“Pennar Industries Limited Q2 and H1FY21 Earnings Conference Call
Hosted by PhillipCapital (India) Private Limited”

November 13, 2020

MANAGEMENT:	**MR. ADITYA RAO – VICE CHAIRMAN AND MANAGING DIRECTOR, PENNAR INDUSTRIES LIMITED** **MR. SHRIKANT BHAKKAD – VICE PRESIDENT (FINANCE). PENNAR INDUSTRIES LIMITED** **MR. J. KRISHNA PRASAD – CFO, PENNAR INDUSTRIES LIMITED** **MR. MANOJ CHERUKURI – HEAD (CORPORATE FINANCE), PENNAR INDUSTRIES** **MR. K.M. SUNIL, PENNAR INDUSTRIES LIMITED**
MODERATOR:	**MR. VIKRAM SURYAVANSHI – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and Gentlemen, Good day and welcome to the Q2 and H1 FY21 Earnings Conference Call of Pennar Industries Limited hosted by PhillipCapital (India) Private Limited.

Kindly note this conference call may contain forward-looking statements about the company which are based on the beliefs, opinion and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone.

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, Margaret. Good morning and very warm welcome to everyone and wishing you all very Happy Diwali. Thank you for being on the call of Pennar Industries. We are happy to have with our management from Pennar Industries today for a question and answer session with the investment community. The management is represented by Mr. Aditya Rao – Vice Chairman and Managing Director; Mr. Shrikant Bhakkad – Vice President (Finance); Mr. J. Krishna Prasad – CFO along with Mr. Manoj and Mr. K.M. Sunil.

Before we get to start with the Question-and-Answer Session, we will have some opening comments from the management. Over to you, Sir.

Aditya Rao: Hi this is Aditya a warm welcome to all our stakeholders to Pennar Quarter 2 FY20-21 Investor Conference Call. I hope everyone is safe and well and taking all the necessary precautions during this pandemic. For the structure, I will first provide an overview and my comments on the second-quarter performance. CFO will then provide details on the major financial matrix and after that, we can open up the call to questions from our investors.

So, to give you an overview of the performance:

In the second quarter, we saw marked improvement in our revenue compared to the first quarter. We recorded net sales of Rs 390.44 crores in the second quarter compared to Rs 166.6 crores in the first quarter. We have recorded a loss in the first quarter due to the lockdown and a resulting reduction in the addressable market. It makes me very happy to report that we have re-achieved profitability in this quarter with the net PBT of around Rs 0.7 crores and a cash profit of Rs 12.85 crores.

Our liquidity remained stable and issuance consistent improvement also over the last few months. We believe that these strengths will continue over the next few months and we project further growth and improvement in our revenue and PBT and capital efficiency over the next quarter. The majority of our revenue streams have now turned profitable in the third quarter in Q3 and we expect as I had mentioned last time the re-achieve of pre-pandemic monthly PBT in this financial year itself in Q4. The second priority for us as we mentioned in the previous call is to ensure we invest a new addressable market that will allow us to increase potential revenue and profitability further.

Consequently, in the past few months, we have invested in our US revenue streams effectively buildings and Tubes IOR. In our railways business units and our automotive ERW business. So we expect to commission of around Rs 75 crores in this financial year in these initiatives and we believe that the combination of these two initiatives which is recapturing our addressable market over the next few months and investments in new addressable markets will allow us to exceed our pre-pandemic revenue and PBT before Q1 of the next financial year.

Another initiative that is critical for us that is a reduction in our working capital. Company is currently using working capital of around Rs430 crores though no stress on liquidity and current assets reducing our accounts receivable in inventory we intend to get to about Rs 420 crores while growing revenue by the end of this financial year.

So that would mean that our capital efficiency improves by a lot from now until the end of this financial year. We are working hard on reducing our inventory and our AR and we are confident that we can sustain the improvements we have brought in over the past six months.

In the last conference call, though I had mentioned that we generally do not give all this guidance, we are indicated that we will achieve higher revenue and positive net profit we have achieved these numbers as committed.

For the third quarter similarly, I can tell you that we expect to increase revenue further and to improve our net PBT to around third of our pre-pandemic PBT and a cash PBT percentage will be higher of course.

So, in conclusion, I am confident we are well placed to regain a profitability level, improve our working capitals and ensure that in the next financial year which is FY22 we have our highest revenue and PBT.

On that note, I would hand over to our CFO for their brief on our Quarter 2 performance.

J. Krishna Prasad: Good morning. I will brief you on the financial highlights:

The net revenue as just stated Rs 390 crores compared to net revenue of Rs 166.19 crores we had EBITDA of Rs 32.67 crores while compared to the pre-pandemic of (-13.27) and this would mean that the revenue we have increased are prior to pandemic enough by 135% and pre-pandemic revenues we have reached close to 65%. We are profitable now in this quarter the additional thing that we would like to highlight is that we would invest in the new step-down subsidiary that we have set up as Aditya has mentioned addressing the increasable market size we have been investing close to around 3.5 million USD in our step-down subsidiary Ascent Building LLC.

