"Pennar Industries limited 2Q-FY23 Earnings Conference Call"

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MODERATOR: **MR. VIKRAM SURYAVANSHI – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY23 Earnings Conference Call of Pennar Industries Limited hosted by PhillipCapital (India) Private Limited.

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I now hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital (India) Private Limited. Thank you, and over to you, sir.

Vikram Suryavanshi: Thank you, Steven. Good morning and very warm welcome to everyone. Thank you for being on the call of Pennar Industries. We are happy to have with us the management of Pennar Industries here today for question-and-answer session with investor community. The management is represented by Mr. Aditya Rao – Vice Chairman and Managing Director, Mr. Shrikant Bhakkad – Vice President (Finance), Mr. J S Krishna Prasad – Chief Financial Officer, Mr. Manoj – Head (Corporate Affairs) and Mr. K M Sunil.

Before we start with question-and-answer session, we will have opening comments from the management. Now I hand over the call to Mr. Aditya for opening comments. Over to you, sir.

Aditya Rao: Thank you. Firstly, my thanks to the moderators. I would also like to begin by welcoming all of our stakeholders who are on this call today. Thank you for joining us for the Q2 FY2023 Financial Results Conference Call.

For the structure the conference call will follow a standard format where I will start with my commentary on our financial results. I will then cover our profitability, liquidity and growth metrics. Following this, our Vice-President - Finance Mr. Shrikant Bhakkad will present an overview and after that we will open up the call to questions from all of you.

So, let me start off with my overview. For the quarter, we recorded net sales of 834 crores. Our EBITDA was 61.8 crores, and our PBT was 21.53 crores on consolidated basis. Now this is a substantial growth in terms of performance on a year-to-year basis. What's driving this growth is many of our BU's scaling revenue and the consequent impact on the operating margin flowing down to PBT.

Profitability, the Q2 consolidated PBT was 21.53 crores at a margin of 2.58%. Our consolidated cash PAT was at 31.9 crores, which is at a margin of 3.84%. We are targeting further improvements on our PBT percentage and the value over the next few quarters.

Next, we will talk of liquidity and working capital. We have reduced our working capital days at the end of Q2. Our annualized ROCE for our Q1 was at 18.5%, and our targets by the end of the financial year, we are looking at 75 revenue days of working capital by March 2023, and 20% ROCE to be achieved by the end of this financial year.

Lastly, I will speak of growth, our revenue and profit growth drivers for the next quarter specifically. Our BIW division has achieved profitability and will continue to improve its margins. Our subsidiary in the U.S. continues to perform well and grow its revenue and profitability. Our PEB division in India has generated a large order book and is projected to dramatically improve its profitability. Based on these growth vectors, we would once again confidently project a high growth Q3 on a year-on-year basis. We are currently expanding capacity at our PEB business unit at Ascent and also in our industrial components business.

I would like to conclude my initial overview by thanking all of you again for your time and attention. As always, we will continue to focus on sustainable revenue growth, profitability growth, liquidity and overall capital efficiency. I look forward to answering any questions that you have for me. And with that, I am handing this over to our Vice President Finance for his comments.

Shrikant Bhakkad: Thanks, Aditya. Welcome to the shareholders to Earnings call for second quarter of FY23. The key metrics consolidated revenue has increased from 551 crores in Q2 2021-22 to 834 crores in Q2 2022-23, which is up by 51%. Consolidated EBITDA up by 42%, and consolidated PAT has increased, almost doubled in terms of what we were there in terms of last year Q2 FY2021-22 numbers.

Taking you through the details of the presentation, increase in the employee benefits and depreciation expenses on account of the U.S. business and the BIW business that we have added in the current year. In terms of balance sheet numbers, the change in CWIP to property, plant and equipment is the predominant change that can be noticed which is on account of the capitalization that we have done during the first quarter of FY 2022-23 for the BIW plant.

