"Pennar Industries Limited Q1FY17 Earnings Conference Call"

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MANAGEMENT: **MR. ADITYA RAO – VICE CHAIRMAN & MANAGING DIRECTOR, PENNAR INDUSTRIES LIMITED**
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MODERATOR: **MS. DEVANSHI DHRUVA - DOLAT CAPITAL MARKETS PRIVATE LIMITED**

Moderator: Good day ladies and gentlemen and welcome to the Pennar Industries Q1 FY17 Earnings Conference Call hosted by Dolat Capital Market. 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Devanshi Dhruva from Dolat Capital. Thank you and over to you ma'am.

Devanshi Dhruva: Good Morning everyone. On behalf of Dolat Capital I welcome you all to Q1 FY17 con-call of Pennar Industries. We have Mr. Aditya Rao -Vice Chairman and MD and Mr. Krishna Prasad- CFO with us from the management of Pennar. The management will brief us about the results and then it will be followed by a Q&A Session. I would now like to hand over the call to Mr. Aditya Rao for his opening comments. Over to you, sir.

Aditya Rao: Thank you so much. To all the stakeholders of Pennar Industries, thank you for joining us for the 1st Quarter conference call on the performance of the company and its subsidiaries.

For the 1st Quarter in question, Pennar Industries recorded gross sales of Rs. 347 crores and net sales of Rs. 308.7 crores as compared to Rs.274.3 crores for the same period last year which is a growth of around 12.6%, EBITDA of Rs. 38.2 crores as opposed to Rs. 26.4 crores which is a growth of 44.8% and net profit of Rs. 7.8 crores as opposed to Rs. 6.6 crores which is the growth of 18.3%. The cash profit for the company grew to Rs. 16.7 crores compared to last year's Rs. 12.1 crores which is a growth of 38.1%. On a standalone basis, the gross sales for Pennar Industries were Rs. 238.9 crores as opposed to Rs. 212.4 cr. last year. The net sales were Rs. 212.9 cr. as opposed to Rs.185.1 cr. which is a growth of 15%. The EBITDA grew to Rs. 18.8 cr. from Rs. 16.2 cr. which is a growth of 16.2% and the net profit of the company was Rs. 4.4 crores as opposed to Rs. 3.8 crores which is a growth of 14.2%.

From a segmental business point of view; all four business divisions of the standalone company showed revenue growth and all the company subsidiaries and all business units of the company showed revenue growth. In terms of EBITDA, all but one division which is the steel products division had EBITDA de-grew and we will get in to reasons for why that business underperformed over the course of this conference call. But it is due to all of these businesses are scaling up where we were able to record both substantial revenue, EBITDA and PAT growth on both standalone and consolidated basis.

From the business unit point of view; Systems and Projects recorded Rs. 68 crores for the quarter and net sales of Tubes was at Rs. 39.8 crores, Industrial Components recorded Rs. 14.6 crores and the Steel Products business unit recorded Rs. 81.9 crores for the total standalone

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sales of Rs. 212.9 crores in terms of net sales and total consolidated net sales as I had mentioned is Rs. 308.7 crores. So the EBITDA break up for the 1st Quarter: Systems and Projects recorded Rs. 9.6 crores in EBITDA which was a very high growth rate of 40.4% in EBITDA. Tubes recorded EBITDA of Rs. 3.3 crores as opposed to Rs. 2.4 crores which is a 38% growth in EBITDA. Industrial components was flattish in terms of EBITDA which was Rs. 2.2 crores as opposed to Rs. 2.1 last year which is a growth of about 3.4%, so very moderate amount of growth in EBITDA. The steel product business units degrew to Rs. 3.6 crores EBITDA as opposed to Rs. 4.6 crores. The steel products was the only business unit at Pennar Industries which underperformed in Q1 in spite of our adding Special Grade CR which showed very good growth in both revenue and realizations and EBITDA in the financial year. Our regular business which still forms a significant part of the revenue of the company, if not its EBITDA, did show a de-growth primarily because of the imposition of MIP and safeguard duty. So the double impact of it has resulted in prices going up and in all of our value-added divisions, we were able to pass this on and even grow our margins in all these cases. In this particular business unit, because it is so close to commodity, we were not able to bring in this price correction with our customers. This has however been corrected in the second quarter or as in the quarter we are in right now. So we expect Quarter 2 to continue to be strong and the issue we had in the steel BU now does not exist when we passed on our price increase and with further increases in our Special Grade CR sales, this business's EBITDA is also projected to increase over the next few quarters including Q2.

