"Pennar Industries Limited 3QFY20 Earnings hosted by PhillipCapital India Pvt. Ltd."

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MODERATOR: **MR. VIKRAM SURYAVANSHI – ANALYST, PHILLIP CAPITAL INDIA PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Pennar Industries Limited Q3FY20 Earning Conference Call, hosted by PhillipCapital (India) Private Limited. 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, please signal an operator by pressing '*' then '0' on your touchtone telephone. I would now like to hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital (India) Private Limited. Thank you and over to you.

Vikram Suryavanshi: Thank you, Janice. Good morning and very warm welcome to everyone. Thank you for being on the call of Pennar Industries. We are happy to have with us the management of Pennar Industries for Q&A Session with the investor community. Management is represented by Mr. Aditya Rao – Vice Chairman and Managing Director; Mr. PV Rao -- Joint M.D.; Mr. Shrikant Bakkad – Vice President, Finance; Mr. J. Krishna Prasad – CFO; Mr. Manoj – Head, Corporate Affairs and KM Sunil.

Before we start with the Q&A session, we will have some opening remarks from the management. Over to you, sir.

Aditya Rao: Thank you. This is Aditya. A warm welcome to all our stakeholders to Pennar Industries Q3 Conference Call. We have capped off a challenging quarter where we have seen a reasonably high decrease in our addressable markets for the automotive process engineering and solar sectors. Consequently, we had a decline in our Q3 profitability on PBT and profit after-tax basis. We believe that the addressable market pressures we are facing are temporary and revenues for all of our verticals have improved substantially in the fourth quarter, which we are going through right now. It is our opinion that the worst is over; however, due to the lower revenue throughput in Q3 and Q4 compared to the corresponding quarter last year, we expect a financial year to be flat on a profit after tax point of view. However, our medium-term and long-term growth strategy remains intact. We do not think any of our addressable markets have undertaken permanent reduction or permanent damage. I think they will come back, but for some sectors, it may take a little longer than others. We will continue to invest in a long-term addressable market, so we get back to growth in revenue and profitability as soon as possible.

With that, I would like to hand the call over to our Joint Managing Director, Mr. P.V. Rao, to take you through the quarter.

P.V. Rao: Thanks, Aditya. Good morning, everybody. I appreciate everyone taking this time this morning for our call. I will go through the specifics about financials. The consolidated financials for Q3 FY2, net revenue is at Rs.537.4 crores compared to the net revenue of 567.6 crores in last corresponding year and previous year, and EBITDA is Rs.50.1 crores compared to Rs.48.7 crores in the corresponding period last year, PAT is at 12.2 as against 15.2 in the corresponding period last year.

If you look at the Consolidated Financial Highlights of Nine Months in Financial Year '20, the net revenue is Rs.1,655.2 crores compared to revenue of Rs.1,548 cores, which is up by 6.9%. EBITDA is 158.4 crores compared to Rs.136.3 crores, and there is an increase of Rs.16.3 crores compared to the last year. PAT is Rs.52.1 crores compared to the PAT of the corresponding period in the previous year, Rs.42.2 crores. So, there is an increase of 23.2% year-on-year.

The Business Highlights are during Q3 we received steady orders across business verticals such as Building Products, Tubes, Solar, Railways, Industrial Components and Pre-Engineered Buildings. The order book for Pre-Engineered Building segment is Rs.455 crores as of now. The order book for Water Treatment and Chemicals segment is Rs.78 crores. The order book for Railways division is at Rs.270 crores.

In yesterday's board meeting, the board approved the acquisition of BIM Technologies Private Limited in supporting science through the clinical process of building information modelling management and data collection. It deals with 3D Digital Building Information Modeling. The services include developing, modelling, converting and mapping of buildings, seamless integration of building data in a 3D model, and the major clients are from Engineering and Construction sectors. As you all know, we already have an Engineering Services division which is doing design and detailing for customers overseas, and this has synergies with that.

Our Q3 performance got impacted due to a challenging business environment. Consequently, we reported a 5.3% decrease in revenue and a 19.5% decrease in net profit. On a nine months basis, our revenues up by 6.9%, our profit is up by 23.2% compared to the corresponding period. Though the Q3 results are challenging, we continue to execute on our strategy, operational and financial objectives of achieving margin expansion across our business segments.

Aditya Rao: Margaret, I think we can open it up for questions.

Moderator: Sure. Thank you very much. Ladies and gentlemen, we will now begin the question-answer session. The first question is from the line of Vaibhav Gogate from Ashmore. Please go ahead.

Vaibhav Gogate: Can you give me color on this acquisition, what sort of revenue will it add to our consol P&L?