The company has a healthy order book position as of now the order book as it stands for PEBS close to around 279.8 and Enviro 49 and railways is giving 249 crores.

In terms of overall the numbers where we are:

The finance cost is Rs19.82 crores and depreciation is around Rs12.18 crores. In terms of account receivable, we have Rs 382 crores in terms of accounts receivable accounts payable as we see the net of LC adjustments is Rs 217 crores and the inventories that we are on Rs 418 crores. So, if we compared to the March this numbers have drastically reduced and close to around Rs 60 crores have been collected from current assets on this. In terms of term loans, we are at Rs148.78 in terms of the term loan and in terms of borrowing, we are at Rs366 crores.

So, with this brief financial metrics, I hand over the call to Vikram for the further questions and making the forum open for any questions.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Sudeep Singh . Please go ahead.

Sudeep Singh: I have a very short question first would be what is the current outlook on the business we have in the railways?

Aditya Rao: The outlook we have on railways is that we are at about 40% of our pre-pandemic revenue perhaps 50% right now in this quarter. We expect those numbers to trend up over the next couple of quarters it would probably take us until next year for the railways revenue to get back to what it was. However, we are continuing to make investments to open up new addressable markets in railways.

Sudeep Singh: Could you elaborate on what investments exactly?

Aditya Rao: Typically, our product profile in railways encompasses structural numbers such as end wall, sidewalls, roof assembly under the same components. We are adding capabilities in robotic welding and robotic assembly which will allow us to get into further components others than these which are also structural in nature.

Sudeep Singh: The second question would be on there was some approval for the sale of land in Patancheru so what has been the status of that?

Aditya Rao: We have taken approval and we have sold the land as in we have entered into an agreement for sale. We need a NOC since all of our fixed assets are obviously this is second charge from bankers on that because we do have working capital debt. We are expecting an NOC from our bankers in the next few weeks once that is done we have been informed by the buyer that capital is ready and we will transfer that and we will complete the sale of the asset in terms of we will record it. They have not recorded a sale of these assets as yet. Our auditor has told us that once the NOC from the bank has been given and funds transferred, we will be able to record the entire transaction. So far, we only received an advance.

Sudeep Singh: So, our intention to utilize these funds is for what purpose?

Aditya Rao: We do not have a lot of long-term debt, but we intend to use it to reduce it further. So, we have got Rs110 crores of long-term debt we intend to reduce that.

Sudeep Singh: What is the current outlook on the solar business I believe we can gain some momentum on that going on?

Aditya Rao: As of right now the solar business looks quite strong our order books are at a record even higher than they were in the last time we spoke. So last year was a bad year for solar for us, but this year turns out to be quite good. So, we expect this trend to continue and from a numbers point of view, I think we would high double-digit growth in this year and next year in our solar revenue.

Moderator: Thank you. The next question is from the line of Swami Nath an Individual Investor. Please go ahead.

Swami Nath: I just had one question as in a few days back there was a news article about Pennar being raided by ED relating to Swapna Suresh's case, can you throw some light on it as in there is any potential litigation for us which we will be able to hear can you throw some light on this?

Aditya Rao: We received some questions from the ED you had mentioned and we have answered those questions to their satisfaction we do not believe there is any pending litigation we have been informed that they have no further questions for us and we believe the matter is closed over there. This is relevant to some orders we had got in Kerala and they had some questions for us in terms of the order process. We have given them everything this is an online process it has completely transparent so of course, frankly, there was not that information that much information to give but whatever is there we have given and it is our understanding that they are satisfied and the matter is closed.

Moderator: Thank you. The next question is from the line of Tejas Mehta from Old Bridge Capital. Please go ahead.

Tejas Mehta: So one question which I have now is obviously the revenue uptake is in my view is not fully to the satisfaction that we would like to have, so given that most of the segments of other businesses have shown a very strong reversal in this quarter, so just from understanding over there that why we feel a lesser reversal than compared to the other industries is one because we form we typically address or cater to the revival of several industries so that is one question. Number two is any guidance on the second half on this front from here on and what would drive the growth in the second half?

Aditya Rao: In the first question in terms of the recovery of our addressable markets various business divisions addressable market recovered at different rates however the recovery is still underway. So as I had mentioned on my introductory brief we expect a full recovery by the end of this financial year only in all markets, but I think Q3 already is a reasonably high growth double-digit growth high double-digit growth over Q2 and Q2 was 155% growth over Q1. So in the second half of the year as I had mentioned while we say we do not give guidance what I can definitely tell you is that both our revenue and our profitability both PBT cash profit are projecting pretty high growth rates for Q3 and Q4 will be higher as well, but at this point, I think what I would like to guide to is a complete recovery of our ability to generate a certain amount of PBT and also our revenue by the end of this financial year in Q4 sometime that is what I can definitely guide you through.

