Pennar Industries
Q3FY2013 Results Conference Call

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MANAGEMENT: **MR. NRUPENDER RAO- CHAIRMAN**
MR. ADITYA RAO- EXECUTIVE DIRECTOR
MR. SUHAS BAXI- PRESIDENT & CEO
MR. RAVI RAJGOPAL- VICE PRESIDENT (F&A) & COMPANY SECRETARY

Moderator Ladies and gentlemen, good day and welcome to Pennar Industries Limited Q3FY2013 Results Conference Call. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Joining us on the call today from Pennar Industries Limited is Mr. Nrupender Rao - Chairman; Mr. Aditya Rao - Executive Director; Mr. Suhas Baxi - President & CEO; Mr. Ravi Rajgopal - Vice President (F&A) & Company Secretary. At this time, I would like to hand the conference over to Mr. Nrupender Rao. Thank you and over to you sir.

Nrupender Rao Welcome to you all. I have great pleasure in introducing a new member of the top management team – Mr. Suhas Baxi, who has joined us recently as President & CEO. He is a very accomplished and competent Manager with rich industry experience. Before joining us, he was the Managing Director of Demag India and before that he was with Thermax. Suhas brings over 24 years of rich experience to our company and he has already taken a lot of initiatives to see that this company is well on the path for rapid growth. So I think you will have the pleasure of hearing him in course of time today.

I will pass on to Mr. Aditya to explain the consolidated results, then pass on to Suhas for Pennar Industries and also Aditya will tell you on the Engineered Building Systems. Over to you, Aditya.

Aditya Rao Thank you sir. As you are all aware, the overall economic environment in India remains difficult especially given the Manufacturing and Infrastructure sectors due to high levels of inflation, fiscal and current account deficits and current high interest rates have continued to put significant pressure on the economy. The Index for Industrial Production (IIP) declined 0.1% y-o-y in November 2012 with the Capital Goods segment registering a 7.7% y-o-y decline. In spite of our core customer segments being negatively impacted from Engineering, Automotive and Railways, we are pleased to announce net sales of Rs. 266 crores consolidated, with an increase of 2.5% QoQ; EBITDA also held steady at Rs. 28 crores, resulting in margins of 10.4%. Furthermore, consolidated order book position at the end of the quarter was robust at Rs. 460 crores enabling us to be confident as we look to the forthcoming quarters. With that I would like to hand over the call to Mr. Suhas Baxi, our new President and CEO.

Suhas Baxi Thank you, Aditya and thank you Mr. Rao. Having recently joined Pennar, this is my first opportunity to interact with you all. I am delighted to say that despite the current industry headwinds, the business is strategically well-positioned. Let me start by covering our quarterly financials and operational performance in more details.

Consolidated net sales have increased by 2.5% as compared to Q2 of 2013. This was primarily due to strong growth in our Solar Projects division. Further, our PEBS division is performing consistently, with net sales growth of 10.4% sequentially and this business now contributes to more than 25% of our total consolidated net sales, up from 22.8% in Q3 and 24.1% Q2 of FY2013. Our Q3 FY2013 EBITDA remains flat sequentially. On YoY basis, EBITDA registered a decline of 17.5%. This was primarily due to margin pressures in our Systems and Projects business. I would also say it is not just margin pressure in Q3. This is actually the result of lower sales in Q1 and Q2, which was essentially caused by lower sales in our Railways segment. The Q3 performance however seems to have brought us back to where we were in Q3 of 2012. As mentioned by Mr. Rao, lower demand in Auto and Engineering segment, Railways segment and Infrastructure sectors has definitely created pressure as far as demand from the market is concerned. It obviously creates a negative pressure on the Company's top-line and profitability. However, our higher level of consolidated order book underpins our revenue growth profile and potential over the next couple of quarters.

As a part of our group's diversification strategy, we have made investments in the Tubes and the Solar Projects business, and both these initiatives are providing very, very encouraging results. Another growth driver for our business has been the Industrial Components business wherein we are working on increasing our product portfolio and reach.