Cash and cash equivalents and the bank balance has increased from 26 crores as at end of Q2 FY 2021-22 to above 100 crores now on consolidated basis. We have cash and cash equivalents and bank balances close to 102 crores. Increase in borrowings is in line with the increase in revenue. The metrics that you have to see in terms of the finance cost and the reduction of the working capital is eminent enough, and the overall numbers for the finance cost as a percentage of Revenue has reduced.

Interest as a percentage of net sales is now below 3% overall for this quarter, and we would continue to see that the interest and the finance costs do not increase above that. With the increasing interest rates that seems to be a challenge, but our endeavor would be to bring it down to under 3%.

Cash flow from operating activities before working capital changes is close to 134 crores and the cash and cash equivalents per se has increased from 37 as on Mar 31, 2022 crores to 86 crores as on Sep 30, 2022 on consolidated basis.

So, with this, I hand over to the moderator for the Q&A session.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Riddesh Gandhi from Discovery Capital. Please go ahead.

Riddesh Gandhi: I just wanted to understand, you know, you had indicated on some of your earlier conference calls that FY23 would be the highest, I mean, actually PAT that you guys have ever done, which historically I think was around the 90 crores odd. Are you guys, actually, it is still in the line to do that, and if you could also then throw some light on the order book?

Aditya Rao: Thank you. You have two questions. One is on a projected PBT for the financial year. We typically don't give guidance, but I think you are right in that on previous conference calls had indicated that this financial year will be our best ever. We will stick to that projection. What was your second question, sir?

Riddesh Gandhi: It was on how the order book is looking compared to how it was in the last quarter? And also if you could throw some light on the kind of profitability you expect from this order book, and if it is higher, and if you could throw some light on that?

Aditya Rao: So, when we speak of order books for us, we have order book-based business verticals in Ascent, our U.S. subsidiary, our Railways business in India, our Pre-Engineered Building business in India and our solar business unit. All four of these business units are seeing very high expansion on their order booking.

Ascent's order book has increased to about US$45 million, and it could be higher. I think, it could be even higher than that if they had needed, if they wanted it to be. But considering that the raw material prices are falling, I think they want to make sure that they don't bite off more than they can chew.

Railways order book also is increasing. It was traditionally at 120 crores, but we are seeing improvement in that in the last quarter. PEB order book is also at heist that we have not seen for a very long time. We have 600 crores in open order book right now. And our solar business also is doing quite well. We have recently gone public. We have given out a press note on some of our order booking about a month ago. And so, order booking across all of our verticals remain strong. I don't see a decline in any of our order book-based businesses from an order booking or revenue point of view.

Riddesh Gandhi: And just like, you know, given all of the actually volatility in RM, how do we think about how we hold inventory and potential risks we have of that? And how we, you know, mitigating any sort of inventory risk?

Aditya Rao: So, there's three ways to do it. One is that we have pass-through contracts where there is raw material price escalations, raw material linked contracts so that our selling price effectively gets adjusted if the raw material price increases or it gets just a downward if it declines. Most of our BUs are doing this because it helps us lock in a margin range, an operating margin range that will make sure that we know what our profitability or operating margin is going to be. That's one way to do it.

The other way to do it is we get into arrangements with our raw material suppliers because we are a larger buyer of certain commodities such as steel and other material, we can work with suppliers such as JSW and Tatas to have quarterly contracts or project-based rate contracts, and that allows us to ensure that raw material price volatility does not impact our profitability.

The third way is to sit on a substantial amount of inventory which we also do, and this allows us to make sure that we don't have issues from a margin point of view. So, the combination of all of these three things make sure that pass through of pricing increases or declines for that matter, and holding inventory and negotiating quarterly and project-based contracts with suppliers of raw material.

Riddesh Gandhi: The last question I had was around the leverage. Obviously, as you grow, the working capital would also potentially slightly increase, you know. Are you guys comfortable with your existing level of the leverage? Or I mean, how do you think of this being adjusted? Or did it get expedited to the earnings or EBITDA as our materially, it can obviously impact, then leverage also goes down?