Railways did very well; we booked multiple orders from Integral Coach Factory and MCF in the North as well. Texmaco and Hindustan Engineering also brought in a lot of wagon orders and BEML also has held steady. We have added new CRF Sections to BOXNS Wagon.

In the solar vertical we have added four new customers, Consol Energy, Nexun Energy, Traxun Energy and Bhoruka Power. We also have other regular customers Sterling & Wilson, Larsen & Toubro, Mahindra, Nuevosol, Sun Edison, Acme, Sterling & Wilson and others. There are lot of them that have also continued to be customers. So for the Systems and Projects business which is a star performer in this quarter with 40% growth in revenue and EBITDA and EBITDA margin as well slight though it is, this business division has performed extremely well in this quarter and we expect this trend to continue.

In Industrial components; the major customers during the quarter were Emerson Climate Technologies, Tecumseh and Endurance and others. We also have some export orders which are going to be executed in the Q2 and Q3, primarily from Xylem and Bailey in the US. We have commissioned a new 260T link motion press which we believe will allow us to improve yields, consequently improve margins and also bring us some capacity expansion.

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Tubes has done well for Q1; in fact in terms of our internal budgeting, Tubes, Railways and Solar exceeded our internal targets as well. We believe that over the course of this year, Tubes will continue to grow well. We are undertaking some CAPEX right now which we had mentioned in the last conference call. We are pretty certain that the tube sector will continue to see strong growth.

Sheet Piles, as we have mentioned, we had received orders from Soma Enterprises, Thermax, Diamond Engineering, among others. We also received repeat orders from several of our customers including Phenix, Power Mech Projects and also IVRCL. Our regular customers Ashok Leyland, Thermax, Larsen & Toubro continue to be customers who provide a lot of core revenue for this business. But as I mentioned, owing to a decreased off-take, we saw pricing concerns here and that is the reason while we had revenue growth we actually have contraction in margin in this business division. As we also mentioned we are convinced that Q2 will not see this pressure. It is because of imposition of MIP and the safeguard duty resulted in a sudden increase in raw material price and which for the lowest margin business for the company, the commodity business of the company, we were not able to pass that on.

Pennar Enviro has done well during the quarter. We received new orders from BHEL, Waterlife, Gamesa Power and Parry Sugar Refinery India. Repeat orders also from United Spirits, I.G Petrochemicals, United Breweries and Tube Products of India. We have also added a couple of new products in the chemical additives business as also in Pennar Enviro and we will soon hope to give you some good news on this as well. From a revenue point of view, it grew up by almost 300% and has added significantly to revenue growth in this quarter.

With that I would like to hand it over to the moderator for any questions you may have on the performance of the company's various business units.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Pratik Bohra, he is an individual investor. Please go ahead.

Pratik Bohra: My question is on the tax rate this quarter and also FY16 our tax rate was 35% and 42%, so your views on this please because this quarter it was around 42%?

Aditya Rao: The tax rate will be higher because we constantly undertake new capital expenditure and that does have an effect of increasing our depreciation which based on where we take it we actually record a higher DTA. But if you look at the actual tax paid out it is close to 33%, it is always going to be. So for year in question you will have 33% but you will have deferred tax liabilities which will result in a tax rate looking a little higher. But from a cash point of view, the income tax for the company will continue to be 33%.

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Pratik Bohra: On the interest cost, year-on-year our interest cost on standalone has gone up by around 36% and consol level by 52%. This is more because in Q4 we had ramped up the inventory to tide over the MIP and the increase in steel price is it that because of our short-term debt has gone up and hence it is reflecting in the increased interest cost or is there some other reason also to it?