Looking to the future, we remain focused on related diversification into areas such as structural projects, where we have seen early success in the Solar Structures business; we enjoy benefit of operationally having a multi-locational manufacturing facility, and the advantages of our plants in Andhra Pradesh, Maharashtra, Karnataka and Tamil Nadu is something which we would want to leverage over a period of time and provide a competitive advantage to our business.

I will now hand over to Aditya for giving you more details on the Pennar Engineered Building Systems business.

Aditya Rao Thank you, Suhas. As mentioned already, the PEBS division has continued to perform well and it remains on track to achieve our aggressive growth targets. Revenues have increased to 67.5 crores in the Q3 and we received a number of high profile orders from new customers, including Hindustan Zinc, Ramky, Godrej, Hindustan Unilever, Continental Tyres, Oil Country Tubular and Jayabheri Group. Furthermore, I am glad to report a strong component of order book from repeat customers which we believe reflects the quality of our products and our services. During the quarter, PEBS achieved another major breakthrough in the form of the Cold Formed Steel Building segment which we commenced recently and have secured orders of 2,300 MT from Assam-SSA through East Line Steels.

And further developments, we are in the final stages of completing the addition of another factory in Gujarat which will add another 20,000 MT to our capacity and also allow us to tap the North PEB market more effectively.

Our order book has grown to 235 crores, and in fact in the month of January, which is a good month, it has grown further to 270 crores right now.

Other than the breakthrough is in the Cold Formed Steel segment line, we made our first entry into the Power Plant sector by bagging a 10.26 crores order from Ramky. We received appreciation for some projects for MES for Vishal Infra. And we have completed a 12 storied high rise building structure for Jayabheri Group, which we handed over in just 60 days. We believe the high rise building segment also offers tremendous opportunity for this sector going forward.

With that I would like to hand it back to Suhas to take us through our 100-day plan and future outlook.

Suhas Baxi After I joined the Company in December, my target was to look at what should be our area of immediate focus. Based on which we embarked upon a 100-day plan which is kind of creating strategy for Pennar during this year, for the next year, and the years after that. The main focus of this plan is 20 core projects that we have started. These projects are aimed at enhancing the business growth obviously both on the top line and bottom line side, driving operational efficiency. We happen to be in businesses where there is keen sense of competition in the market; some of our businesses may not be technology-intensive businesses and hence it is extremely important to achieve higher level of operational efficiency and obviously, create an organization where this operational efficiency can be sustained over a long period of time. The management intends to leverage Pennar`s multi-locational manufacturing base. Now, this is extremely important in our business.

As you would be aware, we have got manufacturing facilities in Andhra Pradesh at three different locations. We have got our manufacturing location in Chennai. We have got a manufacturing location in Tarapur in Maharashtra. And we also have a manufacturing location in Hosur. Now this obviously not only provides us an ability to create a diverse portfolio’s at various locations, but it also allows us to service our customers with logistical efficiency. Further, we have identified focus areas for business growth and are now in the process of building technology and delivery capabilities in these growth areas.

We remain committed and focused towards a steady recovery in the overall business performance driven by Pre-Engineered Buildings Systems, Industrial Components, Solar and Tubes business. As you would have noticed, Q3 of 2013 for us has been steady, a little higher in comparison to Q2. It is also steady in comparison to Q3 of 2012 and that in my opinion clearly indicates that our business in terms of product mix, in terms of what that product mix delivers to us has come to a point where from here, I would say, it is recovered and from here it can grow. The order book position, the kind of response that our new products have in the marketplace, both of it give us a confidence that we will see the next quarter at relatively higher level than where we are right now. So while the impact of what’s happening in the industry and what is happening in the economy is clearly felt in the marketplace, Pennar’s strategy of investing in the diverse product portfolio during this period has definitely helped us. We will continue to work on exactly the same strategy. Go to extended product areas, tap new markets and grow. And I think that is where our opportunity is and that's what our 100-day plan is focused on. Thank you very much.

If there are any questions from here onwards, you are welcome to ask the question.

Moderator Thank you very much sir. Ladies and gentlemen, we will now begin with the Q&A session. The first question is from the line of G Daga from Nirmal Bang. Please go ahead.

G Daga My first question is what is the feeling that you are getting from the Railways? Like after the price increase, Railways is becoming now a bit surplus in a position. So are they thinking of increasing order size, what is the status there, what is the thinking you are getting from the people there?

