"Pennar Industries Limited
Q2 FY19 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, good day and welcome to Pennar Industries Limited Q2 FY19 Earnings Conference Call, hosted by Phillip Capital (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 call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Deepak Agarwal from Phillip Capital (India) Private Limited.
Thank you and over to you, sir.

Deepak Agarwal: Thanks. Good morning, and a very warm welcome to everyone. Thanks for being on the call of
Pennar Industries Limited. We are really happy to have with us today Mr. Aditya Rao – Vice Chairman and Managing Director, Mr. J. Krishna Prasad – CFO, and Mr. Manoj Cherukuri – Head, Corporate Planning. So, without taking much of the time I hand the floor over to the management.
Post which we will open the floor for Q&A. Over to you, sir.

Aditya Rao:

Thank you. To all the stake holders of Pennar Industries, thank you for joining us on the Q2 conference call for investors on the financial performance for the second quarter and for the half year. We had a good quarter for the standalone entity where we saw our net revenues increase by 34% and our PAT increase by 45%. For the half year as well we had 24% growth in our net revenue and a PAT growth of about 57%. For the consolidated company we had net revenue growth of 24% year-on-year and a profit after tax increase of about 1.4% year-on-year. Effectively, going forward we expect this strong double-digit growth for the standalone to continue.

If you were on the call for our subsidiary, PEBS, we are also now glad to declare that for the subsidiary company as well we are quite confident of strong revenue growth. We think margin growth will follow, but as of right now we are quite comfortable committing that on the back of several improvements that have been made to the base operating structure of the company, we are confident on the back of a large order book as well, the subsidiaries also will be growing at high double-digit rates. Correspondingly, for Q3 we are quite comfortable projecting strong double digit growth in revenue and profitability.

For our order book based businesses, which include our railways vertical, solar vertical, PEB,
overall the picture has been quite good. With the exception of our solar business, where we see several headwinds, we are doing quite well in every other vertical which has an order book. We feel all of those verticals will continue to grow. We believe Solar, however, to show flat growth this year, And as a business vertical too we think we want to decrease its importance and its contribution to the rest of the company. We have put several steps in place which allows us to create new revenue streams, to diversify revenue streams to compensate for this lack of revenue growth. Which is why the overall picture shows a revenue growth of 34% for the standalone entity.

With that, specifically, I would like to hand it over for any questions that you may have. Thank you.

Moderator:

Thank you very much, sir. Ladies & gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Rajat Sethia from Riddhi Capital. Please go ahead.

Rajat Sethia: Just a couple of numbers related questions. What is the gross debt on consolidated as well as standalone balance sheet?

Aditya Rao: For the standalone entity the total debt we have, which is long-term, is Rs. 94 crores, for the consolidate entity also it is Rs. 94 crores, there is no other long-term debt in the company. In the course of doing our business we tend to use a lot of cash instruments, cc instruments, for that the standalone entity the total usage is Rs. 268 crores and for the consolidated entity it is Rs. 345 crores overall.

Rajat Sethia: Some of that would be reflecting in the balance sheet and some of them would not be reflecting in the balance sheet, right?

Aditya Rao: It is entirely reflected in the balance sheet, we can pull these numbers out from the balance sheet.

Rajat Sethia: From the short-term borrowings?

Aditya Rao: Short-term borrowings for the period is Rs. 268 crores, for consolidated entity it is Rs. 345 crores.

Rajat Sethia: And what would be the cash levels on both the balance sheets?

Aditya Rao: About Rs. 120 crores.

Rajat Sethia: And this is same for both, standalone as well as consol?

Aditya Rao: This is consolidated that I have given you.

Moderator: Thank you. We have the next question from the line of Varun Gare from Equitree Capital. Please go ahead.

Varun Gare: Sir could you provide breakup of revenues for the first half segmental wise?

Aditya Rao: So, as we discussed last time, we have currently four business verticals in the standalone entity
and two subsidiaries, a total of 44 revenue streams. So we are unable to unpack that for you in the period of time we have left. We are changing our attribution to commodity businesses and high value businesses which will typically break it up in a 60:40 business. This treatment will be available from next quarter, but right now we are not providing segmental breakup for each business vertical. If you specifically some vertical you want, we can obviously give that to you.