Aditya Rao: It is almost completely that. From Q4 to Q1 the debt of the company has not gone up, in fact it has gone down. Consolidated debt has actually gone down and standalone debt also has gone down. But what we do see essentially is the fact that we have to go long on inventory. So for a comparison point of view, the total inventory in the standalone company and for the purpose I'm going to include raw material, WIP and FG. In the last year it was at 19,000, and for the Q1, the quarter in question, we were right now sitting at 28,000 tons of inventory. We did not have a choice because some of the project orders for the company, they are short cycle time so there is no scope for us to pass on raw material price increases. With MIP being imposed and it is reimposed again a few weeks ago we had no choice but to go ahead and do this. We don't want to take risk on raw material; we don’t take exposure on raw material price so that will result in periodically our interest cost being substantially higher. But that being the case you don't need to assume that it will be uniform throughout the year. There will be a little bit of up and down but over the course of a year there is a moderating impact and you may see higher interest cost in keeping with our higher revenue growth. I don't believe you will see a 52% increase over the year.

Pratik Bohra: Actually I was coming from the point that I mean management strategy of shifting in product mix to higher value-added product, is showing up in the EBITDA margin consistently for like over 5-6 quarters. But increase in EBITDA margin or increase in EBITDA is not flowing commensurately to the bottom line also. So like 44% increase in EBITDA that while coming down to the PAT goes like almost half so it’s like around 18% and major portion of it is being eaten up by interest cost. From that perspective I was trying to understand that how we try to tackle this?

Aditya Rao: A very good question. Though I don’t think interest cost alone is contributing to the decrease, to the drop from EBITDA to PAT. Now if you're looking at the net profit you are absolutely right, from 44.8% EBITDA growth you will look at a drop to net profit growth of 18.3%. But what I want you to look at is also the cash profit number. Now that includes the depreciation which is also substantially higher added back and also any deferred tax because of any CAPEX that we do added back, which are non-cash items, these are not leaving the company. Cash profit of the company is increased by 40% which is more in line with EBITDA growth. So the interest cost if increases doesn't actually play a very huge role in dropping the EBITDA growth numbers down. That is a number that for any growth oriented company you will have higher

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increases in depreciation, you will have increases in interest cost as you try to scale up revenue. But as the operating cycle stabilizes, that goes back to the norm, over a period of 3 months to 4 months. But if you look at the cash profit number too, ideally our EBITDA growth should be our PAT growth, according to me, from a growth rate point of view. But it is near there, from 44 it's going to 38.1. So there is a 4%-5% difference from a growth rate point of view but that is something that will get addressed as we keep going through an operating cycle.

Pratik Bohra: But from the cash PAT also I tried another thing from that point also, the cash which is getting accrued that is again we are having CAPEX lined up. The inventory booking exercise which we did in Q4, so cash PAT is also not really helping us reduce our debt substantially or help us generate higher free cash flow which is of course restraining us from giving out dividend also. Essentially we are coming down to the point that free cash flow generation is not very commensurate but the EBITDA also. The whole point the EBITDA at 44% is not getting reflected into PAT of free cash flow generation because we have CAPEX lined up; there is this inventory thing which went into the Q4. So the cash point is well taken but there is again cycle lined up for which we are looking to deploy that cash also.

Aditya Rao: You asked another excellent question and I am fully in agreement with you. Absolutely, we are not seeing the increase in EBITDA, drop down to the operating cash flow. Operating cash flow after CAPEX after inventory changes has to be positive. It is one of the ways we measure ourselves. For the last couple of quarters, we have not seen it. You're seeing an improvement, yes, but not on a consolidated basis also on a standalone basis, you will see an improvement. Otherwise we won't be able to repay our short term debt also. You are seeing an improvement but not commensurate with EBITDA growth. That is something that I am confident we will bring in over the next few quarters. But in our time period in a frame where we are looking at increasing inventory is to guard ourselves against price escalation and this is not the norm. There is tremendous volatility in steel prices right now. There is tremendous amount of capital we are deploying to make sure that our growth rates remain intact. But these are temporary and they have been done out of our own cash flows and we still have capital after this to reduce our debts. So I agree with you, over the medium-term you should see this, over the course of this year you should see our operating cash flow after inventory changes and after the CAPEX increase. But I have to agree with you and you will see this but this quarter you don't see that much of it.