Aditya Rao: We are right now not going to comment on the revenue it can add, but we can say, it will be immediately revenue and profit-accretive, it is a profitable entity, and we are quite confident that it will start generating revenue and profitability right from February this month onwards, but we will not right now be commenting on the exact revenue increase that we see through this acquisition. But what I can say is that because we have done this acquisition, it opens up a pretty large addressable market for us in the building information modelling sector, which we are already

Vaibhav Gogate: What is the ballpark size of this acquisition that we have done?

Aditya Rao: The exact number is Rs.6.22 crores.

Vaibhav Gogate: In the past two quarters incrementally what has gone better and what has gone worse in terms of the outlook for your railways, tubes and other ones?

Aditya Rao: Our order book for Railways remains strong. Our order book for Environment business is also quite strong, higher than it was. So we have not seen any decline in the addressable markets in those specific sectors. Solar, Q3 was a very bad quarter. But our order booking in Q4 has jumped up dramatically for both MMS modules and component supply, all three solar revenue streams that we have. Regarding the other order books, I request Mr P.V. Rao.

P.V. Rao: We have currently about Rs.455 crores order book. Recently, we got a big order from MRF also of Rs.125 crores. So PEBS is doing well in terms of revenue compared to the past.

Vaibhav Gogate: So if we look at the finance cost, they were pretty high this quarter which was around 4.2% of sales. So what is driving this escalating cost?

Management: Total impact if you see in terms of the last Q2, Q3 it is more or less a flat in terms of Rs.22.61 crores to Rs.22.62 crores where it is. Rs.22.62 crores predominantly increase you see is because of IND AS which is applicable from 1st of April in 2019, and if you see the note #8 which we have given in the presentation, the impact on account of IND AS 116 is specifically stated. This Rs.1.12 crore for the quarter and Rs.3.2 crores for the overall nine months period. Overall, the borrowings have substantially increased from where we were last. The slight increase in others and the IND AS 16 that you will look into it is predominantly on account of non-fund being used.

Vaibhav Gogate: What is the gross debt and net debt as of December quarter?

Management: Around Rs.444 crores versus Rs.415 crores, at March we were close to around Rs.401 crores, now it is Rs.415 crores.

Vaibhav Gogate: This is net debt?

Management: Total debt. Net debt is Rs.40 crores.

Vaibhav Gogate: So as of now we are at Rs.415 crores?

Management: Yes, in comparison to March, which was at Rs.444 crores.

Moderator: Thank you. The next question is from the line of Shubhakar Ojha from SKS Capital. Please go ahead.

Shubhakar Ojha: Two questions: One, can you give some outlook on your margin? So, I think what is the benefit of lower steel prices, what is the scenario so far in the current quarter? And second, is how much buyback has already been completed?

Aditya Rao: Raw material prices in the last three months have increased substantially. However, we have been able to pass on the vast majority of that, and we also hold substantial inventory which allows us to cushion the impact that this has. So, we do not project a very large operating profit contribution, percentage decline on the basis because of raw material price increases for ourselves. That being said, I think the order booking we are doing now, as there is a slight impact from the point of view, perhaps more of the market is a little duller rather than material price. But overall, I do not think these are very substantial numbers; I do not think the difference would even be 20, 30 basis points from an operating profit percentage point of view for Q4 also. For the buyback question, we have completed about 30% of the buyback, and we intend to complete the remaining 70% over the next three to four months.

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

Vikram Suryavanshi: Can you share what was the CAPEX for this quarter or nine months and how is the outlook for full-year and next year?

Management: Total CAPEX for the current year is around Rs.68.5 crores, out of that already we spent around Rs.38.8 crores as of now.

Vikram Suryavanshi: And next year would be a similar number or how is the…?

Management: Right now we will guide you to a number which is around that, but we have substantial investments which have pushed back, but right now you can assume a similar number for next year, but we will probably be revising it soon.

Aditya Rao: And this acquisition what we have done, is it under Pennar Industries or Pennar Global, how is that structure, will it be part of a design engineering business?

Aditya Rao: The acquisition is of an Indian company called One works BIM which is going to add to our revenue from Europe mostly. So, it is not under the Pennar Group.

Moderator: Thank you. The next question is from the line of Lala Ram Singh from Vibrant Securities. Please go ahead.

Lala Ram Singh: My first question is that the revenue degrowth has been more than 16% in your diversified engineering business segment. Can you help me the key segments within diversified and their growth rates, for example, railways, tubes, industrial?

Aditya Rao: We will not be giving individual vertical wise revenue because we have reported segmental revenue as per our compliance requirements, but what I can tell you is that the decline in revenue has primarily been in our Tubes vertical and in the Steel Tubes. Declines are more than 30%, and that has contributed to an overall decline in revenue of about 6%. We expect these verticals to come back. They have already come back a little bit in Q4, I would say about after damage has been reversed, but for a complete reversal and getting back to growth that may take time. Primarily the automotive sector where tubes got heavily impacted is one sector which has resulted in the revenue fall and the process engineering sector; the solar sector also underperformed quite badly in Q3.