Rajat Sethia: I wanted to know basically in the railways segment, how is the demand in the wagons and coaches side?

Aditya Rao: Railways has done well. I will not give you percentage growth, but it was very high percentage growth in this quarter compared to last year. Our total revenues last year from the railways business was about Rs. 220 crores on gross sales, this year we expect extremely high double-digit growth on top of that, and this quarter was not an exception.

Rajat Sethia: And are you participating in the wagons contracts?

Aditya Rao: We are and we expect revenue generation in Q4 for the new wagon orders that have already gone. So you can expect even further growth in railways in Q4.

Rajat Sethia: And on the standalone margins, where do you see the margins going forward in the next two quarters? Because our guidance was around more than 10%, around 11% or so, but this has been languishing around 9.5%.

Aditya Rao: You are correct. So one of the nature of the business is that we are a manufacturing entity and every three years we have a revision in worker compensation rates. Now these are effective, it is a flat thing, it is a step increase as opposed to a gradual increment year-on-year. So for the next three years the price is frozen. Unfortunately, that came in August, so that has resulted in some impact on the financials. But by and large, the story of margin growth should continue, I think this is just the effect of the increments which we have to give to our workers, and we have over 1,000 workers, that are recruited every three years. So, from a margin point of view, you should continue expecting growth from us. So, please hold us accountable for that 10% to 11%, we will get that done in this financial year.

Rajat Sethia: And last question, the expansion in the precision tubes, that is done or by when will it be completed?

Aditya Rao: It is done, tubes CDW expansion has come on line, growth also has come in. I think we had record 1,500 tons of production of CDW a couple of months ago, and we project it to grow further. We are now thinking about how to grow it further, next year we will have another capacity expansion round. And by this time next year we should have further growth on top of that. But our tubes vertical has grown quite well also it is another vertical which is going to see above 30% growth.

Rajat Sethia: What is the capacity in CDW and ERW?

Aditya Rao: So, we are near capacity. ERW is at about 2,200 tons and CDW is about 1,500 tons right now.

Moderator: Thank you. Our next question is from the line of Raj Gandhi from Victory Capital. Please go ahead.

Raj Gandhi: Aditya, I will be honest, I am new to the company so far and my knowledge might not be completely up to date. But I just wanted to get your sense on two things, one is we are leading that there have been lot of product diversifications, we have entered into a lot of new categories over the last three, four years, in terms of segments and now we are merging the subsidiary as well. So, where do you really see this company, if one takes a medium-term view, three to four year view, in what segments of engineering do you think this company really gains a strong prominence? And second question, frankly, when I see the promoter holding it is roughly about 34% - 35%, I know management should not be concerned about stock price, but the stock has been absolutely in a value zone for the last so many years now. So, any intent by the company in terms of doing a buyback or showing some strong intent in terms of even increasing the promoter holdings?