Aditya Rao: Mr. Gandhi, I got part of your question, but could you repeat your question? You are saying, what's your question?

Riddesh Gandhi: How do you think about the leverage levels right now? Are you comfortable at these levels? Do you expect it will reduce it over the next year or two? How should we need to think about with debt levels?

Aditya Rao: If you are looking at leverage as in debt to equity, I am not happy. We are at 0.7. I would prefer that that number to be 0.5, and we are working towards that. And the best way to do that is to ensure that we don't increase our debt levels, and we make sure that we hit our targets, but if your question was regarding operating leverage, there is a tremendous amount of that and that's possible. Our operating margins are at 15%. Our net profit or cash profit margins are at 4% or

5%. I think there is a lot of rationalization on fixed costs that can happen as they bring in more scale. So I won't call it economies of scale, but purely operating leverage and it has the potential to add 100 to 200 basis points to our bottom line. So, I wasn't sure if your question referred to operating leverage or?

Riddesh Gandhi: No, it was the financial leverage, but you have answered it, and you have answered the other one as well. So, it's fine.

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

Vikram Suryavanshi: Sir, we have seen a strong growth in custom designed segment of our business, but PBIT margins were quite low. So, what was the reason for impact on profitability in custom design business or which are the verticals where we have seen impact, if you can explain?

Aditya Rao: So, the custom design business refers to our PEB business. And what has happened is we are set our cost or I think it a little bit of the last question. Our fixed cost in our PEB business are high. The scale is coming in now. So, as of right now, we project a 5% PBT, not PAT, but PBT in that business to be achieved in this financial year. That will help bring up the margin profile of that business, but I agree with you, that the margin that we are getting from it right now based on the current PBT is lower than it should be.

Vikram Suryavanshi: And what would be this BIW plant, what we have started, would be annual revenue potential at full capacity, if you can give some idea about in terms of potential in that business?

Aditya Rao: So, as I had mentioned, we are continuing to invest in our BIW business. As of right now, the business is at about 120 crores plus on an annual gross sales run rate basis. So, 100 crores plus on net sales. We expect to double that by the next financial year, and our PAT margin would obviously be much higher than that.

Moderator: Thank you. The next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Sir, I just wanted to understand now in one of the questions of the previous participant, you maintained that this year will be the highest profit in the company's history, right? So, which our previous best was about 90 crores PAT in FY18. So, I just wanted to understand in the first half, we have done about 30 odd crores of PAT. So, that effectively means you would do at least 60 crores of PAT in the second half as per our expectation. So, sir, I just wanted to understand what will drive that change in the second half? I mean somewhere it has to be revenue or somewhere it has to be margin improvement. So, some understanding on that would help that what would drive the doubling of profit in the second half versus what we have achieved in the first half.

Aditya Rao: So, what is going to happen over the third quarter and the fourth quarter, and what we had already seen is a further expansion in our margins. Post the pandemic, there were some business units whom we gave some time to resurrect their financial balance sheet, the P&Ls and the cash flows. That has now happened. So, we are slowly but surely climbing the margin ladder. So, that will ensure that our margins are much higher. I do want to point out one thing. In the year that you were talking about, there were some significant one-time expenses.

So, when I talk of us hitting up our peak profitability, it would be around that number, but I would ask you to take that into account as well and look at our actual PAT after taking those one-time expense into account. But I think the fundamental question you are asking is will we see this doubling? And we are very confident that we will have continued to see dramatic expansion in our bottom line in Q3 and Q4.

Deepak Poddar: So, sir, that will be driven both by margins and revenue growth, right?

Aditya Rao: It will be driven by revenue growth. It will be driven by margin growth, both, yes. What's growing right now is the high margin business. So, as this differential revenue at a higher operating margin comes in, a lot of that operating margin goes directly to PBDT or PBT frankly for that matter. So, we don't have a lot of CAPEX. We don't have a lot of depreciation coming in.