Lala Ram Singh: So Tubes and Steel have degrown by more than 30%. Is that what you said?

Aditya Rao: Yes, the number is that the revenues and operating profit decline; consequently, fixed cost not declined by that much, those businesses had a huge impact on their profitability. The other business excelled but overall, the damage because of these two business verticals, was too high.

Lala Ram Singh: So, Railways and the Hydraulic business has grown in this quarter also?

Aditya Rao: Railways has grown, industry components have grown, Pre Engineered buildings has grown, Pennar Enviro has grown. The only thing that has not grown is Steel and Tubes, but they have declined badly. So, that is the reason; they declined by 35%, 36% each.

Lala Ram Singh: Second question is on the second segment, which we call as Custom Design Building, in that we have seen a 12% revenue growth, but our EBITDA has more than doubled which is because of our margins have come back to around 10% compared to 5.6%. So, can you help us understand the drivers of this improvement in margins?

P.V. Rao: See, the order book is good in the current financial year and warehousing sector especially because of the boom in eCommerce business and introduction of GST has started getting more jobs in warehousing and Engineering Services growing up, we added a few new customers also in the US, and Solar also started improving a lot, and the fixed cost is constant, that is the reason why the increase in revenue will directly fall under the profit. So, order book also currently is Rs.455 crores, we are bullish about perhaps in the time to come the next financial year.

Management: But I think the order book was always not an issue for us. Margins were…

P.V. Rao: There was a problem in the order book in the last year. The last quarter it was less, it was Rs.355 crores, now it is again gone back to Rs.455 crores.

Lala Ram Singh: But if you exclude this quarter for the last six quarters, our margins were less than 8%. So it is not a one-quarter phenomenon, and 11% is…

P.V. Rao: There is a mix of products what we have in our services. So in the services sector, the revenue increase and the profitability increase, has resulted in an overall increase in profitability. Solar has declined, compensated by a higher margin in Engineering Services.

Lala Ram Singh: The engineering where we support our global clients in designing, is that what do you mean?

P.V. Rao: Yes, design engineering, both.

Aditya Rao: Significantly increased. So there the margins are high. That is why whatever some setbacks in solar and all, has got compensated with the increase in margins in Engineering Services.

Lala Ram Singh: Going forward, how would you want to comment on the margins in this segment?

Aditya Rao: I think it will be the same; roughly about 8% to 10% we are expecting.

Lala Ram Singh: And the acquisition which we have done, how is it different from our Engineering Services business?

P.V. Rao: Engineering Services is designed and detailed using software tools like Tecla, MBS, Autocad and all, whereas this is nothing, but it gives 3D digital building information modelling. If you are constructing a building, by doing beam designs and all, so we will be able to know what is polling and all because there will be civil works, electrical works, mechanical works, air-conditioning, everything. So, all will be mapped together to see if there is any polling happening within the building. And that is useful for even procurement, that is useful for project management. It is a very good tool. Nowadays, many of the customers in the US and Europe are preferring beam model for their projects.

Lala Ram Singh: So, this is relevant for commercial, industrial and also residential projects?

P.V. Rao: Yes, any building projects.

Lala Ram Singh: And how many employees are there in the organisation which we require as of now?

P.V. Rao: We have around 100 people as of now.

Lala Ram Singh: What is our plan with that organisation want to? It will be done independently as a separate company or…

P.V. Rao: Business unit within Pennar Industries.

Lala Ram Singh: Yes, how will be the change in the way the company is run – we will be involved, or it will be an independent team, I want to know that?

P.V. Rao: Management is Pennar Industries only. The existing employees will continue to stay there.

Lala Ram Singh: The owners of the company are fully exited, or they will also be operating?

P.V. Rao: They have an earn-out also for some period I believe.

Moderator: Thank you. The next question is from the line of Vaibhav Gogate from Ashmore. Please go ahead.

Vaibhav Gogate: You are undertaking a few business development activities in Raebareli for Railways and PEBS businesses. How are things proceeding over there, from when can we start expecting revenues from there?

Aditya Rao: Yes, next financial year, which is FY'21, Q2 is when you can expect to see revenues coming in from Raebareli.

Vaibhav Gogate: As far as Tubes is concerned, you are undertaking expansion into wider diameter tubes. So where have the things gone on that front?

Aditya Rao: We currently do not have a date for you on that, but the project is underway. We will guide you towards the completion date for that project in the next conference call. I will write this down, but right now, I do not have a date for you.

Vaibhav Gogate: Incrementally, the outlook on Tubes getting better?