Aditya Rao: Thank you. Two questions you asked, first is, of course, how we see ourselves as an engineering
company three years, four years in the future? We are right now and will continue to be a diversified engineering company. We invest working capital and are into revenue generating fixed assets to generate a certain return in engineering industries, these comprise railways, automotive, industrial components, hydraulic systems and building construction as well with EBS and our treatment systems. So, it is diversified. And obviously, as you mentioned you are new, firstly, welcome to Pennar as a stakeholder. But, obviously, it looks complicated, and you are right. So, our attempt right now is to rationalize this into a operating system which allows us to project to you the growth businesses which are high value, high ROCE, and legacy businesses which are standard, which may continue, we will not be killing them, but they are things which we will not expect high growth in. Overtime, all the verticals, revenue margins that we are adding will be at above 15% and definitely will be above 20% ROCE. So the effect that it will have over the next three years, you should look at us as a diversified portfolio of engineered products and services covering major gross fixed capital formation in this country and internationally. Specifically, that would mean building construction, railways, automotive, factories , water treatment, and private sector. If you look at us as that kind of a company. And L&T is what would be the closest to what we want to be. So that is how you should look at us for next three years, with focus on ROCE. The second thing, as far as stock price is concerned, I cannot at this point comment, I am forbidden to discuss any buyback or dividend policy, any corporate action as far as the decision on the merger is under way. The decision has been taken for or against in the next few weeks, we will be able to comment on this further. But, obviously, I can definitely communicate that all options are on the table and the board can decide to discuss these issues. We are sitting on a lot of cash, if you looked at on previous questions, if you look at our long-term debt at Rs. 94 crores and our cash is Rs. 120 crores, our net debt on a long-term basis is positive. Working capital will continue, there is no way for me to not have that, we will have non-cash LCs usage and even cash usage. But from a cash generation point of view, we are sitting on a fair amount of cash, and we have the ability to deploy that into any corporate initiatives that the board feels necessary. But as of right now, we cannot give you any clarity. But definitely, we can have a discussion about this in the next few weeks and decide what is to be done. And that is a decision for the board to take.

Raj Gandhi: Thanks a lot, this is very candid and clear from your side. And one thing also I should add is that even though it is a small market cap company and a fewer investors, your disclosures and your presentations are absolutely detailed and very transparent, which is a very good sign I should say from your perspective. So thanks for that.

Aditya Rao: Thank you. We will try to maintain and improve on it.

Moderator: Thank you. Our next question is from the line of Rohit Potti from Marshmallow Capital. Please go ahead.

Rohit Potti: Sir, my questions are more on the balance sheet actually. I was wondering that even with such stunning growth on the profitability numbers and the revenue numbers, I believe on the standalone basis the cash is coming down. Could you explain that a little bit?

Aditya Rao: The cash on the company, you mean the balance sheet item cash and reserves, that is what you are referring to?

Rohit Potti: Yes, the standalone cash is coming down despite the growth, which if you could explain, that would help.

Aditya Rao: Effectively the high growth for us comes at a working capital cost. So we are deploying a fair amount of that cash back into it. The only output for that cash is fixed assets growth and revenue generating assets growth, as I prefer to call them, and for working capital margin money. So that is what it has gone into. We will give you a precise breakup. However, if you look at cash generation post operating cash flow, positive cash-flow generation, that has always been there. Post that working capital changes for high growth takes away a significant chunk of it. Majority of our cash usage is going back into working capital, unfortunately we are in a working capital intensive industry, but are trying to break that above the normal. Over the half year we would have generated, as a consolidated entity, about Rs.42 crores.

Rohit Potti: So, I was just following-up on what numbers you said, so you said the cash flow from operations, is it post working capital of Rs. 40 crores – Rs. 45 crores you are talking about, or pre?

Aditya Rao: No, it was pre working capital. Post working capital changes it would be negative. Primarily because of the growth rate. So it is a little perverse, if my growth rate was zero I would obviously have the entirety of that as positive cash flow. But since our growth is high I need it to fund that growth. And I have a two to three months of working capital cycle.

Rohit Potti: The next one I had was on the other current asset number which I think has grown substantially again on the standalone basis. Could you explain that a little?

Aditya Rao: So, those are GST provisioning that we had to make, it is the accumulation of GST input credit.. So, typically our raw material is at 18% GST but our output for some of our businesses is at 5%. We used to see this impact in solar as well, but now solar has gone away but railways has replaced it even more powerfully. So, what you are seeing there is a GST credit which we will apply for and get it back. On a sustainable basis we will review this further and get back to you.

Rohit Potti: So, this growth from Rs. 69 crores to Rs. 109 crores is primarily because of this, is it? So, it is a net increase of Rs. 40 crores.

Aditya Rao: 15% of our railways revenue, yes.

Rohit Potti: And a couple of last questions, in response to the previous participant, and I understand totally why you mentioned that you cannot talk about buybacks at this point of time. But could you indicate from a promoter standpoint do you have intent, of continuing the buying and selling in the medium term as well?