Pratik Bohra: Why are around 7.5% shares of promoters pledged?

Aditya Rao: The pledge created is for PEBS, which doesn't have anything to do with fund-raising by the promoters. It has more to do with us putting the money down for banks and institutions. That is

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as a security instrument, since PEBS is a young company. It is only five years old. That would be the reason that it is there but there is no promoter funding that has been undertaken.

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

Vikram Suryanvanshi: Just wanted to understand in your other expenditure the growth is much higher than the revenue growth. So is there any particular reason for higher increase in other expenditure?

Aditya Rao: Do you mean on a standalone basis or a consolidated basis?

Vikram Suryanvanshi: Consolidated.

Aditya Rao: The other expenses are higher for consolidated basis primarily because we are undertaking some activities in engineering services also and also developing some engineering services platforms. There is no capital work in progress; there is nothing in PEBS that has been left on the book. So the entire thing has been expensed out on the advice of our auditor and that's the reason you see that other income figure being a lot higher. So most of this is cost in terms of procurement of licenses, some AMC charges we have paid, some product software development which we have done to develop certain platforms for continuing the engineering services work. All of those have been expensed out and that's the reason you see other income being higher. It is entirely because of that, for the consolidated company.

Vikram Suryanvanshi: Can you share the revenue from Enviro business?

Aditya Rao: Q1 was Rs. 23 crores as opposed to Rs. 7 crores Q1 last year.

Moderator: Thank you. The next question is from the line of Pawan Kumar from Unifi Capital. Please go ahead.

Pawan Kumar: I just wanted to understand your performance of steel division further. Do we expect things getting better going forward? Pennar Enviro I understand there has been tremendous growth but I also wanted some clarity on how is the working capital situation playing out.

Aditya Rao: The first question which you had was on what's the prognosis for the steel business unit. You have to break the steel business unit into two parts. One part is the legacy business of the company what we call CRSS and CRFS. That will continue to persist with low growth rates. However we have done some CAPEX if you do recall in Q4 of last year. We completed it and commissioned the Special Grade CR project. That has already started adding about 800 tons to

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1000 tons a month which is close to about Rs. 6 crores in a month being added and this is at higher margin, the differential EBITDA is at 12%. We believe this can go to 2000 tons which means it can add another maybe 70-80 crores in terms of revenue this financial year, in addition to what we are already adding, which means it will go well past over 100 crores. So this year compared to last year in question we are confident you will see growth in the steel products business. You will also see margin expansion. But what we would want also is raw material price stability because that is the one place of the company, that is the one business unit which can be thought of to be commodity and we are exposed to the usual risk the commodity companies are exposed to. That being said I'm quite confident that Q2-Q3-Q4 will see growth in this business verticals and also EBITDA margin expansion.

Pawan Kumar: What was the price rise due to MIP that you had to take in this particular quarter?

Aditya Rao: The entire price rise was about Rs.4500 per ton, close to about 15% to 18%.

Pawan Kumar: With this you are saying has affected your volumes pick-up, is it?

Aditya Rao: Not so much volume pickup, volume pick up we wouldn't mind. We don't really focus in growing this business division. But it’s the margin; we were not able to pass on. The entire 15%-18% price increase, we were not able to pass on. The steady state EBITDA we make in this business division is only around 6%-7%. So when you have price increases of 18% and that 70% of your cost is just that raw material price and our inability to pass that on well will result in dislocations to EBITDA. We actually did a reasonably good job, in my opinion, in passing through that cost but we just were not able to overcome that in the first quarter itself. Now we have gone ahead and done that, we have passed on the cost increase and also I am sure there is certain amount of margin expansion has happened because of Special Grade. So you should see that this year we had growth in sales in all business divisions and growth in EBITDA in all business divisions but this one. In Q2, I'm hopeful that we will be able to remove that caveat and say we have revenue and EBITDA growth in all business divisions of the company.

Pawan Kumar: For some granular understanding, can I understand what kind of raw materials do you use here and I understand the end products as CRC sheets but what are the raw materials you use here?