Suhas Baxi Our indication is probably exactly on the lines of what you just now said that after the price increase there is a good chance that there will be more orders coming for wagons and coaches, and I think we are very positive that this will happen. However, as I said earlier in my presentation, our dependence on Railways for the purpose of achieving the current level of turnover and probably also a little higher level of turnover from here is on a lower side. We would be very happy to do this additional business of Railways and we are exactly hoping for that.

G Daga As I just look at the debt number, largely working capital debt from almost 118 crores to 100 crores. So is this is a one-off seasonal item and next quarter again it will pick up or is it just like we are investing our cash in our working capital, what is the scene there?

Ravi Rajgopal The debt part of it will depend upon our growth strategy and other things. The current level of working capital is sufficient for the current level of operations.

G Daga My next question to Aditya about the PEBS. Order book, if I see compared to last quarter from 280 crores gone down to 235 crores by end of this December quarter, and if I subtract back like 45 crores and If I see the execution of 68 crores, we hardly got around 22 crores order. So has the inflow slowed down during the December month? As you said also that picked up in January. So was it a seasonal quarter slow down or what was that condition?

Aditya Rao As far as order booking for the quarter goes, it was very robust, more than what we pushed out. The total number of orders booked if you look at it from calendar to calendar perspective was 90 crores, but there were a lot of spillover of booking orders from December to the month of January, which is why order book jumped by a lot in January. So currently stands right now it is 270 crores. We really look at maintaining around this level in terms of an order book and future growth and scalability will come from not an increasing order book rapidly but by pushing out more into this. So we are focusing and we have taken an exercise to make our operating cycle short reasonably but even shorter to rationalize the raw material procurement and to see if we can get credit from raw material suppliers also, and effectively in that way allow us to essentially make sure that we can have a lot of confidence in the way we are pushing orders out month-on-month. Our revenues have gone up by 10% but our order book I would state that it is quite stable and we expect it to improve over the next few months.

G Daga What was our volume in PEBS this quarter in tonnage terms?

Aditya Rao The total volume would have been about 8,400 tons.

G Daga And for the 9 months you have the number?

Aditya Rao It will be close to 30,000 tons.

G Daga So we have capacity of 60,000 tons and so we are operating at almost 40,000 tons. That is the normal run rate we should assume?

Aditya Rao This is a little bit of a misnomer because it depends very intimately on the way the project is sized because only 50% of our capacity is a beam fabrication line which is a bottleneck. The remaining roll forming capacity can be anything. This quarter especially we are going to be doing a lot of Cold Form buildings which doesn't hit that bottleneck. Cold Form buildings essentially consist of Roll Formed components, back-to-back the channels. So we will essentially see better capacity utilization this quarter, that is also a geographical capacity paradigm here. So our plant in Gujarat is probably going to be operational in the next few weeks, definitely in about a month`s time from now, and we are immediately feeding that plant with orders. So the total capacity per se would go up to about 90,000 tons but in terms of our total output for the year, we will look at close to 40,000 – 42000 tons this financial year.

G Daga Next year any number?

Aditya Rao We haven't yet completed our budgeting and planning exercises but I think I can go and say there will be growth.

G Daga I understand because you are adding 50% capacity. Would it be near about 55,000-58,000, that should be the right number to go by, because we will operate at almost 2/3rd of the capacity?

Aditya Rao We will have a very significant double-digit growth, but the exact number is something which while we are working on it internally, and we will be able to give that to you very soon.

G Daga How much CAPEX we have done on this new project?

Aditya Rao The new expansion in Gujarat is actually a lease project. It is an existing plant that we took over and it is a long-term lease agreement we have with them. CAPEX is very minimal. The amount of cash spent was very low, close to 3 crores.

G Daga Any amount pending to be paid to the lease supplier?

Aditya Rao No more. There is of course a yearly rental fee that will come in for use for the plant and buildings, but it is a long-term lease and it is a secure arrangement that we have got into. So we will look at a steady state amount of about 3 crores being paid every year, which is inclusive of user buildings, land, rental, equipment, everything.

G Daga That would be around roughly you can say, not much, 2% of your revenue?