I would also pay some attention to our PBDT, our cash profit or our PAT plus depreciation if you want to look at that. That's shown even more substantial and strong growth from a value point of view because our depreciation is quite heavy. It's never been this high. So, on an overall basis, we are generating cash. Our working capital margins are improving. Our ROCE is improving most importantly. The combination of all of this plus margin expansion will make sure that we hit our goals for this financial year.

Deepak Poddar: Fair enough. And you did mention about this one-off expense. What is the quantum of that expense?

Aditya Rao: I will get back to you on that. I don't have the exact number with me, but I will make sure to get that to all of our investors.

Deepak Poddar: Fair enough. And what's the split of your revenue between first half and second half? Generally, second half is much better, right, for us?

Aditya Rao: Usually, the second half is substantially better than the first half. Our weakest quarters tend to be saddling the Q2, Q3 period. Q4 tends to be our strongest quarter.

Deepak Poddar: Weakest is second quarter and third quarter?

Aditya Rao: Most of second quarter, little bit of third quarter.

Deepak Poddar: So, second half generally we do what 60-40 second half, I mean, 2H versus 1H, 60-40% or 55-45%?

Aditya Rao: I would hesitate to give you a number exactly like that, but I think a good benchmark would be 60-40.

Deepak Poddar: 60-40 is the right benchmark.

Aditya Rao: Yes.

Deepak Poddar: And then my final query is more on the medium term. I think we had been speaking that our overall goal is to have a net profit margin closer to 5%, right? So, any kind of rough range we have that what's the timeline we are looking and maybe one to two years or earlier? Any understanding we can have on that?

Aditya Rao: Understanding on what, sir, exactly?

Shrikant Bhakkad: 5%.

Deepak Poddar: So, this 5% PAT margin, by when we would like to achieve that actually?

Aditya Rao: Our goals are to hit, let me unpack this a little bit for you. So, the way we think in the company is on PBDT because a lot of our depreciation is as a cash item. So, it's not an actual expense. So, we tend to do think of that and then to PAT. We have plans in place to achieve that over the next 1.5 years.

Deepak Poddar: Over next 1.5 years. Fair enough.

Aditya Rao: Anything that you add, there is a certain fixed cost increase that we will get in a year. And we have had substantial increases from last year to this year primarily because of our U.S. subsidiary. But the answer, I guess, I would like to tell you is that if you add revenue at a contribution that's higher than 15%, then the equation works out well, and that's what we are doing.

Moderator: Thank you. The next question is from the line of Arvind Joshi from Bateleur Advisors. Please go ahead.

Arvind Joshi: I just wanted to get some additional insights on how our verticals like defense and railways are evolving? This could be a multi-year opportunity now. Any special effort being taken on asset allocation, planning, strategy, etc.? I would love to hear that from you. And I am also very keen to know what exactly is going to be our contribution in Vande Bharat, especially considering the kind of major involvement we had in train? And also, any business updates on wagon orders?

Aditya Rao: Railways business I mentioned in my preface it is the growth vectors we have. I mentioned that Ascent in U.S. PGI, our PEB business, BIW and the industrial components business continue to be growth vector. Railways as I had mentioned, our order book is increasing. And also, to your point, we are one of the suppliers of Vande Bharat components, and there is substantial order book inflow coming in from that. But we have taken a call as an organization to not focus on businesses which have only one end customer. So, though we supply to ICF, MCF and others, ultimately, the owner of all of this is the Railway Board. So, I am not including railways in our rapid growth plan. We will get orders and it's more opportunistic to an extent, but we are not focusing on railways or Vande Bharat or wagon orders, and we are not investing in that as of right now. There are other companies which are doing that, and we are paying attention. But as of right now, I have other than an increasing order book and improvements in our revenue and profitability for that business unit, I don't have anything to share. We don't have a railways growth plan which is 5 years in the making. No.

Arvind Joshi: And sometime back you had mentioned there could be some positive news coming on the export front for the railways business. Any updates on that?