Aditya Rao: So, I have been explicitly told that I cannot comment on that as well, for me to say that I am going to buy is going to be an impact. But what I do not need to comment on is our record over the past few months, which is that we have been interested, we have been buying whenever it is legally permissible for me to do it. I can tell you I am a strong believer in this company, I can tell you that it is very important for me that the promoter shareholding gets shored up, not because 34% is low or high, but because I think we are a fantastic investment. And that an objective as you can expect me to be. But whether I am going to buy or not, I think I am expressly forbidden from telling you that until the merger is done.

Rohit Potti: Thank you, that really helps. And just a question from my side, you mentioned your intent to divide business segments as high and low ROCE businesses.
I mean, as the Managing Director, because it is such a diverse business with such diverse revenue segments, it becomes difficult to understand. So, how do you view it? And if there, as you said, low ROCE business, why not phase it out gradually instead of keeping them?

Aditya Rao: I see my role as deciding what revenue generating assets and capabilities we have, deploying capital accordingly, prioritizing those where ROCE is highest. I think if I do a good job on that the company will have good growth in terms of profitability and cash generation. So, we have identified all of our revenue streams, all of our capabilities, and there is many of them, I said 44, it is actually 48 right now. And we know we have a dead date for each one of these. And how do we know the business is going to die? We see a decline in both ROCE and in growth of contribution, operating profit. So, if both of those go down we believe a business is going to be done. We starve those businesses of capital and re-divert to businesses which are going to grow. So, this is the model we have accepted where we make a certain amount of revenue, make a certain amount of profits, use that profit to fund further revenue generating assets and working capital, specifically in businesses which are generating high ROCE. And businesses that are not, we will deprive them of capital and ultimately they will become a smaller and smaller portion, and fully will die out as well. But we have strong controls in place now which ensures that we have positive operating cash flow generation. We have strong procedures in place that our revenue generating asset growth continues, and I think overall the system looks to me to be very stable, I think we have covered all of the risk, cash flow risk whether we will get orders, cash flow risk in terms of whether our customers will pay us, margin risk in terms of whether we will be able to retain and hold on to the margins that we have. And ultimately, ROCE, everything guided by ROCE. So, the business is where we get 7% operating, but we fund it because our ROCE is fantastic in there, like our retail business. So, we will continue to go through this, it seems to be working quite well over the last 1.5 – 2 years, I believe it is very stable. The one challenge we have which we are still trying to work out is when we are growing this quickly how do we generate positive cash flow after working capital changes and CAPEX, that is something we are looking at. And I think we will solve that by getting into businesses which are over 20%, 25% operating margin. We are at 15% now, if we get to 20%, 25% then we will be able to do that. So, in a nutshell, that is what I am trying to do.

Rohit Potti: Sir, just a follow-up on this, that answer was very helpful and thank you for sharing in so much detail. Do you see, when you are entering newer businesses and your revenue streams are increasing, do you feel that the company might need to beef up with senior management? Because if you are acting as a capital allocator, I am guessing at operating level you would need more people to do that bit, right?

Aditya Rao: Absolutely, you are right. It is a continuous process, you have to keep briefing up the senior management. But the idea is, it is not so much people driven as system driven, do we have a system in place so that there are constantly new revenue streams being added, old revenue streams being removed, all of this is resulting in a scale up. So, we should have an operating system that can take care of all of these complexity, make sure that we are doing revenue profitability cash flow generation, and our ratios are intact. And also be able to communicate this to all of our stakeholders. That is a work in progress, I am confident on the management part, absolutely, I feel confident that even if were not involved; I am not involved, frankly, in the day to day operations of the company, I trust my operating heads to make sure that they deliver that. And they are very well aligned with what I want and what the stakeholders want. So, that will continue. But risk management is something I am keeping with myself right now. Over time, over the next one year I think that too will have a person in charge. But to answer your

question, yes, we need to dramatically improve, create the structure which will see us through for the next five years. Right now we are good for this year and next year, but within the course of a year we have a new HR head coming in from a pharmaceutical entity, even our board is being briefed up to focus on human capital and structure. And I really think, I mean, it may feel like it is just words or something, but I really feel the correct operating structure with controls and systems in place can do magic. And I strongly believe that is all we need to do to make sure we continue to grow at these rates for the next few years.