Tejas Mehta: So, is it fair to assume that Q3 may be at 80% of the pre-pandemic run rate and Q4 exit will be closer to 100%, is that something that one can give that on the guiding tool?

Aditya Rao: Let me clarify that a little bit more so when I say we will recover our pre-pandemic I mean on a monthly run-rate basis which is what we consider to be. So, on an overall basis, Q4 will not be 100% of Q4 last year but one thing to understand is Q4 last year was muted also frankly. So PBT will definitely be I can assure you the PBT in Q4 will be higher than Q4 last year, but what I am referring to is recovery to pre-pandemic December, January is PBT recovering that on a monthly basis. Q4 yes absolutely you can take it to the bank that a Q4 PBT will be higher than in this year than in last financial year.

Tejas Mehta: And the driver for these the segmental drive base seems to be different like you said last year railways was very strong, but railway this time is kind of muted for us and I think solar has come into the track and solar was not there last year, so what would lead the growth in the second half?

Aditya Rao: We currently expect all of our business revenue verticals to grow, but I think the major growth which has not come in so what we are expecting and what we are confident of is for PEBS to recapture a lot of goods because PEBS is at 50% of what it was pre-pandemic so we expect that to come in strongly, we expect our environment business to grow more. It is already around the same level it is there last year, but our order book recently has increased substantially so we expect that business to grow. Railways we will see moderate growth I think it will be probably middle of next year before railways completely recover, but we may get new growth in that in terms of our new revenue streams may open up in our railways which can improve that a little bit, but the old addressable market will take I think definitely more than two quarters, but maybe not as much as four quarters so somewhere in that timeframe. The other businesses where we expect a lot of growth is our new BIW business, our engineering services business has exceeded by a lot our pre-pandemic revenue as well and it is a high-profit business as well so that also we expect to see significant growth and our industrial components business also will exceed what we had last year. So pretty much all of our business will grow but primarily driven by PEB business and environment business and our engineering services business scaling up beyond what we have right now.

Tejas Mehta: Now on the balance sheet side there are a couple of questions, one is in these other financial liabilities in the current liabilities line there were Rs 62 crores, can you just help us understand what this element is of the financial liability?

Shrikant Bhakkad: Other financial liabilities consist of two things one is the current maturities of long-term borrowings we have. So Rs 48 crores is comprising of that and then we have retention money playable which is close to around 11 crores and the balance are the very small amount and we have one sales tax deferment loan of close to around 4 crores there these are the main component others being small.

Tejas Mehta: This is some sort of borrowing only actually which is there in other financial liabilities all of these elements?

Shrikant Bhakkad: Other financial liabilities basically consist of any other form of payable which is not either you are trade payable or other things.

Tejas Mehta: So, if you add your long-term borrowing or short-term borrowing and other financial liabilities that is about Rs 525 crores?

Shrikant Bhakkad: Yeah Rs516 crores is what it will come to in terms of the total borrowing.

Tejas Shah: And that was Rs 475 crores in March so we have increased by a debt by about Rs 50 crores and our cash has dropped by about Rs 25 crores, Rs 27 crores so there has been a total drawdown of close to Rs 75 crores in this first half it has all gone into the working capital?

Shrikant Bhakkad: Yeah basically if you see the cash flow statement has been given being the half-year and if you see trade payables have come down corresponding close to around Rs 60 crores in that and from the investing activities you have the borrowed amount is close to around Rs 40 crores there.

Tejas Mehta: So basically, that taken a toll on our investments right because our investment is only about Rs 9 crores in the first half as per your cash flow statements?

Shrikant Bhakkad: Investments will happen because of the pandemic we have not incurred any major capitalization of the amount that are being invested are either in working capital or in the form of advances. The capitalization and other things will come only in Q2 and Q3 sorry Q3 and Q4.

Tejas Mehta: And what is the outlay over there for the CAPEX in the second half now?

Shrikant Bhakkad: As Aditya said the total outlay for the year is, we are expecting is close to around Rs 75 crores.

Tejas Mehta: So, second half your entire gain in your operating cash flow will all go towards your CAPEX essentially by and large?

Shrikant Bhakkad: Yeah.

Tejas Mehta: And this CAPEXes have largely on the US subsidiary or can you give me the split how much is the investment in US subsidiary or how much in India?

Shrikant Bhakkad: It is US is about 26.5 million USD. So, the 26 crores are in the US the remaining is in India.

Tejas Mehta: So basically, our debt level will not decline from here till the end of the year?