Aditya Rao: No, sir, I don't think we have been successful in triggering anything of that nature. The vast majority of our railways revenue is domestic. We have a lot of exports in the company, but they are primarily in Pre-Engineered Buildings or hydraulics business, engineering services, even our BIW is entirely export oriented, but not railways.

Arvind Joshi: And we should have some engagement with Bharat Dynamics for some shell components and all that. Any improvement in the engagement with Bharat Dynamics and defense in general?

Aditya Rao: So, that is a small business. It is in our Railways business unit, but again, it is at this point not material enough to move the needle. I mean, really for us from a gross sales point of view, we will have if we are looking at 3,000, 3,500 crores this year, our goal really is for us to take that number to 4,000 next year. We are not going to get that from the defense sector. So, it will continue to be targets of opportunity. It will be one BU. It will be the CEO of that business Mr. Dayasagar, it will be a level or two under him. So, these are not sectors we are focusing on right now.

Arvind Joshi: And any catalyst you see around that could make you change your mind on revenues or you are very clear no more serious look at the business, whatever comes?

Aditya Rao: We have already more towards private sector CAPEX, private sector fixed capital formation and exports. Railways is none of these things right now. Now if Bombardier and if other railway companies were able to and Alstom were able to enter in a stronger way, and to my knowledge Alstom has exited India, the railways business.

So, unless that happens, unless we see dramatic, international opportunities, I would not focus on, but on the aerospace front, as you know, we have made an acquisition in France last quarter.

I have high hopes for that, but little bit premature now. Next quarter I will share our plans in more detail, but we are setting up our team there. We are setting up addressable markets. We are going to work on scaling revenue there. But that's better. That has non-government revenue, private sector revenue, many customers, high margins, sustainability I think we are moving away from one customer businesses.

Moderator: Thank you. The next question is from the line of Soniya from Dalal & Broacha. Please go ahead.

Soniya: In this quarter, we have reported other income of 15 crores versus 3 crores last year. So, it's a huge jump. So, can you share what does that include?

Aditya Rao: The other income includes certain provisions that we have written back from the earlier years, and predominant amount has come from the exchange fluctuation gain that we have. So, out of that 60% is exchange fluctuation. Close to around 20% is provision for write back, and the balance was other income that we have regularly.

Moderator: Thank you. The next question is from the line of Dilip Kumar Sahu, an individual investor. Please go ahead.

Dilip Kumar Sahu: Congratulation on very good set of numbers, particularly in revenue growth. So, I had a couple of questions. One is regarding salary and wages, and the accelerated hike in salary and wages. Last quarter Mr. Aditya talked that there is a one-time cost and the endeavor will be to reduce the salary cost and definitely not exceed the past average, whereas salary has grown more than the revenue growth. So, that's one question. Your comments on that.

Second is regarding the BIW business. We invested around 70 odd crores. So, for the current run rate of 120, 130 crores per year, is it enough or have we reached the peak capacity in BIW? And at 10, 12 crores per month, is it a breakeven business now or you need to at what price, at what revenue you will make profit? That's the second question.

Third question is regarding the order book. There was some news article that NTPC had given a large order of 500 MW to Pennar. So, this 1,160 crores order that we have picked up in September, does it include or is it tender we are L1 and order will come later? That is the third question.

Aditya Rao: Let me answer that. So, the salary growth is entirely because of PGI. You are absolutely right in terms of saying that it's a onetime thing last quarter. So, what has happened is a lot of our bonuses and variable costs in PGI, I have also gotten recorded in this. But to your fundamental point that our fixed costs have grown further than, faster than our revenue has, not a profit, but definitely faster than our revenue. I think that's a very fair point. I think it's something that we are looking hard at. A lot of these are initial setup costs. We have just set up in Ascent, and they are already doing really good job. Well, let me approach it this way. We are continuing to look at it. We are going to work on rationalization. There has been an attribution difference which has resulted in bonuses and variable cost, but overall I do think we have some work to do on rationalizing, specifically salary growth and fixed cost. That's question number one.