Rohit Potti: One last question, you talked about risk management, so just wondering, if you could detail what the major risks you think right now are? And in particular, I mean working capital requirement continues to grow and our borrowings continue to grow, is there any particular metric or number that you look which might make you uncomfortable?

Aditya Rao: Yes, so the way we measure working capital debt risk is, we cap our total interest cost at a certain
percentage or gross sales. And also borrowing, but the way you can absolutely see it is, we commit to you that for the consolidated entity it will never cross 3.5%. We will be at 3.3% for the consolidated entity. So, that is our interest cost with percentage of gross sales, not net sales but gross sales. So that is sacrosanct for us and it is an output of a business model which we have decided. The other risk we see our revenue and order booking risks, we constantly watch out for pre-revenue leads so that we can make sure that our order books for order book businesses and our revenue for these businesses are strong and continue to be strong. And if there is an impact there, we have a mechanism to feed that back. The other risk we look at is margin risk, we make sure our margins are what we say they are. So, we do that by the combination of curtailing cash flows and allocating only what is necessary and forcing our business unit heads and our functional heads to use only that much capital. So, they are starved of excess capital, not what they need but what they tell us that they need, that is the only amount we give them. So there is no shocks as far as margin risks are concerned, they can only spend what they say they will spend, which is part of our margin. The third risk we look at is CAPEX risk, when we are deploying capital at the rate that we are, which is Rs. 70 crores, Rs. 80 crores, it is very important that we make sure that that capital is being deployed wisely and that everyone is held accountable ultimately to the board and the shareholders for the money that has been spent. So, we measure something called CAPEX efficacy where if any time CAPEX is triggered there is a operating profit promised that is made. And that operating profit also includes differential fixed cost, it is not so much contribution or even EBITDA, but differential PBDT, even interest working capital is removed. If they do not deliver on that, it completely affects their increments, and not just for the business unit heads, it affects increment for the entire reportees underneath them. So there is tremendous amount of focus and pressure on making sure that we spend CAPEX money wisely, generate the revenue when they say that they promise, and make sure the margins are what they are. So, we typically end up where

we are expecting to end up. And all of this is backed up by strong cash flow controls, making sure that we make the operating profit we want to. That is our risk management.

Rohit Potti: Great. That was very-very detailed, thank you. Any plans of analyst meet in future, or do we continue con-calls for now?

Aditya Rao: Everything is post merger now, because I think the merger decision is eminent, AGM dates have been declared, once that is done we would absolutely love to do this. We would love to do an analyst meet and increase our transparency, the information we provide at every level by a much larger thing. But after merger, yes, we want to do an analyst conference and other investor conference.

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

Vaibhav Gogate: What is the current outlook on your retailing initiative?

Aditya Rao: So, retail has taken up strongly. We were projecting Rs. 100 crores in sales in this financial year. I do not think we will reach that. Our current run rate is Rs. 72 crores per year, but we expect that to ramp up quite soon. ROCE expectation is near what we expected to be, about 35%.

Vaibhav Gogate: I had one more question. You mentioned that wages have increased in this quarter, but then the wage expenses look flat? And another question is, what is the current order book status on Pennar Enviro and what sort of revenues you made at Enviro this quarter?

Aditya Rao: So, we will not be giving Enviro breakup. So, wages correspond to workers, but we have significant proportion of workers on our rolls and workers who are not on our rolls, contract labor. So, some of that growth is captured in there and some of it is not. So the combination of other variable cost, it will be captured in contract cost, so there is other expenses. So you would see an increase in that. Enviro, we will not be able to provide a breakup, but hopefully once a merger decision is taken we can go back. But as of right now, since we have not given it, we can not get into that, I guess.

Vaibhav Gogate: So, has there been any change in terms of the kind of order book that you are generating at Enviro front?

Aditya Rao: No, it is doing quite well.