Aditya Rao: It's a wide variety of them; again I will keep Special Grade aside. But we typically buy wide grade of HR Steel and this can be ST01, ST02, WT01, high carbon steels, low carbon steels, manganese chromium alloys and a various different kinds of steels, varying in its strengths and it depends a lot on what our end customers want. So the diversity in procurement is quite high in this business.

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Pawan Kumar: About the working capital in Pennar Enviro.

Aditya Rao: Pennar Enviro doesn't use a lot of working capital. The total working capital limits last year were about 12 crores including CC, non-cash. The cash portion has not increased, the non-cash limits have increased but the utilization is still around only about 10 crores. And the idea is the using that 10 crores, we are able to generate revenue. Last year's number was 100 crores and we can expect well in excess of that, a high growth this year also.

Pawan Kumar: But overall on the working capital side you are saying the inventory value has increased, that is what has got the jump in debt levels?

Aditya Rao: Not inventory value, inventory holding. So in a sense, yes, inventory value, but if you look at it from a per ton unit in a standalone company, we went from holding 19,000 tons to 28,000 tons. For a while we even crossed 30,000 tons. We had no choice in this, we have orders and we have to book raw material because we do not take exposure on the raw material steel prices. In PEBS in question also, the total inventory that we hold went up from about 5000 tons to about 7000 tons. Again, we had to and in fact there will be some press notes which we are giving out regarding PEBS performance from the last quarter in order booking. But PEBS order booking has done really well in Q1 and we are going to releasing a press note on that. This is a necessary response to uncertainty in steel prices. If MIP comes and if raw material price volatility is existent, our only response will be to book raw material.

Pawan Kumar: Lastly about the CAPEX plan for FY17.

Aditya Rao: We have a divisional capex. On the overall consolidated company we expect to spend about Rs. 40 to 45 crores in terms of capital expenditure, all of it financed by internal accruals.

Moderator: Thank you. The next question is from the line of Anubhav Gupta from Maybank. Please go ahead.

Anubhav Gupta: My first question is on the consolidated revenue, congrats on the good performance for the system and tube businesses. But the industrial component and steel product business have been the drag on the strong performance for the first two businesses. So what I believe is there are two main factors for this, number one is the demand outlook for the industrial components and second is the volatility in the steel prices. Just wanted to understand what steps or what's the strategy in the medium term to prevent this volatility in the earnings and revenue? When do you see the external factors like the money improving for the industrial components over the next few quarters?

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Aditya Rao: On our steel products, you are absolutely right and also in industrial components. Because of monsoons, we saw both the white goods sector and the automotive sector which is the core business market vertical for industrial components, suffer. We are seeing an improvement in this quarter but you are right for industrial components, we are not saying that we will have a very high growth. That's the one business division in the company where we will have growth but not very strong double-digit growth. The reason for that is because of the products that we employ, the product development life cycles are very huge and while we have a lot of products which are in the development stage, including the hydraulics business which is doing well and we are doing some things in terms of new product development, to shorten this 9 month cycle that we have. We will not be promising high-growth, we'll have growth, we are pretty certain that Q2 will see growth as well as Q3 and Q4. We have booked a good amount of hydraulics orders again from Bailey, which will drive revenue up. We are looking at increasing with the new 250T Link Motion press that has been set up. We are confident that our orders with INEL and others would also increase. But there is a concern here in terms of the market not being very strong especially in Q1 and Q2, to drive sales very strongly. So we will see a growth but not very high growth.

Anubhav Gupta: What's the strategy to protect the company's earnings from the steel volatility?

Aditya Rao: I believe the response we have is that, the moment we book orders, the moment we have exposure, we go out and buy raw material. Now, if the raw material price were to be volatile and move up a lot in that time frame then we are protected so we are not going to be exposed to any raw material price variations risk. But if the raw material price will fall down obviously we give up on that benefit. So the call we have taken that we are not a trader, it is impossible for us to predict what the raw material price will be a quarter from now, two quarters from now. We can generally follow the trends in industry. But because of our policy while we sometimes bear a higher inventory carrying cost of a crore maybe or a couple of crores, we will protect ourselves completely from any margin fluctuations.

Anubhav Gupta: My second question is on the Pennar Enviro business, what's the outlook there, what's the order book? Obviously first quarter has been quite good, you think this growth is sustainable for the rest of the year?