BIW, our CAPEX, our gross block is about 60, and at 120 crore run rate, that's an asset slip of only about two, which is not good. You are correct. This is base CAPEX including some technology that we had to get in, obviously, the plant itself. What is happening now is capacity expansion, which takes that gross block up from 60 to closer to 78. And when that happens, our revenue doubling would effectively improve the asset flip to closer to 3.5. Still not good, but it is representative of what is seen in this industry. Margins, of culture, jump tremendously, and that is what we are looking at.

So, I think you had a question on whether the business unit is currently profitable. Yes, it is, but the PBT or the PBDT, let me talk of that, is hardly 3 to 4%. When we commission the next phase, you will see a dramatic improvement in our margins, but as of right now it is profitable. It is growing and their work expanding capacities. So, both the revenue to asset flip and PBT margins improve.

I will not be able to share individual order sizes because our customers explicitly request us not to do that. However, you are right. The 1,000 odd crores that we had declared is inclusive of this NTPC order that we have received. We have received their contract a few weeks ago officially as well. So, we will be executing that order. It's a profitable order, but Yes. That's I am not at liberty to share exact contract value.

Dilip Kumar Sahu: And I have got two more questions if I may ask regarding PEB business, you know, as per the segmental revenue, 419 crores in the engineering building business and 16 crores is the profitability, which is around 4%, less than 1% PBT. And it comes out. It's almost like a 50% of our revenue this quarter. So, my question is, is it purely an inventory issue or is it because of the US operations? Can you just comment on this profitability of PEB business?

Aditya Rao: Can I get some clarity on your question? So, you said is what an inventory issue or that, I mean, you mentioned?

Dilip Kumar Sahu: Our PEB business, which is this year, this quarter PEB business is 419 crores as per the segmental revenue disclosure.

Aditya Rao: Yes.

Dilip Kumar Sahu: And our profit was 16 crore, so which is around 4% profit, operating profit. So, my question is, what is the reason for such a low margin for the current quarter PEB business? And what is the outlook?

Aditya Rao: I would attribute that to as I had mentioned to one of our previous questions, we are scaling up the PEB business unit, and the PEB business only makes money after a certain point, after the breakeven. But once you have crossed that breakeven point, even 10, 20% increases in sales volume bring a dramatic amount of improvement to our bottom line. As I had mentioned, we are targeting for our India businesses a PBDT of about 7% for our PEB business also and our U.S. business is above that. so we will continue to bring these in.

I also want to mention at this point that for our U.S. subsidiary, which is also in the custom design building systems space, Be that as it may what you can look for to quarter-on-quarter is continued improvement in our PBT margins for our Pre-Engineered Building business in India and in the U.S. That I can comment on.

Dilip Kumar Sahu: The last question is regarding the French acquisition and we have actually made two acquisitions in Europe. If you can just throw some light, is there some traction coming over in the momentum in terms of customer engagement? And our service business surprisingly, pleasantly doesn't surprise, has gone up to 13, 14 crores. Is it because of the revenue, volume increase or is it because of the Forex gain? Where is the momentum in services business coming from? That is my last question.

Aditya Rao: I will answer the question about our acquisition of Cadnum. As I had mentioned before, it's still early days. Please do give us the quarter. I will commit to giving a far more informative idea about where we are going. However, I can tell you right now, we are very optimistic with setting the team up there. We are hard at work, making sure that they have the assets that are necessary to grow. And I am certain that they will add materially to our revenue and bottom line over the next two years. But I will request a quarter for us to communicate a plant deal. That's point number one.

Point number two, you asked about our services business scaling up. It's a combination of both Forex gain which exists and also the revenues in that business unit increasing from a year-on-year basis. Again, we expect continued improvement in revenue in this business unit. It's already at a higher margin. We believe those margins are sustainable.

Moderator: Thank you. The next question is from the line of Srivathsan from Spark Capital. Please go ahead.