Aditya Rao: Yes, right now, Q4 is better than Q3 by almost 20%.

Vaibhav Gogate: So initially we have guided for CAPEX of upwards of Rs.120 crores, and now I guess the CAPEX has been reduced to Rs.68 crores. So what were the reasons why you decided to cut back on CAPEX?

Aditya Rao: Substantial amount of the CAPEX was in business verticals which saw an addressable market decline. So, perhaps it is the wrong decision to take, but it is the necessary decision for us to take right now because we want to be more conservative in terms of our cash flows. So, we are reviewing all of our CAPEX projects again making sure that it will result in an increase in the addressable market which leads to increase in quote activity which leads to increase in revenue and profitability. So we are reviewing that which is why I said we would revise that number soon, but as of right now, we are only investing in projects which we are extremely sure will result in revenue profit growth. So, if there is an element of uncertainty because of the recent issues with the Indian credit market automotive sector, process engineering sectors, then we want to review that against. So that is the reason why we have pushed a lot of projects a little further. So, I would not call them as cancelled projects, but we are deliberating further before we green-light further CAPEX in businesses which have seen a large addressable market decline. That is the reason why we have revised that number 120 to 68 because that is what we are sure of now. It may go back up once we complete analysis and decide that yes, investing in these assets will result in revenue and profit growth.

Vaibhav Gogate: Last year, Q4 was a very good quarter. And if we look at this year, the outlook is not so great. So what sort of Q4 can we expect?

Aditya Rao: You should expect Q4 where our profit will be lesser than what it was in Q4 last year. That I can say. The reason for that is because as I had said, these markets which took a huge hit in Q3 are in the process of recovering. Our Q4 profitability will be better than Q3, that I think we can tell you, but the numbers are not going to be what they were in Q4 last year. We will leave it at that point of view, but you should expect a decline from Q4 last year, Q3 to Q4 you can expect growth.

Moderator: Thank you. The next question is from the line of Ashwin Reddy from Samata Investment. Please go ahead.

Ashwin Reddy: Can you explain what proportion of your overall revenues, are you in a position to pass on the raw material price increases or decreases, on what proportion is fixed, so how does that work?

Aditya Rao: Price increases on 100% of our revenue streams have to be pass-through because they are a value add, right, I mean, our operating profits range from 12%, 13% 14% all the way up to 40%. So, margin ones we can cushion a little bit but others we have to pass through nearly. The answer is 100%.

Ashwin Reddy: The reason I ask is because of late the global prices of steel have been coming down, prices of metal have been coming down in the last one month or because of the corona issue and all?

Management: There is a steep increase in revenue.

Aditya Rao: Absolute reverse. The price has been increasing a lot, and we have passed that increase.

Ashwin Reddy: Right now, you are saying in the last month.

Aditya Rao: In the last two months, the price increase in base rates deal, which is what we talk about, has been in excess of between 10%.

Ashwin Reddy: In Q3, I believe the prices in India have gone up, I understand that. But of late in the last three weeks or so, there has been a dip globally, right, prices of metals, copper, steel and everything else along with crude. So is there any visibility or do you think would that translate to coming down as well or that does not have impact in India, how does this work, how does the steel industry dynamics work in case the prices come down, is there a case for them to come down in India as well and for you to benefit in any way?

Aditya Rao: So I will try to answer as best as I can and also request Mr PV Rao to chime in after that. If I understand your question, you are saying the raw material prices have fallen in the recent past in the last three weeks in steel. We have not seen this decline quite frankly. But we do not take a call on raw material steel prices. We book orders, and we cover our costs to make sure that we can ensure that there is no margin shock due to an increase in prices, and we also do not try to target price increases. So for us, it is a pass-through, and we have to pass on price increases or decreases also, quite frankly to our customers. That is a commodity explode. So it is very difficult for us to estimate it and we do not have any hedge, we do not have any arbitrage against that. Our standard business plan is that when we see a price increase, we pass it on. When we see a price decrease, we pass it on. And while there may be temporary margin impacts because of volatility often, we do not plan for it in any sense of the word, I cannot say.

P.V. Rao: Actually, raw material price increase has been there in the last three months to the tune of 15% If you look at different products what we have, if you look at Pennar Industries products, these products we book the jobs, the second time is very less, we book the job at a current price, or we order the material on the same day, whereas in the PEPS, we have contracts signing from three to six months. So, there is a risk of price increase, but what we do normally is that we maintain a healthy inventory and expecting some price increase and we maintain some good inventory and then some of our customers we have price escalation clause also, for example, recently we got Goa airport job from GMR, where there is a price escalation clause. So where the customer has not paid an advance, where the site is not ready, there we have to pass on to the customers, and we are successful in passing on to the customers.