Aditya Rao: Yes I believe so. I think Q2 will be stronger than Q1, substantially stronger compared to not just Q1 and Q2 of last year but compared to our performance in Q1 as well. We are quite sure. In fact Q1 would have been even better but for a lot of revenue which because of the monsoon got pushed to Q2, which is now happened in Q2. So we are quite confident of growth in Q2. When we do the Q2 conference call I am sure we will have better numbers than Q1 for Q2 and Q1 number themselves are very high from the corresponding quarter last year.

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Anubhav Gupta: What are the main growth drivers for this business?

Aditya Rao: We are essentially trying to leverage our technology. So we have a lot of technologies in industrial water and waste water. We are not in the municipal water space; we are in the industrial space. So we have completed desalination plants for Sanofi, one of the largest pharmaceutical companies, the largest manufacturer in the world in fact. We have completed a demineralization water plant for JBF, one of the largest refineries in India. We have done Zero Liquid Discharge Plant, Effluent Treatment Systems and Effluent Recycling Systems. We are also working with Nuclear Power Corporation and others. Some other orders, we cannot reveal because our customers have requested us for confidentiality but the order book for this business remains strong. It's a technology company and employing a wide range of technologies. We are able to provide solutions which allow us, similar to PEBS, a very short operating cycle of 3 months to 6 months. We are able to get in, finish the project and come out of it unlike municipal projects. The return on capital employed is quite good.

Anubhav Gupta: Since you are not into municipal segment but we do hear the government will come up with lot of sewage treatment plants, for cleaning up of Ganga. So would you be interested in taking such contracts so you think the private sector demand is sufficient for the growth in this segment for the next 2 to 3 years?

Aditya Rao: The private sector demand will be enough to sustain. We will look at anything that comes our way but rather than saying that municipal, we will not do a government. So, for us the most important aspect is capital efficiency, resource efficiency and capital is one of our key resources. So if we were to take an order, the main factor for us would be that the return on capital employed be above a certain level, the cash flow cycle be very quick and our payment terms be secured. If those are given, then we will absolutely explore opportunities but typically in government orders and you mentioned large STP orders, you typically don't see this kind of a margin profile. But if there is certain high-technology applications, high purity water applications, then we will take a look at it provided the payment terms are secured.

Moderator: Thank you. The next question is from the line of Pawan Kumar from Unifi Capital. Please go ahead.

Pawan Kumar: Can you elaborate the outlook on projects and systems business and how much is it expected to grow this year? What are the orders we have got here?

Aditya Rao: We will not give a number in terms of guidance but I think I can safely say you will see very high growth this year, high double-digit growth in Systems and Projects will definitely be accomplished by us. The reason for that is simple. Our coach orders are quite good from ICF.

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They themselves are expanding. We have now expanded that further to also take orders from MCF (Modern Coach Factory) as well. So that order book is strong, it has a very high margin. So we are quite confident that growth will go ahead. We also have the good wagon pick up, as I mentioned, we have picked up orders from HEIL and Texmaco, so that will definitely also increase wagon take off as well. In Solar, we are choosers. We choose what orders we want to take. We have completely full right now in terms of our production capacity for solar. We are adding new capacity constantly; we are adding a new fast 2 mm roll forming mill which will allow us to do close to 2000 tons amount increase in the solar, in MMS systems, we can supply. That will allow us to increase revenue further and of course that will allow us to book more orders also. But we are now constrained more by our capacities in solar then we are by orders of the market. In fact Q1 and Q2 are typically low in Solar, Q3 and Q4 are the larger providers of orders in execution and revenue. So we are quite confident on the back of Coaches, Wagons and Solar, Systems and Projects will do very well this year.

Pawan Kumar: Can you put some numbers of the order book in coaches and wagons?

Aditya Rao: The coach order book is at around 140 crores, the wagon order book is little unchanged from last quarter, it's still at about 40 crores. Solar orders, typically now when we give order book, we give you end of Quarter 1. I don't have the solar order book at the end of Q1 but I have the order book right now, which is quite substantial, which will be around 80-90 crores.

Pawan Kumar: Can we surpass the growth that we have achieved last year?

Aditya Rao: In what business?