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Moderator: Thank you. Our next question is from the line of Manan Patel from Equirus Portfolio Management Services. Please go ahead.

Manan Patel: Sir, my question was again on Enviro. So, while you cannot give the numbers, I wanted to understand the working capital cycle of the business like in terms of days…

Aditya Rao: Enviro does not use a lot of working capital, finance or otherwise. So, the best way to answer that question is to give you an idea of what total current assets would be like. It is about a month, I guess, less than one month. So it is not working capital intensive at all.

Manan Patel: Understood. And sir, Pennar Industries hold 51% of Enviro, so who would be the remaining shareholders?

Aditya Rao: The remaining shareholders are the promoters of Pennar Industries. And one of the reasons for the merger is that we get a lot more clarity into that. I do not have holding at the parent and subsidiary level. So that is one reason why the merger is being undertaken. But yes, remaining shareholders are promoters of Pennar Industries.

Manan Patel: And my last question is on the CAPEX, you said we are spending around Rs. 70 crores to Rs. 80 crores every year. So what would be the maintenance CAPEX versus expansion CAPEX in that manner?

Aditya Rao: Maintenance CAPEX is typically 3% of our gross block. If you need an exact number, we will get back to you, but that would be very accurate. It is actually Rs. 8 crores to Rs. 10 crores.

Moderator: Thank you. Our next question is from the line of Sachin Khera from Smart Equities. Please go ahead.

Sachin Khera: Sir, is there any element of FOREX at all in the P&L?

Aditya Rao: Yes, we have Rs. 100 crores of revenue per year from our US dollar businesses, so we get that. And, obviously, considering US dollar and rupee, it is done quite well. But it is not something we have recognized or put into, but yes, net FOREX exposure is negative, we get more US dollar. Of course, if dollar depreciates then that is a risk again, but as of right now we do not see that situation.

Sachin Khera: So, as per my understanding, there is no FOREX gain that was in the P&L throughout this quarter, right?

Aditya Rao: Upon realization because we run accounts receivable, upon realization we do apparently have it.
So, yes, it has been recognized.

Sachin Khera: And as per your understanding, are we through with the steel price volatility? I mean, I understand that they may continue to remain elevated, but at least are we through with the volatile bit of the cycle?

Aditya Rao: I do not know. honest answer, I don't know, our indications are that volatility has decreased a lot. We do not expect a further 30% increase over the next 1.5 years, but effectively there are suppliers, they are good people, they would not like me saying this, but it is the truth that it is near duopoly right now with Tatas and JSWs, with all the other steel companies having gone out of business.
With Arcelor's acquisition of Essar, I think we have started some procurement from them as well, from Essar. So that may moderate a little bit, but what we hope for is stability, as you said. So, it is hard for me to give you guidance on that, but as of right now we do not think that the volatile we saw in the last 1.5 years will continue. But the onus is on us to make sure that when there is such volatile we do not let it impact the working capital and our margins.

Sachin Khera: And assuming status quo, you guys are able to maintain your margins or even improve them, as you said, through value addition?

Aditya Rao: If there is a status quo, we will commit to maintaining margins and improving them over a period of quarters, yes.

Sachin Khera: Sir, as far as the receivables are concerned, most of them are unsecured, right, on both standalone books as well as the consolidated books?

Aditya Rao: Most are. But let me qualify that by a little bit. There are some that obviously are, those are secure. But the vast majority of our receivables are to companies which we have worked with for many, many years. There also is a very good credit check that is done to understand what the past behavior of the companies we extend credit to . So, combination of relationship over many, many years, plus a credit check allows us to give a reasonable secure way to give credit to others, and we do not have massive write-off. Proof of that is in our write-offs over the last four, five years which are sub 0.5% of our revenues. So we are quite confident that we do a decent job as far as managing credit risk is concerned and that will persist and continue. If there is any company we have a doubt about, we insist on upfront payment or pre-dispatch payments to make sure, especially in solar for example, we ensure that our LCs are secured, we do not give credit.

Sachin Khera: Sir, does the interest coverage ratio, which has I think dwindled to around 2:1, does this trouble you or worry you at all?