Shrikant Bhakkad: Debt level in terms of working capital also there will be reduction and as you just pointed out the financial liabilities which are appearing they have to be paid over a period of next one year so close to around Rs48 crores the repayment of term loan itself will be there and with the increased growth also as Aditya said in the beginning of the conference we would like to maintain close to around Rs 420 crores is what our overall working capital.

Tejas Mehta: Sir my last question on the gross profit margin front given that kind of scale momentum that we have seen across the board I expected your gross margins to be much higher than what you reported especially through inventory gain so there has been some inventory gain I agree, but I hope that this inventory would have been the gains would have been much larger, can you just give some understanding over there?

Shrikant Bhakkad: I think the point that we are trying to drive is overall if you see our inventory level has come down so we are just maintaining just in time inventory so there are not too much inventory gains that happen at a large for us so that is one part of the question that you answered and the second part of the question in terms of overall working capital gross margin. The second gross margins have slightly increased so if you see earlier, we were at 39.33 and now it is 41 so gross margins have slightly increased there.

Aditya Rao: There would not be a big jump in gross margins can you explain your thinking in terms of why gross margin would improve?

Tejas Mehta: No, because we have seen steel prices jumping up from close to Rs. 32,000, Rs. 33,000 to Rs. 42,000 to Rs. 43,000 so ideally if you were sitting on that kind of historical inventory then you would have seen there is a significant gain in your gross margin that was the question.

Shrikant Bhakkad: The thing is that whatever inventory we have is typically backed up by our order book and well steel prices have jumped our order booking now what we do for that we will buy raw material now. So, for the raw material we already had inventory, we already had current debt should we already had that is relevant to the orders we had before that. So, there would not be a tremendous change in margins. However in the third quarter, I think you will see substantial changes we are seeing some positive, but again the movement will be in the 100 to 150 basis point range from a gross margin point of view it is not going to be much higher than that. So typically, we are a pass-through steel prices have increased, our procurement cost also increases if steel prices decrease and whatever inventory we have focus our order books where it does not matter whether the price will go up and down.

Tejas Mehta: Your inventory days are about 70, 75 days, right?

Management: That is correct fluctuations are going to be there, so we are going to take in one advantage the other is going to be a disadvantage. See what the management has a view so whatever inventory we are having it is more or less backed with order and those are price are more or less same. So, whenever we are having increased price for that we will be getting an increased price from the customer also. So, on inventory we would be at any trace losing the margin or gain in the margin to an extent to a large extent we will be not having that type of thing.

Tejas Mehta: So, 1% on inventory out of these Rs 418 crores of inventory how much we finished inventory and how much would be raw material?

Aditya Rao: I do have the precise breakup, but we can get back on that. My sense of it is it would be about half and half, but we will get back to you on that.

Tejas Mehta: So overall broadly say over the next I know it is very difficult to give a guidance here, but by FY22 where would you want to deal on your balance sheet front?

Aditya Rao: Balance sheet front we are our internal targets are to get to a certain cash include the cash outflow cycle which affectively becomes your networking capital cycle from a number of days point of view. We target 60 my assumption is that we will be somewhere around 70, 75 working capital days.

Tejas Mehta: And you would like to see lower debt level by FY22?

Aditya Rao: Absolutely I think our debt-equity right now is about 0.7 and we would want that to be closer to 0.5.

Moderator: Thank you. The next question is from the line of Pranay Jhaveri from JNJ Holdings. Please go ahead.

Pranay Jhaveri: Sir if you can just guide for your CAPEX number for FY21 and FY22?

Aditya Rao: FY21 we expect our top ceiling of 75 crores that is what we think we will be commissioning this typically this is going into our US projects and about 26 crores and the remaining is in our Indian projects which BIW, railways and our industrial components division capacity expansion so that is the CAPEX for this financial year. For the financial year after that we have not finalized our plans as yet, but broadly speaking if we make a full recovery as we fully expect to and get back to our pre-pandemic revenue profitability and are able to exceed it also then we would look at something approaching a 100 crore for our CAPEX for next financial year, but again this is a number that request to all of us to get back to you in Q4 where we will finalize our plans for the next financial year.

Pranay Jhaveri: Sir this land sale what is the amount that we expect?

Aditya Rao: So, we are selling about 5 acres there is a total of 50 acres that we have, and we expect about 20 crores from these 5 acres at least.

Pranay Jhaveri: Sir one question on the balance sheet like your working capital days has gone up and when I compare your March block to the September block and your debt level also have gone up, so if you can just throw some light on this?

Aditya Rao: Two things on that in terms of working capital overall if you see there is a reduction in terms of receivable as well as a reduction in terms of payable. In terms of receivables, it has decreased by close to around Rs 45 crores trade receivables and inventories have decreased by 22, but in terms of payables close to around Rs 61 crores is the decrease. So, the increased collection and reduction in inventory has matched up with the trade payables as you rightly said there is also an increase in terms of working capital, in terms of borrowings. The new borrowings that we have started taking these are vender bill discounting schemes that we have been taking earlier, but lastly, on March we stopped now we have started on the vendor bill discounting. So, the increase is on account of vender bill discounting that we have taken at the end of the month in September.