Pawan Kumar: Projects and Systems business.

Aditya Rao: Definitely. Last year you saw us grew from I think 90 to140 or around that, we will surpass that.

Moderator: Thank you. The next question is from the line of Anil Sarin from Edelweiss. Please go ahead.

Anil Sarin: I had two questions, what are the margins for railways and solar separately, we know the consol margin, but individually what are the margins?

Aditya Rao: What I will give you is the operating margin. I know that's not what you want. But we tend to blend them together for EBITDA. But the three verticals you would want to look at, the coach business, the wagon business and the solar MMS business. So what I will give you is the contribution, a margin after variable for each business, for each of the three verticals which are

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taken separately. For coaches we typically tend to get a 35% to 40% depending on the quality of order book for our contribution, wagons we source about between 15% and 20% and solar we get about 12% to 15% in margin after variable. Now this can vary from an order to order basis but if you look at the entire order book right now, what I have given you is the conservative least margin that we typically book orders at.

Anil Sarin: And it all boils down to around 14% EBITDA margin after all the overheads are included?

Aditya Rao: That is accurate but is exposed to scale. In any high operating margin business where the gap between EBITDA and operating margin is very high, by definition there is a lot operating leverage present. So you would have seen over the last few quarters margins in this segment also scaling up by about 50 basis points, 100 basis points a year roughly, so that also can continue. But as of right now you are correct it's 14%-plus margins EBITDA.

Anil Sarin: I wanted to highlight the fact that the margin year over year has not grown. It is around 14.1 last year same quarter and same for this quarter as well at our percentage EBITDA margin level.

Aditya Rao: That's correct, 14% last quarter and this quarter. That would have been because of the change in terms of wagons and coaches. But if you look at the full year in question, then you will see growth in coaches, growth in wagons, growth in solar, so all of that blend together will result in margin expansion over the course of a year. Which is why if you look at quarter-to-quarter also it is flattish in terms of EBITDA margin growth but you can expect margin expansion in this business. It is by definition going to happen if we just execute our order book.

Anil Sarin: Anyway it’s now very close to becoming the largest segment coming closer and closer to the steel products, so as it becomes the largest segment the operating leverage will start kicking in and this 14.1 could become 15-16 is possible? Of course the product mix also dictates a part of it but if the product mix were to be optimum and the scale would be optimum what maxima can we achieve?

Aditya Rao: If coaches were to comprise 50% of systems and projects revenue, the wagons were to comprise 25% and the remaining 25% of solar; we can aim at EBITDA margins in the high teens.

Anil Sarin: I missed out that part, Enviro what was the revenue in this quarter?

Aditya Rao: This quarter between 22 and 23 crores.

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Anil Sarin: So Enviro as a business has been growing very rapidly in the last three years, how long do you expect, first of all the base is getting is bigger and second you maybe cornering a part of the market and incrementally maybe proving to be difficult, so I guess what I am asking is that what growth rates can one reasonably expect on the high base that you achieved last year?

Aditya Rao: We obviously would not have a sustainable 300% growth rate which is what we had last year and the year before that, so we grew from 7 to 30, 30 to 100, so we are not going to see that sustainably happen obviously. Our five-year strategy plan for Pennar Enviro calls for the high double digit growth over the next 4 to 5 years. Next four years we have detailed out. We are in the middle of a five-year plan but growth will continue primarily because of the technologies we have employed, the addressable market sizes are very large and as we grow and as we try to implement more and more, we are also expanding our capabilities to push out more and more revenue out of the order book, to squeeze more out on a quicker time basis. We are bidding on a large order right now, for example. We are very scared frankly that we are bidding on it. It is a 600 crore order and we are very scared of bidding on it but we believe cash flows are strong, we believe that the technology is good and there is a good amount of tie-in with tubes business, fair amount of precision components that needs to be sourced from them. So taking all this into account, I believe you can expect a strong persistent double-digit growth CAGR over the next four years.

Anil Sarin: One last thing, on solar, considering the mega wattage that is getting added in solar in India and your early entry into this segment don't you think the revenue from solar needs to be much higher?