Aditya Rao Much less. Also the advantage from that is also break even is very low, at 500 tons output, we would break even and we are confident that next week we will be booking an order based out of Mumbai which will allow us to get the break even in the first two months.

G Daga And any thought for FY14 as a company as a whole from Mr. Rao?

Nrupender Rao Suhas and Aditya are undertaking a very elaborate budgeting exercise. So I think by the time we meet next I think the budget will be ready, and I am sure we would like to share the budget with you.

Moderator Thank you. The next question is from the line of Ankur Jain, individual investor. Please go ahead.

Ankur Jain Could you please provide the debt figure and the breakup of the consolidated figure as of 31st December 2012?

Ravi Rajgopal The debt figure for the company as a whole is 117 crores consolidated.

Ankur Jain And what is the breakup of that into term loan and working capital?

Ravi Rajgopal In terms of long-term borrowings, it will be about 37 crores and for working capital part of it which we get it from the bank is 99 crores and we have the cash equivalent of 19 crores. So net debt is coming to 117 crores.

Ankur Jain What is the blended cost of debt for the company?

Ravi Rajgopal Around 12.50% - 12.75%.

Ankur Jain So in this current quarter, we see a finance cost of 6.94 crores, Could you please provide the breakup, what is the total amount spent on bank interest and other charges?

Ravi Rajgopal 6.95 cr is for the consolidated basis. For standalone company Pennar as such is 4.6 cr..

Ankur Jain I want to know what is the breakup of this 6.94% into bank interest and discounting charges?

Ravi Rajgopal 460 lakhs which is the interest which we have shown, the interest for the bank is 2.57 and 2.03 is for bank discounting. This will depend upon the mix. May be here it is 5:4; somewhere it will come to 5:3 also it will come depending upon our the terms with the bank and what is the rate of interest that one discounts etc.

Ankur Jain But the numbers, for example in this current quarter, the finance cost is 6.94 cr.

Ravi Rajgopal That is including consolidated number.

Aditya Rao Including PEBS, if you want, PEBS breakup, PEBS pays 52 Lakhs a quarter on term loans and working capital cost is around 1.7 crores inclusive of LCs, BGs and other instruments.

Ankur Jain I want to ask another question and this question is about the CRPS which are outstanding for the company. They are close to around 1.7 crores CRPS which are outstanding. Though the financial position of the company is very good and there should not be any problem in the redemption of those CRPS, but is the company in the process of creating any redemption reserves for the same?

Ravi Rajgopal We plan to create the redemption reserves for the preference shares. I think in one of the discussions, the suggestion has been floated and we will definitely consider it this time..

Nrupender Rao The preference shares are to be redeemed in three equal installments, starting next year, year after and year after. So we don't see any difficulty in redeeming that and we will do it whenever it comes.

Moderator The next question is from the line of Ruchita Maheshwari from Nirmal Bang Securities. Please go ahead.

Ruchita Maheshwari I just want to know what was the revenue in Solar business during this quarter and last quarter?

Suhas Baxi It was 45 crores in Q3 and 30 crores in Q2.

Ruchita Maheshwari What was the EBIT margin for the same?

Suhas Baxi The EBITDA margin on this business is in the range of 10%

Ruchita Maheshwari If I see your tax rate, it varies a lot. In Q1FY13 it was 37%; in Q2 it is 24.8%; in Q3 it is 30.9%. So what is the reason behind that plus what should be the ideal tax rate we should take for the projection and all?

Ravi Rajgopal Around 30%, you can take for the total year.

Ruchita Maheshwari But what was the reason for such a volatility in your tax rate?

Ravi Rajgopal We make a projection based upon our expected revenues and other things. And based upon advance tax calculation we do that.

Ruchita Maheshwari I am just asking what is the reason for the volatility in your tax rate?

Ravi Rajgopal You are talking about a consolidated number. The consolidated number, the calculations depends upon whether we have to pay MAT taxation for the units or not.