Pranay Jhaveri: So, what are your targets in terms of your networking capital days for FY21 from the current levels?

Aditya Rao: We would look at about 60 days, but we are right now at around close to above 100. We are at above 100 we are targeting 60 and there has been a consistent improvement. A lot of this has to do with a low revenue basis. As the revenue goes up those deals come down dramatically. I think we can commit 75 days at a minimum by the March when we do the next balance sheet, yes, but we can report this number for the next quarter as well and it would be obviously a number between 175.

Pranay Jhaveri: So basically, is there any debt target that you have in mind in terms of FY21, FY22 from a balance sheet perspective I am just curious to know that?

Aditya Rao: I think it is critical for us to make sure debt-equity.

Pranay Jhaveri: When I say debt means long term, short term as well as your current maturities?

Aditya Rao: Yes so if we include all of that we are at about Rs 520 crores I see that number going down in the next financial year and we increase our turnover I think the ratio that you would have to look at rather than the particular number of a debt I think if you can look at debt ratio number and how our interest cost is in comparison to our net sales those are the things that we internally monitor. We generally see the debt equity ratio should not increase drastically and we are targeting ourselves from 0.67 to close to around 0.55 or 0.5 is what they want to end up.

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

Vikram Suryavanshi: Sir you give idea about PEBS revenue is almost like a 350% of pre COVID, but can you just give slight more details on how is the gross margin or margins at EBITDA level in PEBS now and is there any change in competitive landscape post COVID in overall PEBS market in India?

Aditya Rao: So, the gross margin is more or less it has not been a massive difference in that, there may have been a reduction of 50 basis points gross margin wise. The concern over the past two, three months has been that the capital goods sector has not recovered enough for a regular order booking to come back. I believe in the last couple of months we have been able to address that somewhat and I think in this month especially I think we are seeing dramatic improvement. So, I think the market is definitely coming back for PEBS. So on the back of that we would say we are quite confident of at least moving that 50% of pre-pandemic revenues for PEBS that up to something approaching 70% I think that we can definitely commit to and that happens obviously the impact on profitability also is quite substantial.

Vikram Suryavanshi: And how is this development of this new capacity addition in railways and Raebareli project so you can give some idea on that?

Aditya Rao: So Raebareli we have postponed the CAPEX to net year primarily because as we have said railways offtake from ICF, MCF has decreased for us it is only at about again 40%, 50% of what it was. So, while PEBS and Enviro we expect a faster recovery we believe for railways revenue to recapture it may take a few more quarters a couple of more quarters perhaps. So accordingly we have readjusted the timing of that ideally we would have want to have this plant finished in this financial year, but I think we are going to be pushing it to next year the Raebareli project, but we are commissioning CAPEX in Patancheru especially in our robotic assembly unit so that CAPEX will go ahead because that will result in immediate revenue increase once commissioned.

Vikram Suryavanshi: And would it be possible to give in terms of the revenue guidance or growth in Pennar Global or overall engineering services?

Aditya Rao: Both of these businesses are doing quite well I think engineering services in this financial year if you would look at that revenue stream along I think we are looking at close to 25%, 30% growth we expect that to continue because we are actually actively seeing not too many orders right now so we will look to scale that up dramatically over the next few quarters and for the rest of Pennar Global also because of all these investments that are going in our hope is that we add a fair amount of revenue to that and once the project has been commissioned we expect nothing less than a $100 million over the next two years to come out of that, but obviously it is a process to complete the investment we have to build up the order book and then get the revenue. So probably a year from now is when we will see an extremely substantial amount coming in, but some amount of growth will definitely be there because it is a low base. Our total revenues in PGI is only about $11 million so we expect that number will grow quite well, but our ultimate goal is to get to $100 in the US.

Moderator: Thank you. The next question is a follow up from the line of Tejas Mehta from Old Bridge Capital. Please go ahead.

Tejas Mehta: Sir one question on the margin front so despite we running at 60%, 65% of pre-pandemic revenue we have already touched a 7.8% EBITDA margin on this quarter and that is largely coming through because your other OPEX is also down by about 30% as the revenue is also down by 30%, 32% so do we see any sustainable gains out of this other OPEX or will this other OPEX also scale up as you touch back your peak revenues?

Aditya Rao: See other OPEX cost predominantly consist of the job worker charges, the freight cost and other cost which are in line or in proportion to the revenue as revenues have come down this expenditures have also come down and on the other hand if you see in terms of the total proportion in which it has come down it is more or less the similar. So, the revenues go up the other OPEX will also go up to a certain extent.