Aditya Rao: It should be. We have a caveat there. While on the market side we can literally go out there and book as many solar orders as we want, we will absolutely have the ability to do that. A lot of the people currently developing solar projects are doing so on a stringy budget. I think essentially they expect people like us, MMS suppliers, to finance their working capital during execution, their CAPEX essentially I would say, and also there are certain minimum payment terms that we expect which they may not be able to meet. So, while the actual market is huge we tend to work with only companies who are very strong financially and these include Mahindra, Sterling and Wilson, Tata Power, among others. So we will ensure that we work with good companies and good payments terms. We do not give credit to anyone except people like L&T where its fine, our relationship with them is so strong, we can give them credit. That is the kind of a bottleneck for us. Actually more important than the market right now is our capacity. We will be adding capacity in solar, so solar will continue to grow, a strong growth vertical for us this year as it was last year but the bottlenecks here are our production capacity and our financial requirements, our payment terms which we will not compromise on. But in

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spite of that we will see growth. Were we to compromise on those? Absolutely, we would have seen much higher revenue but we are not comfortable doing that at this point.

Anil Sarin: On the steel division the revenue growth is not yet reflecting the MIP. In the past while there was volume growth in the steel division the fact that steel prices were falling consistently but leading to a situation where the revenue was flat or negative. Now that the opposite is happening as far as prices are concerned, shouldn't the steel products division be showing strong top-line growth just because of the pricing action?

Aditya Rao: It would, but the tonnage that we are outputting also has decreased in the commodity business. So, it has been a decrease in tonnage in the commodity business as well as inability for the sale we have, to fully pass through the price. To a large extent we had succeeded, because typically we have very short operating cycles in this business as well, but that is the reason for both the revenue not being substantially higher and also the margin not being higher, that we had tonnage to output decreases as well. In the other businesses, tonnage also grew but in this there was a tonnage decrease as well as a margin decline.

Anil Sarin: If you can help me with the figures of tonnage last year same quarter, this year's quarter?

Aditya Rao: Last year, we had close to about 11,000 tons output from the steel products business unit and this year we were substantially lower close at about 9,500 I think. I'll get back to you with the exact number but it is between 9000 and 9500.

Anil Sarin: The volume was down?

Aditya Rao: The volume was down in the commodity business, yes.

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

Prateek Bohra: We are looking for 40 crores CAPEX this year, right?

Aditya Rao: That's correct, between 40 and 45 crores across all companies.

Prateek Bohra: We are looking for 40-45 crores CAPEX at group level including PEBS, Enviro and Pennar Industries, right?

Aditya Rao: That's correct.

Prateek Bohra: Are we looking for any debt repayment also this year at group level?

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Aditya Rao: Yes we are. Well, we don't have long term debt per se in PEBS and also in Pennar Industries now, but we will have debt repayment, yes.

Prateek Bohra: So working capital debt also, by debt I mean both CAPEX and working capital debt?

Aditya Rao: Yes.

Prateek Bohra: So this year we are looking for some generation at FCF level also, Free Cash Flow level?

Aditya Rao: Yes. So basically what we'll do is whatever operating cash flow we have post CAPEX, post working capital changes, which will not be tremendous, while right now we have working capital, we don't expect that to persist definitely, there is going to be a moderation in that. Once that happens, that cash flow very quickly enters back into our system. It just takes a month or two for it to all come back. Once that happens and after deducting from that positive cash flow of the year, whatever we have in terms of CAPEX, whatever we have in terms of any working capital changes, the remaining capital we will use to pare down debt.

Moderator: As there are no further questions, I would now like to hand the floor over to the Aditya Rao for closing comments.

Aditya Rao: Thank you to all the stakeholders for joining us. We are proud of what we have achieved in this quarter, in a volatile period and also typically the monsoon is a difficult time macro-economically in India. But we are quite confident that we have set the base for good growth this year and I believe that we will come back to you with good growth in all operating verticals for the next quarter, in Q2. Consequently, for the year in question also, we have good growth plans and we believe the company and its subsidiaries are well placed to take advantage of the opportunities we have. Thank you so much for your support.

Moderator: Thank you. On behalf of Dolat Capital Market that concludes this conference. Thank you for joining us and you may now disconnect your lines.

(This document has been edited to improve readability)

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