Moderator: Thank you. The next question is from the line of Venkat Subhramanyam from Organic Capital. Please go ahead.

Venkat Subhramanyam: In the previous concall, we said our positioning is comparable to that of Ion Exchange. Companies like Ion Exchange have different segments where some of their offerings are very value-accretive, they have chemicals, etc., How are we comparable, can you talk about our business qualitatively?

Aditya Rao: So Ion Exchange revenue streams lie in additives which includes chemicals, resins. The second business division they have projects, which is executing PC projects in the waterside…In Pennar Enviro, we have our review; our business divisions are in additives which overlaps with Ion Exchange business. We also have our projects business, which is water projects and water engineering and we have standard plants and other businesses where we make standardised rack-mounted, containerised pigment plants in the desal, ETP and STP space. We also have capabilities in process engineering, which is not there in Ion Exchange's product profile, but overall the technology set that both they command we command is quite similar, but they have a lot more scale, and we are in the process of building a scale. So, I assume Ion Exchange at Rs.1,000 crores is much bigger than our business for those verticals which are a little between Rs.100 and Rs.150 crores. But we are optimistic that over the next couple of years we should be able to scale these verticals up through a direct consequence of being able to increase our additives revenue which has a very good margin profile and also our specialised steel and ETP plants where we have technological capabilities, design capabilities, engineering capabilities which are quite good.

Venkat Subhramanyam: What kind of visibility do we have? We have probably good growth that you can realise now. Where can we get let us say in the next two or three years?

Aditya Rao: I would say in the water space and space any order that Ion Exchange and Thermax can quote on, we would want to quote on which is saying we want their addressable market. So, their addressable market is close to Rs.4,000 crores in India and in other geographies which we would also want to be present in. So, we see that as the addressable market, then I think a market share of 10% is what we think is good. We do not want to be number one in that business; we do not want to be number two in that business necessarily. What we want to be the strong capital-efficient player so that I would suggest means over the next few years we can take the Rs.100 crores to a much higher number.

Moderator: Thank you. The next question is from the line of Lala Ram Singh from Vibrant Securities. Please go ahead.

Lala Ram Singh: Post the merger of the different entities, we had said that we will relook at our different business segments and also the way we report so to make it easy for investors but looks like we have not yet done that, we are still showing Rs.2 crores buckets which does not give much understanding of how each business is moving because we have like effectively more than 30 different product segments. So, do you want to comment on how you want to present your financial information going forward for the investors to analyse the numbers better?

Aditya Rao: Fair criticism, I think you are right, we did have the new attribution which is basically as I discussed last time, it is metal products, projects and engineering services. Those are the three verticals where everything we do, fits into those three verticals. The addressable market we function in then becomes effectively engineering and environment. We have presented to the board. The board has approved it, but unfortunately for us to give it to you, we also need a stat auditor to sign off on it because of the revenue attribution. We have assigned all of our revenue, profitability, fixed cost, balance sheet numbers such as capital allocation; everything has been done, we have that. I think on behalf of the management team I would like to commit that next quarter we will give you as per that breakup. So it will be three business verticals which together will be covering 100% of our revenue. We will give you an addressable market for each vertical; we will give you an idea of what our core capabilities for each are and definitely capital employed and revenue and profitability for those businesses as well. The three verticals will be products, engineered, metal products, which will cover railways, which will cover our building materials, projects which will cover engineered systems and also water treatment and solar projects and our engineering services business which will include structural engineering and our So I am confident that will add a lot of clarity in terms of understanding of businesses and verticals where they are headed as opposed to talking about eight P&Ls which is what we have to do right now if we have to give you an idea of how we are doing. But you are right; I think we are a little delayed. We are ready from an overall management point of view, but we need a Stat Auditor Sign-Off which is imminent, which will happen. In the next conference call, please take us on record committing that we will get this to you. The board has already approved the new attribution.

Lala Ram Singh: We will wait for the new disclosures. Secondly, in this quarter, can you share the cash flow from operations and CAPEX figure for this quarter?

Aditya Rao: The overall number for the quarter for nine months of cash profit after the working capital changes are 36.53.

Lala Ram Singh: And for this quarter, do we have the number?

Aditya Rao: Quarter, I do not have the number ready

Lala Ram Singh: So, with Rs.36 crores of cash from operations, then effectively the interest cost and all we had a negative right and even CAPEX?

Aditya Rao: This I am telling after reduction of CAPEX only.

Lala Ram Singh: And CAPEX was around Rs.38 crores for nine months, right?

Aditya Rao: Yes.

Lala Ram Singh: Also, can you share what is happening with the joint venture with NLTech JV which was supposed to cater defence industry?