Tejas Mehta: So basically, your margins are not expected to improve as you scale back up?

Aditya Rao: Gross margins yes, but EBITDA net margins we will see obviously a very high improvement, but gross margin no I think as I said 100 to 150 basis points.

Tejas Mehta: No what I am saying is that earlier we were at an EBITDA run rate of closer to 9.5%, 10% if you look two, three years back and then for various reasons our EBITDA decline to 6.5%, 7% kind of range and now we are at 7.8% I am only trying to understand that can we expect this EBITDA to go back to 9.5% 10% or there is more or less?

Aditya Rao: Yeah 100% let me clarify this so we are talking about gross margins 41% that will not change much, but when you do more revenue we are right now at very low capacity utilization so when a capacity utilization as you said would not put 60 odd put it less than that once it goes up to 75%, 80% all of that falls down to EBITDA and that boost up EBITDA because your fixed cost which was 8%, 9% if it gets divided on revenue-based which is 20%, 30% higher than 200, 300 basis points will get added to EBITDA. So, EBITDA will go up without a dramatic change in gross margins so that you can expect. Going above 9 is a near certainty EBITDA but not in gross margins.

Tejas Mehta: So out of the total cost which you had last year was about 180 crores of staff with OPEX how much of this would be fixed cost in nature?

Aditya Rao: Fixed cost we do not have apart from the employee salary cost I think the other cost is more or like rent, admin and legal and professional charges of what is these certain things those you can constitute maybe around 10% of the overall other expenses cost.

Tejas Mehta: So out of Rs140 crores roughly Rs14 crores could be fixed and staff of Rs43 crores is fixed so that is fixed so we will get leverage on that OPEX as you scale up from here and that could improve your EBITDA margin.

Aditya Rao: Yes.

Tejas Mehta: Sir for the US revenue for the US subsidiary currently our revenues are about $11 million?

Aditya Rao: Right now, we are at $11 million per year as a run rate basis for our US subsidiary correct.

Tejas Mehta: And when you say $100 million the $100 million would be on a gross block of what number, what would be the gross block number for that?

Aditya Rao: Effectively what we are investing in our Tubes IOR and this project, which is about 30, 32 crores so about $4 million to $5 million.

Tejas Mehta: So, for 20 x asset turnover?

Aditya Rao: Steel prices in the US are especially for these products are double what they are the margins are much higher and they are double of what we are in India both the commodity wise.

Tejas Mehta: And what were the margins you make on $11 million today?

Aditya Rao: I have those numbers, but I think once the project is done and once I would be comfortable, but we are projecting and please do take these numbers in the spirit that are intended these are our plans, but double of gross margins which we makeover here close to about 30% is what we expect gross margin point of view.

Tejas Mehta: Gross margins means you mean EBITDA or gross margin?

Aditya Rao: No contribution you have to remove fixed cost EBITDA levels would be around the 10%, 12% level it would not be very different from what we get in India.

Tejas Mehta: So that is why I am going to ask you the EBITDA margin is not very different, but your asset terms are very high and what is the expectation on the working capital cycle there for the US business?

Aditya Rao: It is typically slightly less than what it is in India because in India we would undertake design manufacturing and execution in the US the system is different people like us only to design and manufacturing. So consequently, our working capital cycles cut down by a month. So, it is three months here it is only two months in the US.

Tejas Mehta: And to support that business all these borrowing or debt that you would take would be from the US or would you be supporting it from India?

Aditya Rao: Working capital from India only the CAPEX which I had mentioned is about 4 million.

Tejas Mehta: Otherwise all the debt will be raised in the US utilized over there?

Aditya Rao: Working capital loan will be raised. The current asset over there is options available there for a current asset it is backed by current assets and whatever you buy you get for that.

Tejas Mehta: And then whatever money generate you will utilize to redeploy in that geography?

Aditya Rao: We have not finalized our repetition plans the board is evaluating all opportunities I think we would definitely want to see the capital invested being repatriated remaining we will use to grow in that market.

Tejas Mehta: And this $100 million revenue your target is to touch that by FY23 right?

Aditya Rao: Right now, for the first year it would not be anywhere near 100 sir 20 additional so will be 30 or 40 over the next two years yes, we can say that we are targeting that number.

Tejas Mehta: Sir fair to assume that so leave this year aside last year we were at about 2,100 crores of revenues next year let us say we grow 10% on that that means 2,300 crores so by FY23 is it fair to assume that we would cross 3,000 crores of revenue?

Aditya Rao: That is our growth plan yes.

Moderator: Thank you. The next question is from the line of Karthikeyan VK from Suyash Advisors. Please go ahead.

Karthikeyan VK: Just continuing on the same question regarding your US business couple of things who would be your target customers and what is the distribution model you propose?

Aditya Rao: Is this for all of our CAPEX is that what you are asking?