Srivathsan: Hi. I am relatively new to the company. Just wanted to get your thoughts when you look at the disparate products and services, wanted to get your thoughts how will you bucket each of them purely from a free cash flow generation or a return on capital employed framework? And also the second framework I was looking is how would you look at it from a competitive advantage where you would be a top two, top three, top four player in the market, or I just want to get your thoughts between the various products and services you operate, and how will you look at on these two frameworks?

Aditya Rao: So, one was diversity in our product profile, and how they are going to bucket it. And the other part of it was our focus on whether we look at ROEs, we look at free cash flow. Let me answer the first part first. Currently, we had as of last year 13 revenue streams of business which we have cut down to 10 through a process of merging these revenue streams into existing business units or by a process of exiting businesses which we think are not going to be able to be capital efficient or return cash over the long term. And this process will continue.

And at the Board level also, we are looking at having lesser number of units which can be larger in individual size as opposed to chasing multiple market opportunities, addressable markets which, you know, maybe give you some amount of comfort that, you know, you will not have reduction or decreases in revenue because if one business unit expired, other BUs can take up the slack, but what they will have is robustness in terms of long-term addressable market growth, which will help us scale Pennar further.

So, that's our thought process as far as diversity and revenue streams is concerned. If we can get to 6 BUs, steady state there, make sure each of them has a multi-thousand crore revenue opportunity, which means a multiple, multi 10,000 crore market, addressable market opportunity. That's what we are aiming for, and we see that most of the hard work on that has been done. It's a matter of time, and we will get down to lesser number of BUs, larger sizes, and more sustainability in Revenue.

In terms of whether it's capital efficiency or free cash flow, we target a ROCE of 20% for our manufacturing business and a higher number for our services business that will continue to be the guiding light for us.

Cash flow generation is a little trickier. From an operating point of view, we do want all of our businesses to throw up cash, but in a positive working capital cycle, when you do have substantial growth coming in, you do tend to have negative cash flows. So, we have to balance our desire for growth along with our desire to have a positive cash flow as well. Both of which are important. Neither of which can be made subservient to the other.

So, I think the stable response we have found is a certain amount of growth is healthy enough in a year from a revenue point of view, and if you want more growth than that, then that those things should come from rationalization of working capital. We are a heavy user of working capital. If we can optimize that, then it could allow us to have growth and free cash flow. But over the long term, we would slightly be more on our, focusing more on cash flow than we would on heavy growth.

Moderator: Thank you. The next question is from the line of Patanjali, an individual investor. Please go ahead.

Patanjali: Great numbers in top line growth. I would like you to remind that on earlier occasions every time in the conference calls, you have said and maintained that you would be doing the best ever performance in the recent past for this year as well as for the next financial year. So, one, whether you have maintained that? Two, do you see the reduction in your loan, which is currently at a high level? Listening to you, your growth plans, it looks like that is not on the anvil as of now.

And till such time you have been growing well. You think that that is under control. So, some plans of selling your surplus land, which I saw sometimes back you had liquidated to the tune of about 30, 40 crores something, do you have any plans of liquidating that and adding to your growth and as well as reducing your, you know, outstanding loan? Thank you.

Aditya Rao: So, I think there were three questions asked. One was on the performance for this financial year and for the next few financial years. The other was on our current debt levels, on our comfort, and how that plays in considering our growth plans and CAPEX. And the third point was whether we would be willing to use sale of our land to reduce either our debt burden or to even finance CAPEX? Those are the questions as I have understood them. I will answer them one by one.

So, from a performance point of view, you are right, and I will stand by our statement, and I don't think I am over promising. I do believe that this will be if not the strongest, one of our strongest years. There is always ambiguity, but from what I see on the table right now, we will have a very, very strong year in terms of both cash generation, in terms of profitability and also critically, how they are going to be positioned in the last quarter for the next financial year. I think we have become vastly more profit focused and cash flow focused than we were historically. We are making tough choices in terms of liquidating businesses which don't make sense to us from a long-term point of view, returning that capital back. So, consequently, we are seeing improvements in ROCE and also a reduction in our working capital number of days. I mean, two years ago we were at 120 days and further improvements also will come in. So, from a performance point of view, I can comment.