Aditya Rao: I think we have we created the joint venture about a year and a half ago. I think the order book for that has grown substantially. So, we have Rs.60 crores, Rs.60.5 crores approximate order book in NLTech and the revenue starts in that in the Q4 onwards. I think you should see that business unit, their subsidiary doing quite well from a revenue point of view. In Q4, Q1 FY'20, Q2, I think it should start scaling up, but it is profitable, and it looks like we are getting some good traction on that.

Lala Ram Singh: So, this is catering to Indian markets?

Aditya Rao: The order book is entirely in the defence sector in India

Lala Ram Singh: And can you throw some light on the kind of products which we are doing there because the defence is a very …?

Aditya Rao: Customers, I cannot tell you, products we can say, it includes NLTech's current product profile which includes defense shelters, it includes certain integrated products for the defense industry on a scanning point of view and other things which quite frankly I have to check if I am at liberty to disclose that, but it is certified military engineering services vendor, and it is doing quite well, but the order book is strong.

Lala Ram Singh: Overall our ROE still is at around 10%. So, can you throw some light on the efforts which we are taking to increase this return ratio profile?

Aditya Rao: Our ROE target, as explicitly mentioned in our strategic plan, is to get above 15% over the next two years. We will do that through a combination of revenue increase and also our margin; we are focusing a lot on margin growth now. So, the board has also said that we will specifically prioritise revenue which is more than 15% in margin. Q3 was a little bit of a surprise because of the addressable market shock, but over the medium term, we are quite confident that will not affect anything. So what we would say, we intend to do is over the next few quarters increase the revenue proportion from higher-margin products which tends to have a result in our ROCE going up and ROCE going up as long as your capital is being used properly, will result in ROE going up as well. So we are targeting about 20% ROCE and above 15% ROE over the next few quarters and we will give you quarterly updates on where we are on our ROCE and ROE basis from now on.

P.V. Rao: We expect to gain further margin expansion, deliver strong cash flow generation and drive profitable growth with our customers. And these lists are supported by our ongoing cost initiatives, acquisition synergies, and we have a very disciplined capital allocation strategy also. So with that, ensure that our ROE will increase.

Lala Ram Singh: Also, can you tell us how we are planning to reduce the finance cost line item, or do you think that it will remain at these levels as a percentage of revenues?

Aditya Rao: We have to reduce it. The vast majority of this interest is working capital, and again in working capital, the majority is non-cash, while our business model does not matter how much money we have, we have to have this, we have to give LCs for raw material, we have to give biggies for our customers. So that will continue. But it can be controlled to a certain percentage of revenue. Our current controls are that they are at 3.3% of gross sales. We have exceeded that in this quarter. But IND AS adjustments, everything aside, I think our long term goal is to reduce our working capital enough to ensure we can meet this 3.3%. So our goal is 3.3%, and the way we do that is by either reducing our current assets or by increasing our accounts payable enough or quite frankly the combination of both of those has to yield 3.3% effective interest cost. So that is our control, and I request CFO to comment on this.

P.V. Rao: We are closely following the interest cost. The first month, it has gone up because of the LCs and the band of discounting which we have done. And also last quarter to this quarter comparison if you do, we have little higher in terms of term loans. So that is also another point. And we have capitalised certain interest cost earlier which now having the assets being capitalised; now we have to charge up. But overall control as being said, like gross sales, we will keep 3.3% as our target and try to achieve that number by year-end or in the coming quarters.

Lala Ram Singh: Do we use suppliers credit because of payable days look very high, and as far as I know, steel companies do not give so much of credit period.

Aditya Rao: We have LCs predominantly with all the steel suppliers. Other than steel suppliers, we have started using the supplier credit only for MSME vendors. So when we use LCs, we do not net off from our accounts payable. That is why accounts payable look high. But in actual fact, since it is in our working capital, we have already paid for it, we are paying an interest cost also for it. So it is in a sense double-counted, but if we look at our non-LC covered accounts payable, then it is about 15-20-days for the entire company, not very high, which is not necessarily a good thing.

Lala Ram Singh: Have we seen any jump in our cost of debt the light of recent scenario in the credit markets?

P.V. Rao: No, there is no increase overall in terms of percentage where we are. It is five basis points come down

Lala Ram Singh: And on the customer side, have we seen any challenges with a collection of money?

P.V. Rao: Our accounts receivable is higher a little bit, in a number of days two days it is higher.

Lala Ram Singh: But anything alarming which you feel?

Aditya Rao: Nothing that we want to communicate right now.

Lala Ram Singh: And as a percentage of overall sales, how much would the government sales for us, private versus government overall company consol?

Aditya Rao: Zero, I would say. Let us correct. It will be a very very low number if it exists, but it is so low that we do not even really… Now we are excluding PSUs from this, PSUs are some of our best customers, but the state government, the central government is near zero, 100% is private or PSUs.