Karthikeyan VK: No, I am asking about the US business the Pennar Global?

Aditya Rao: So Pennar Global there are two aspects to it one is our Tubes IOR business and one would be metal building business. Metal building, we would be targeting all nonresidential construction so the market size for that in the US is about $7 or $8 billion we will be targeting that. For Tubes IOR it is about precision tube so that I used in process equipment, boilers not really structural though there is some element of that, but high precision tube such as CDW cold drawn welded tubes what we would be selling in the US. So, the end use for that is typically process industries automotive and process industries.

Karthikeyan VK: And you would be selling these to distributors, or would you be selling directly to customers?

Aditya Rao: We would be selling direct to customers OEM.

Moderator: Thank you. The next question is from the line of Pranay Jhaveri from JNJ Holdings. Please go ahead.

Pranay Jhaveri: Sir I just want clarity as you said capacity utilization currently is what?

Aditya Rao: Our current capacity utilization varies across our businesses but to answer the question about 50% as an average across verticals.

Pranay Jhaveri: Just like to increase this utilization would there that we would chase some orders and therefore some lower EBITDA margins if you can just throw some light on it?

Aditya Rao: I do not think we want to do that and that is one reason why though we had a substantial recovery in Q2 to Q1 and we have an even better recovery in Q3 compared to Q2 I think we have been very discipline in terms of it is our assessment that we are being very disciplined, but we want to be very discipline that is undeniable. We want to make sure that we only take a minimum profitability each of our business we want to make sure they at least hit certain percentage PBT and only then we service orders. So low margin we would probably be not be involved in. In fact, any CAPEX we do also our board is very clear now that we only due to our margin business. Our every effort will be to make sure that we do not take low margin revenue if it is a choice within low margin revenue and less profitability, we will choose less profitability.

Pranay Jhaveri: So where do you see your utilization rate at the exit of FY21?

Aditya Rao: That would be higher closer to 65% to 70% which is pretty much what it was prior to the pandemic.

Pranay Jhaveri: Sir I am unable to figure out say we are at 50% utilization and stretch working capital cycle still we want to do a CAPEX of about 75 crore for this year we are at 50% utilization so we have a long way to go to I am just trying to figure out?

Aditya Rao: It is a great question let me answer it best way I can. So, as I had said as a 50% capacity utilization cuts across sectors. So, in some sectors we are vastly below 50 some sectors we are much higher than 50. So our CAPEX plans are based on which sectors where do we see, where can we if we add capacity we will be able to increase revenue that is typically the proposal awaiting and because we have a diverse range of products it is very possible for us to add capacity in businesses which are at capacity or we see an opportunity and that is what we are investing in right now wherever we are putting our capital in new addressable markets, in new businesses which is why in my introductory note I had said our growth plan will follow two folds. One, getting existing capacity utilization back up to some 60%, 70% and adding new capital assets which we will be able to further increased revenue and profitability. If it is only one product then obviously what you are saying is absolutely valid and true, but what I am trying to say is if we made only product and we are at 50% capacity utilization and we are spending 75 crores that makes very little sense, but the fact of the matter is in several of our business we are actually do not have enough capacity to service demand. In several other businesses we have a lot more capacity and we are waiting for the market to come back such as PEB. So, we are not adding capacity in PEB in India, we are not adding capacity in Enviro, we are not adding capacity also in solar and others. Where are we adding capacity, where is this 75 crore going it is going into a BIW project where we have a strong order book but our LPS line is just coming online right now, our HPS line is coming online right now, hot stamping line it is coming online. The movement they are up, revenue jumps up right now we are not able to cater to our orders on that because we do not have the equipment. The other places where we are putting up capacity in the US. So, we have been in the US for a long time, we have substantial team over there we have revenue of 11. We invest this capital we are going to be able to grow revenue over so that is the rationale behind this. What we will try to do is give you a break up of what are capacity utilization is division wise and this CAPEX is for new growth, new revenue, new addressable markets combined both of them and we expect substantial growth by the end of this year.

Pranay Jhaveri: I am just trying to understand if you are investing a rupee today what is your return or the ROC that you incrementally target so I am just thinking from say if I have five businesses because of the cyclicality there will be one or two businesses which will be laggard and one or two business which will be moving and we start investing in that business as on this point of time and maybe two, three years down where we see that cyclicality hitting then we will have another business where we need CAPEX so I am just trying to understand what is that ROC number that you look for that every rupee invested over a period of say 5 year, 10 year will fetch that?

Aditya Rao: On a working capital point of view we expect a minimum of 20% on a capital point of view we expect a minimum of 30% CAPEX return on investment when we deploy capital.

Pranay Jhaveri: 30% ROC.