Suhas Baxi Let me just add some clarity on that. PEBS received the sales tax benefit from the government. Now this is we have an opinion from an auditor that this is essentially a capital receipt and not a revenue receipt and hence won't suffer taxation. So we have accordingly started using the treatment. So based on the proportion of PEBS sales to the total net income, you will have variations that come in. In addition to that as Ravi Rajgopal has said, the amount of advance tax that we are paying for the year based on that we do make projections on how much we will be paying at any point of time and deferred tax asset also plays into it. So it is a reasonably complex equation but I think as Mr. Ravi Rajgopal said for the whole year, we believe that it will be near close to 30% overall.

Ruchita Maheshwari And by what year the sales tax benefit we will be enjoying?

Suhas Baxi We have it for five years from the point of commencement. We commenced operations in 2011 FY, so it will be there till 2016.

Ruchita Maheshwari If we see the Auto Components are not doing good, even your Railways order there is no clarity, and the Infra is also not doing good. So what should be the trigger point in your stock?

Suhas Baxi Auto Components are not doing well and we are actually not in the Auto Components business. We are in Industrial Components business. If you really see what we do, we do Press Metal Components. And the Press Metal Components go in Auto industry, it goes in White Goods sector, it goes in Industrial sector. Our current size of the business in the Industrial Component business is relatively small. We are not a very large player in this. Our focus in the path has been our conventional business of Steel. So for us to acquire incremental market share, by widening our product portfolio and by acquiring a few new customers, while it is not a very, very easy task, but it is not a very difficult task even when the Auto Components industry is not growing. The second question that you had was about Railways. And you are absolutely right that the Railways business is something which we have not been able to rely upon for the last few quarters or almost a year. Now, it was important for us to find a substitute segment which allows us to grow despite of cyclicity in one segment. So, for example, if Railways business is not going up, am I able to do a better business of structural steel, better business of structural project, I think that is where we are focused on. We focus on the business of Solar Structures and we have been able to get a wonderful gain in the business of Solar Structures and hence we think we have come to a point where going forward, our reliance on Railways for the purpose of giving a critical mass in turnover as well as growth has come down substantially. Yes, we would be happy to take the Railways business but we are not extremely dependent on it for the purpose of our growth now. To your question on Industrial Components I would want to kind of give a corollary to that. Our investment in the business of Tubes wherein we set up CDW Tubes Mill, was aimed at helping us go from to tubes to tubular components. We were always making ERW Tubes but with our ability to make CDW Tubes, we can get into tubular components which is a very, very high value-added business. And that is where we started seeing growth. If one has to look at it from a point of view of where is Pennar growth and hence where is Pennar's value delivery coming from, Pennar`s value delivery is now essentially coming from high valued engineered businesses such as Tubular Components, such as CDW Tubes, such as Press Metal Components which are Industrial Components and Solar Structures, where there is a fair amount of engineering which is coming in. And all of this together is not only mitigation for Railways but it provides us an independent growth opportunity.

Ruchita Maheshwari Are you suggesting that over few years down the line, we will be shutting off the Railways business and would be more concentrating on other departments?

Suhas Baxi I don't think we are meaning that. What we are saying is that, almost every business has a mix of industrial segments that it services. If I just hitch my business onto one industrial segment, then I get wedded to the fortunes of that industrial segment. For a business of our size it's extremely important that we are focusing on multiple segments for our growth. By focusing on multiple segments and multiple products, what we are also able to achieve is we are able to mitigate that cyclicity. As I said, we are very, very happy to do Railways business; we have capacity and capability to do it. And when the business really grows, we will be able to grow our business with that too. But in addition to that, our story is not only now the Railways story, we think that we have now other segments to focus on which will give us multiple growth opportunities.

Ruchita Maheshwari There was a point in your press release that PEBS capacity has been expanded from 30,000 to 90,000 tons. So when this expansion will get completed? And secondly Mr. Aditya also mentioned that the lease you would be paying somewhere around 3 crores for the lease. So what is the tenure for the lease, and is there any incremental or escalation hike in the lease?

Aditya Rao The lease is an 8-year lease and extendable after that, there are no appreciations or increases in rent that are perceived and it is a reasonably clean agreement, and we expect that this sum will stay constant for the term of lease. And we also have a call option to purchase the assets whenever we deem necessary. So it is essentially a low CAPEX model we want to get into and our rights are pretty well secured. Getting back to your question on the expanded capacity we intend to bring the Gujarat plant on line certainly a month from now as I said and we intend to also load it up with orders immediately, a fresh order book which would be generated only for that plant.