Lala Ram Singh: Aditya, what is happening in the retail business which was very positive some time back?

Aditya Rao: I think some of the calls we work out well, some of the calls do not work out so well. We are not comfortable. It still exists as a business. We expect it to do about the same revenue that we had. But of course, the overall plans for us were to make it Rs.100, Rs.200, Rs.300 crores. I think it will be somewhere between Rs.50 to Rs.100 crores. I do not think we are deploying a lot of capital into that business anymore. What we are seeing, we are not liking. It takes a tremendous amount of energy to maintain that and to scale those verticals. So, while we will grow it over time, right now we do not see it increasing its attribution in our revenue or profitability by a lot. So it will stay where it is, and we will try to grow it conservatively. But I think it is a fair point to say that what our expectations were for it to become a multi-hundred crores business, it is not going to happen.

Lala Ram Singh: We do not plan to shut it down?

Aditya Rao: No-no, I would not say we are shutting it down. We are looking at reducing the number of outlets that we have which is we have about 20; we will reduce that by a certain percentage. But what is it is reasonably robust. That we will continue to grow, we will look at perhaps adding a little bit to the product profile over there, other products that we make, which we can sell, perhaps solar kits perhaps and others but we will not be shutting it down, I do not think we see that.

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

Lokesh Behl: You said that our gross debt is somewhere around Rs.445 crores and net debt is Rs.415 crores. Is the figure of Rs.30 crores as cash, right?

Aditya Rao: Earlier the March numbers where we have, it was like Rs.445 crores, now it is Rs.450 crores. So overall there is a decrease in terms of debt by Rs.30 crores and net debt if you see another Rs.40 crores reduction from Rs.415 crores, so which is like Rs.375 crores.

Lokesh Behl: It gives a figure of approximately Rs.30 crores to Rs.40 crores of cash what we have, right?

Aditya Rao: It is mostly in the form of mutual funds in the treasury and fixed deposits.

Lokesh Behl: I want to know whether this Rs.30 crores because we are doing buyback also and there we said that we had completed 30% of a buyback. So the total buyback size was Rs.40 crores. So if I take 30% out which is Rs.12 crores, we are supposed to do a buyback of Rs.28 crores more, right?. This Rs.30 crores are inclusive of that Rs.28 crores or that is earmarked somewhere else or some escrow account?

P.V. Rao: Rs.10 crores out of that has been earmarked for buyback which is separately from Rs.40 crores.

Lokesh Behl: That is separate from this, right?

P.V. Rao: That is only Rs.10 crores which is earmarked and kept in the form of fixed deposits to do the buyback.

Lokesh Behl: I did not understand this properly. So there is no overlap. Basically, this Rs.40 crores does not include those Rs.28 crores or remaining buyback, right, that is the understanding?

Aditya Rao: Yes.

Lokesh Behl: You said that our finance cost exceeds that 3.3% of our sale, which is our target. We want to reduce it, that is fine. But how do we reduce it? If I see like Rs.450 crores is our gross debt, and we are paying quarterly around Rs.22-23 crores as a finance cost. If I do simple arithmetic, then it comes around 20% of the total debt. Is it not very high if I look into the industry standard?

Management: To answer your question, "how do we plan to reduce," we are doing through a combination of reducing terms of working capital. So, if you see overall working capital, this quarter also we are almost flat, we have not increased in terms of…

Aditya Rao: Question is why is your cost of capital increased?

P.V. Rao: The finance cost includes the fund based and non-fund base costs. Take the only fund based cost. It is hardly less than 11%. Non-fund cost, which is like LC cost and bank guarantees cost that gets added in the finance cost, which does not appear as a borrowing, but it adds up to the total finance cost.

Lokesh Behl: Are we satisfied with the kind of buybacks we are doing because the purpose was it would give a boost to our share price. So, I want to know your opinion on this because the share price is more or less hovering around the same thing since we started the buyback?

Aditya Rao: I think the purpose of the buyback, as far as the board is concerned is that at the current PE multiple, which is substantially less than 10, it is less than five right now, and we believe that our EPS is sustainable and can grow over the near-term. So clearly, there is an opportunity here is what the board has decided, and that is the rationale. So we will go ahead and complete the buyback. Now, obviously, the lower the price at which we complete the buyback, better for the company from amount point of view. So I have no comment per se on what the share prices and whether we are happy about it, but I think that the range in which we want to buy and the range is pretty broad, and as long as in that range we will continue buying. There is still a substantial amount of the buyback still has to come through. So we will go ahead and complete it, and over time I think with actions such as the corporate actions and continue the robust performance, I am sure it will come up. We may be undervalued for a few quarters or something, but ultimately if our performance continues to scale, and if not, we continue to use corporate actions such as this. There will be an inflexion point sooner rather than later, in my opinion. So my answer is that we will stay the course and continue performing and continuing these corporate actions. That is our current strategy.