Aditya Rao: Well ROC is total capital employed in a business we tend to break it up into two pieces. We look at working capital differently, we look at CAPEX differently if you want to add both of them up then I think you should probably look at a number closer to 22%, 23% because typically we use more working capital then CAPEX. I am glad to get into this more detail if you want offline so I think the good question and I understand we may not have fully answered it, but you are right business was cyclical and we have to be careful in terms of when we deploy capital and capacity expansion itself is not the answer I think it is about the way we look at it if we deploy capital how confident are we that we can grow sustainable revenue profitability and when do we get our capital back. So, we will try to explain that to you in detail and take your advice on if you are missing something.

Pranay Jhaveri: I am nobody to the advice I am just trying to understand from an investors point of view that any money invested what is the return that you would expect over a period of time?

Aditya Rao: 20% to 25% is what I can guide you.

Moderator: Thank you. The next question is from the line of Vijay Kumar, an Individual Investor. Please go ahead.

Vijay Kumar: My question is Aditya from the PEBS we are having an order book of 520 crores last time and this time the execution is about 190, 195 crores and your closing order book is about 280 crore so is that fair to say that our order books have come down in PEBS?

Aditya Rao: Sorry your question is what has been the evolution of PEBS order book if I am correct?

Vijay Kumar: Yes are we seeing a climb down in our order book was there any cancellation or was there any natural activation or non-execution I see the order books coming down it is not matching up to the execution this quarter with respect to open and closing balance?

Aditya Rao: I think as of September end which is number that we have we were in a position where our order book in PEBS was declining you are absolutely right and that was because as I mentioned the capital goods sector was not recovering well enough, but I think in this month and in the last month we have seen substantial improvement and we expect the order book to it has gone up in last month it will go up again in this month we are quite confident. So, it will go about 300 and I think if we can get to a number closer to 400 then I think we are comfortable, and I think I see that happening in the next two months.

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

Dilip Sahoo: My question is regarding the bad debts our last two years of bad debts has been 20, 23 crores almost 20% of our PBT, 1% of our sales is it a normal in the industry or there is some division contributing to bad debt more than others?

Aditya Rao: No, I think historical numbers we have looked at we have looked at what turns bad and we provision a certain percentage of our receivables automatically. I think that numbers is 0.5.

Management: The new method in terms of provisioning of receivables is more of an expected credit loss method so this is the new method under which we are making the provision so it is not that we write off certain things, but overall we take in this business as a norm 0.05%, but certain debt do become bad and in terms of the overall range we are like anywhere between 0.5 to 0.6 in terms of our total revenue.

Moderator: Thank you. The next question is from the line of Tejas Mehta from Old Bridge Capital. Please go ahead.

Tejas Mehta: Sir just a follow up to form previous investor's question so you mentioned that we would end up doing CAPEX in the lines where the capacity is not up to the market for the order book that you ask to execute, so when you are penciling in or when you are building in a 20%, 25% ROCE on that CAPEX typically what is the capacity utilization that we assume over a period of time?

Aditya Rao: 75% I mean we do not call it capacity utilization we call it OEE and we expect 75% utilization on that and we build up that much capacity so that 75% of the capacity caters to what we believe to be sustainable revenue and order book.

Tejas Mehta: So the point is if we look into the past track record the thing is that in every year there are different segments of business which lead the growth and you would end up doing CAPEX for those segments and those segments in the subsequent say after one or two years they will fall off on the growth benchmark and something else will emerge for you in terms of growth so yes while your growth is very well hedged the point is that overall your capital efficiency may not be up to the mark compared to what you are building into your model, is there a fair assumption?

Aditya Rao: You are absolutely right I think the point you made also is that and the previous person asked the question also made is that it is possible for a lot of these business to be cyclical so like solar for example we have made CAPEX with the assumption that we get a capital back in about three years let us assume and that has actually been the case so we have invested does in the first year in the second year revenue drops off because the sector is going through some upheaval or orders are not being placed because of some new excise duty rules and what ends up happening is that the CAPEX efficacy as we call it which is how efficiently they are deploying capital drops for that. In the next year, it does come back then again it may not come back so what that tends to do is that while on paper we implement those projects with the expectation that we get 20%, 25%. In practicality it falls down to a number less than that, that has happened in the past what we are trying to do now is to factor that in and not take next one-year revenue, but take sustainable revenue which is we average out the revenue assuming that their businesses are cyclical and will go through ups and down especially in the automotive space, especially in the solar space and even in the railway space. Once we do that, we are moderating it by about 30% that should get the numbers to align up better, but yeah that is what we are doing now, but in previous years we have not done that.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was the last question. I now hand the conference over to the management for closing comments.

Aditya Rao: Thanks to all the stakeholders for their questions and we will endeavour to explain them as best as we can. We will work on some of the broad question categories which were there and hope to address them better to some of you but thank you again for the question and Happy Diwali to all of you.

Moderator: Thank you. On behalf of PhillipCapital (India) Private Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.