a sense of what we are looking at?

Aditya Rao I don't know if that's a comparison that makes it, but I guess we can give it to you. Last month we were at about 9.5 to 10% EBITDA in the standalone company and PEBS is it around 10.5%.

Theo Daniel Okay in terms of PEBS you said earlier that the margins are under pressure in last quarters. Is this going to be sustainable at 10.5 to 11 or do we expect better margins?

Aditya Rao I am not sure we said PEBS EBITDA margins were under pressure, PEBS primarily books order at a certain contribution level, so that's where margin pressure comes in, if you are unable to book orders at a certain price which you are able to before. Now when we look at our order booking and we report a lot for our orders that we get we have been able to maintain a gross margin of 20 to 22% plus. Now the idea of course is that as you divide the gross margin larger and larger revenue over a smaller and smaller fixed cost base, then your EBITDA should expand and that's what we think is going to happen. So as far as margin pressure on PEBS is concerned, it will depend on our ability to push out scale in relation to our fixed cost and for the next two three months we expect to bill at least close to 30 crores a month so I would see margin expansion, I won't see margin pressure in PEBS on the EBITDA and PAT level. Contribution will remain the same.

Theo Daniel You have said that we would increase value added products with what we are already doing to have better margins if, that's what I know from the last call?

Aditya Rao And that has already fructified into orders. We have just booked around 16 crore orders at a very good margin product called cold form buildings. These are very different from what we have traditionally executed, but we have the design and manufacturing capabilities to complete them, so we have bidding a lot for those orders. Those are 16 crores right now, but we expect it to double over the next one/two months. As far as the engineered solar ordered are concerned where we have leveraged Pennar Industries' manufacturing capabilities, but we do the design engineering and the site project management that too is something that should yield some orders, we expect about 30 to 35 crores in this financial year. This will be additive of course and are not included in our projections for the year but what was shown, so both the cold form buildings and the solar orders will be additive to our year end revenue and margins.

Theo Daniel And in terms of PEBS you have also spoken about increase in capacity which it still says that your planning to increase capacities, is it still a plan or when are we going to see it realize?

Aditya Rao We are on track to look at capacity expansion coming in later this year, but certainly by the end of the financial year you will see this new capacity in the North of India hitting. There is also the potential for expanding capacity in Hyderabad that we are going a little slower, because we would want to concentrate on North India plant right now. So we are at 60,000 tons in the Hyderabad plant, almost expandable to 90 we have done a lot of the work but we will go a little slow, probably this time next financial year we will have 90 in South India and 30 in North India.

Theo Daniel And now you are looking at 30 in North India, is that right?

Aditya Rao Correct.

Theo Daniel Okay and in terms of railway orders, how much is the order book currently?

Nrupender Rao As we have told you, we want to do something better than what we did last year and last year we have had 200 odd crores in the railways and we hope to do similar amount this year. So we are already holding about 60-70 crores worth of order doing, and we expect to close the year definitely with something around 200 or more. That's the plan actually.

Theo Daniel Okay in terms that companies like Texmaco give you orders, what portion of their orders would come to you, is there particular percentage or do you have an agreement with them or anything of that sort?

Nrupender Rao Yeah incentives, Texmaco we have first supplier and we use to have something like 80% in one year two years back and even now we get about between 60 and 70% of whatever they get from railways.

Theo Daniel Any other clients?

Aditya Rao Titagarh Wagons and Besco also in Calcutta. Jessop, we don't do too much and Standard Wagons in Ghaziabad. So these are on the wagon side and on the coaches' side as we told you Integral Coach Factory at Perambur. We did about 60 crores last year. We definitely want to do that and little more, about 70 to 80 crores of business of that. If they made more coaches we will go up to 100 also but in fact there is an acute shortage of coaches and wagons for whatever reason the railways have not ordered..

Moderator Thank you. We got the follow up question from the line of Theo Daniel from Unifi Capital, please go ahead.

Theo Daniel What is the cost of capital that we are looking at for the year?

Aditya Rao The total cost of capital will be about 12.25% for PIL and for PEBS it will be about 11.35% that includes all capital at use, that's term loan, cash credit, non-cash limits such as LCs and BGs.

Moderator Thank you. As there are no further questions I would like to handover the conference to Mr. Nrupender Rao for closing comments, thank you and over to you sir.

Nrupender Rao Thank You very much and we wish you all a very Happy Diwali and let the festival of light bring more light into our industrial climate of the country which we are sure it will. And I think both from the central government and also the industry is moving forward and I definitely expect that the country is poised for a much better future in the second half and beyond. Thank you very much.

Moderator On the behalf of the Pennar Industries Ltd. that concludes the conference call. Thank you for joining us and you may now disconnect your lines. Thank you.

*****