Moderator: Thank you. We take the last question from the line of Lal Ram Singh from Vibrant Securities. Please go ahead.

Lala Ram Singh: I think you said that we had kept aside Rs.10 crores for the buyback. And if you exclude that amount, we still have Rs.40 crores of cash. Is it correct?

Aditya Rao: Yes.

Lala Ram Singh: And overall buyback amount was Rs.40 crores, out of which we have already used up Rs.12 crores, is it correct?

Aditya Rao: More than that, but yes.

Lala Ram Singh: Rs.12 crores, Rs.10 crores we have, so Rs.22 crores are that, and there is a deficit of Rs.18 crores, and we have cash of Rs.40 crores, and I am sure we need that in our normal business operations. So, do you foresee that you will be using the entire committed Rs.40 crores or we may also stop the buyback in between?

Aditya Rao: No, I think legally, we have to spend a certain amount, but ultimately I think the board has taken a decision to complete the buyback and that is our intention right now. Unless the share price goes above the price which we had indicated, we indicated a pretty broad range. I do not think there is any danger of us cutting the buyback short. In answer to your question, yes, the Rs.40 crores I want to stress is not involved in the operations of the company right now. As our joint CFO mentioned, it is there in mutual funds and other investments, and of course, some cash and FDs as well I would assume, but that is not involved in the business of the company. I want to stress that we remain a company which generates from a cash flow point of view close to 7, 8 crores every month. So we have another three months, four months left for the buyback period. I am saying we retain the ability not to touch that Rs.40 crore and still complete the buyback.

Lala Ram Singh: Yes, I understand that, but given our working capital-intensive business and growth which we are anyways aiming for, we might have to redeploy the capital in supporting that growth, and that is why I was…?

Aditya Rao: Vast majority of our debt is working capital debt, and that debt is non-cash mostly. It does not matter how much I have, $10,000 in my bank account; I still have to give an LC; I will still have an interest cost; I will still have that. So there is no way around that. I will still have to give a BG; I will still have to give BGs performance bank guarantees and others, which will have finance costs. So, there is no way for me to replace these financial instruments with cash we have on hand. They are two different things.

Lala Ram Singh: No, I understand that. My only point was given the nature of our business, we need a significant amount of capital, not maybe fixed capital, but working capital to support the growth. Even if it is non-fund based, it is still an interest cost, and our interest coverage is now almost I think 2x, right, Rs.160 crores EBIT and Rs.80 crores, so it is not a very big buffer as such. So, there may be a discomfort that we are using the cash to buy back instead of just keeping it as a buffer for any events which may be unforeseen in the business scenario. That is the only point I was trying to understand how we think on that part.

Aditya Rao: Basically, you are talking about a potential cash flow risk for which we should have a buffer. We retain substantial current assets. Our quick assets are positive more than Rs.200 crores. So, the possibility of us running out of cash and thus not being able to sustain operations is very-very minute. We have substantial capabilities, assets and use limits which we can use. And I would reiterate that even if we were not to do the buyback, it would not functionally improve the situation at all because my having 40 crores FD or mutual fund investments which I am not spending on a buyback or not spending on other things, does not materially change our ability to give LCs and BGs which are independent of those limits, that is where our debt is. If you look at our total debt of Rs. Crores, I am not even talking about net debt, I am talking about overall debt also, Rs.300 crores plus of that is non-cash. So, I do not think we have an issue

Lala Ram Singh: I would like to add one point here. You said we are a positive cash-generating company and one of the metrics, the real cash is dividends, which the company gives right? CFO may remain positive, dividend which is coming to a bank account tells us that this business is generating cash. So, do you want to comment on our dividend policy also going forward to reinstate the fact that we are a cash-generating business?

Aditya Rao: The board has reviewed dividend versus buyback and chosen buyback as the preferred option. And that is it, and the board review this decision on a time-to-time. I think there have been some changes in the dividend distribution tax also. Mayor may not make it more viable. But as these numbers change, as our cash generation improve, I think the board will review this, and this decision will be taken at the board level periodically, but as of right now we have a buyback ongoing, and we do not have a dividend policy which the board has authorised me to discuss with our stakeholders. So right now, that is where it is.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference over to Mr. Vikram Suryavanshi for closing comments. Over to you.

Vikram Suryavanshi: We thank the management of Pennar Industries for allowing us to host the call and taking time out for interaction with the investors. Thank you all for being on the call.

Moderator: Thank you. Ladies and gentlemen, on behalf of PhillipCapital (India) Private Limited, we conclude today's conference. Thank you all for joining. You may now disconnect your lines.