Ruchita Maheshwari What the plant is all about, is it an old plant or a new plant which was not functional, what is the scene like?

Aditya Rao I will give you details of the plant, I cannot give any names right now.

Ruchita Maheshwari No, it is fine.

Aditya Rao It is a new plant. It was constructed 2 years ago and we are essentially taking it over.

Ruchita Maheshwari I just want to know, what will be the ideal debt number we will be closing this financial year?

Ravi Rajgopal This financial year numbers, actually whatever we are having it right now, we will be continuing the same thing, that we do not expect much of a CAPEX to come now.

Ruchita Maheshwari So it will be somewhere around 136 crores total debt. Any repayment going forward?

Aditya Rao We might have a repayment in PEBS, but we will cover that probably in the next quarter. So we cannot really give details right now. But PEBS cash flow position remains quite strong. So we will look at repayments.

Moderator The next question is from the line of Avinash Khanapur from UNIFI Capital. Please go ahead.

Ravichandra This is Ravichandra. One is in your press release, you have guided for a turnover of 375 crores for Q4. I would like to know, what is giving you the confidence to put that number 25% QoQ growth? That is one. And the second thing was the outlook on PEBS. Whatever I have been hearing over the last three quarters, we got the impression that is a high growth segment, but the numbers clearly reveal that there is a clear slow down on PEBS side. So if you can just give us the current status and where do you see that division over the next 3 – 4 quarters that will be helpful?

Suhas Baxi We divide the question into two parts. The first question is with respect to the guidance and where does the confidence stem from. I think if you look at our release, what we have also said is that we have an order book position of 460 crores and we are already 45 days into the last quarter. So the combined effect of the fact that we have a very healthy order book. Number two, we have seen our performance over the last 45 days and we are just 45 days remaining for the balance part of the quarter, I think we are fairly confident of meeting this estimate. The reason why we felt we should be giving an estimate was that, this is the last quarter of the financial year and we felt that it is important for us to let know the investors where are we going to and probably as far as this financial year is concerned. So we are confident and I think we felt it is right to give quarterly guidance in the last quarter of the year.

Aditya Rao You are right, we do perceive PEBS to be a high growth business and we would like to further drive that perception and that opinion. Certainly, you are seeing only 10% growth on the top line right now for the quarter in question. But if you look at our order book, it remains as strong as ever and stronger. We continue to book further orders. This has been a year of consolidation for us, if you can call "Double-Digit Growth Consolidation." We have implemented ERP, we have expanded and set up CAPEX, we have added Shot Blasting and Paint capabilities, we have expanded into the North of India in terms of our sales presence, we have added Cold Formed Buildings and made a marvelous beginning on that, which you will see this quarter in terms of the amount of addition it brings to our revenue, we have even brought other kinds of Engineered

Building Systems design into our fold, high rise buildings, we made a very strong entry also . So overall even if you consider this year itself in spite of all of these initiatives, we will still see for the full year, you are going to see pretty good growth. I am not sure if I have given guidance of, but we can give guidance of 375 crores, so I guess I can tell you where we are going to be. We expect to be about 350 crores this year as opposed to 270 crores. So that's a good 20% growth rate and we expect to even increase that next year. As I said we will not be able to give you a precise figure for next year, but the growth story for PEBS continues unhindered, it will be driven primarily by our access to new markets and new technologies, and on the back of that, we hope to impress you next year.

Suhas Baxi If there are no further questions, I would say thank you very much for participating in this call. I think the questions were from multiple areas and I was really happy to see that there are questions which are coming from our new business segments such as Tubes and Industrial Components and the Solar Projects business. The clear rationale behind creating these business units is driven by the way the market for these business is structured and we think that we need to be structured in our organization to focus on how the markets are structured, what is the competitive landscape in the market and what do we need to do for succeeding there. That is the reason why we have created these business units and I think going forward, I will be very happy to provide how we are progressing on these business units that we have created and how are we driving the growth within Pennar Industries as a standalone business and within Pennar Engineered Building Systems.

Moderator Thank you Sir. Thank you, members of the management. On behalf of Pennar Industries Limited, that concludes this conference call.

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