Our long-term debt is at 110 crores and our overall net debt is 672 crores on consolidated basis. This for a company with gross sales and I use gross sales, because that's what debt finances and working capital finances. For us to have gross sales of 3,000, 3,500 crores, maybe 4,000, is I believe not inappropriate. The number that we do look at for you to judge what we will guide, what I can guide you to is our total interest cost is a percentage of our sales.

I think that's a very important metric Finance cost as a percentage of net revenue because it measures what you are actually doing with that capital, whether it be CAPEX or OpEx. So, that we have articulated that our desire is to maintain a number. I mean, we were at 3.3% last quarter. This quarter we are at 2.96%. We will keep it around 3%. You should guide me. I mean, I would love to know your thoughts.

But from an analysis we have had with, we have talked to the smartest people we can find, and we think that 3% is sustainable for our business model. And as long as our margins continue to improve, our operating margins continue to improve, and we are able to scale, that combination will result in PBT and PBT percentage increasing. It also keeps overall debt in control because if your debt increases but your revenue doesn't or revenue doesn't increase in the same metric, then this number tends to go up.

Since you are predicting stability in this number, I would request you to give us your thoughts. We don't need to do it in this forum, but I would invite your commentary on that. But that's what we are thinking. When we think of debt, we think of it that way.

From a land sale point of view as you are right, we have sold substantial land assets. I see us as an engineering company, as a manufacturing company. We are not a real estate company. So, I also don't believe there is a lot of sense in having expensive land and running revenue generating assets on top of it. However, this is a decision for the Board to take. There is a certain periodicity on when we want to do this, but I can assure you what we are not going to do is divert a lot of our CAPEX into land purchases or anything like that. That is absolutely not going to happen. We will look for wherever we set our factories up, we will look for land that is cheap, that is cost effective and make sure that the overall return on capital employed is justified.

Our existing land assets, the Board has to take a call. As of right now, we have not articulated strategy, but I think we have shown intent the last time we sold. I think it was about a year and a half ago when we sold that land asset. So, we are not looking to, you know, build up our land assets if that's the question.

Patanjali: No, no, perfectly, can I come in? So, Aditya, I am very new to investing and attending to conference calls. So, do forgive me if I do not follow the protocol, but let me share a story of our South India-based company. I will not take the name for obvious reasons. About seven years back, they had a parcel of land, which was being sold for something like, you know, 160 crore, right, which would have retired all their debt which they hung up on, not selling it, which resulted into because of 20 crore or something is what they were not getting it. So, the very obvious thing which I thought to an outsider that the power of compounding in the period is lost on companies, and they invested something in the U.S. where they are incurring a loss. I would say that please have a look at it in case if those land prices are not going to increase any further, it makes immense common sense to, you know, sell and retire a bit of a debt or put it in your CAPEX. You will grow far faster. Take, you know, column that. We have some wisdom. I thought that is a very smart thing to do. Thank you.

Aditya Rao: I thank you and appreciate your candor, and what you have said makes absolute sense to me.

Patanjali: We are a long-term investor, and I see my old age with your company.

Moderator: Thank you. Ladies and gentlemen, we take that as the last question for today. I now hand the conference over to the management for their closing comments. Over to you, sir.

Aditya Rao: Thank you so much, sir, for your time and attention again. We will continue to make the improvements we are going to make. All that we have shared with you information. Please let us know if there is any more clarity required in the interim, but we are hard at work to closing the third quarter as per our commitments to you. Thank you again for your time.

Moderator: Thank you. Ladies and gentlemen, on behalf of PhillipCapital (India) Private Limited, that concludes this conference. We thank you all for joining us, and you may now disconnect your lines.