Aditya Rao: Our interest cost at 3%, my net profit margin right now. And for the sake of argument, bear with me on this, let us add depreciation also into it at a similar level. So, my PAT is equalling my cash profit, maybe the cash profit is a little more. I do not believe that to be a good situation, I think it seems to be what the business model is outputting, but as I had mentioned, as we keep focusing on better ROCE projects, and I am saying above 30% also. And any revenue we are adding, if we are adding at higher margins then I think that risk tends to go away a little bit, and over time our hope is that we see our interest cost or our DSCR get better. So that is our thing right now. But as of right now, I would be lying to you if I said I was comfortable with it. But we have evolved systems and controls which address that, and to a great degree I think we are doing okay.

Moderator: Thank you. Our next question is from the line of Ranjit Kothari, an individual investor. Please go ahead.

Ranjit Kothari: My question is regarding solar segment, our traction has reduced in this segment from Rs. 400 odd crores on consol level for last two quarters. What is your outlook for the short-term, like two or three quarters, and for medium-term like three to four years?

Aditya Rao: I believe, I think in everything that we are doing right now, and I would include PEBS, Enviro, everything on this, the only business vertical we have which gives me a lot of concern right now is our solar business. The others which we know what to do, but solar, as you had said contributed Rs. 400 crores last year and this year, frankly, I do not like that business any more. I think it has become too competitive, we are not adding enough value for us to get it. If you look at any of other businesses, automotive components, hydraulics, railways, engineering services, CDW, all of those are such high, like it is on a completely different platform. What I would like to guide you to is, we would want to decrease our exposure to this vertical, I do not believe it is a good business, I do not believe it is a good revenue vertical for us. So we will have substantial revenues this year coming from this business, from solar, and on consolidated level and on a standalone basis. But we are already at work, for last two, three quarters we have been at work, reducing this vertical's revenue percentage, and also our working capital which will deploy into it. We are tightening working capital we deploy, the payment terms, we want to exit this business, frankly.

Moderator: Thank you. Our next question is from the line of Anirudha Agarwal from AAA Investments. Please go ahead.

Anirudha Agarwal: My first question is on the railways business, so what is the order book in this business currently?

And over what time period is it executable?

Aditya Rao: It is not an order book business. So, our retail business model is essentially us having various centers which we set up at physical location, stores that we set up. So, we have about 14 of them right now. What we do is stock on the basis of orders that we see from them, which are very short term, which are like one week, two weeks, we typically tend to stock 15 days of finished goods there. And effectively, in those 15 days we are able to sell it at a high ROCE, whatever we deploy we get back 35% annualized. Right now for the last one year that is what we have seen. From scalability point of view, we have competitors, so we are doing about, let's say we want to reach about Rs. 100 crores a year which is sustainable, we have competitors who are doing Rs. 200 crores a month. So, there is tremendous scale opportunities which are there. It is not order book based, it is about having physical locations through which you can push finished goods at a retail level at a very high ROCE.

Anirudha Agarwal: And overall on the standalone entity's EBITDA margins, so the EBITDA margins are a little surprising, even excluding the impact of the higher wages that you said, margins ideally should have gone up because the contribution of our high value businesses like railways and tubes going up, so is it that solar is now incurring losses or it is at a very low margin which is cannibalizing the incremental margins from railways, can you give some clarity over there?

Aditya Rao: That is actually exactly what happened. So, what did happen is a couple of solar orders, I wouldn't mention the customers, went from 12%, 13% operating to 2.5%, 3%. So, we took a little bit of a hit on that, that actually is what happened from a solar point of view. That is something that is an output of failures on the part of our vendors who to supply in time and also on account of certain clearances which came in a lot later. But as I said, solar is a very demanding business, so we were even caught off-guard. It is a one-off, obviously, but that has resulted in I would say 0.5%, 0.6% impact on the entire company. So, there were a couple of orders which went bad which resulted in that, but it isn't something that has dramatically affected our margins. But certainly the impact of wages was high.

Anirudha Agarwal: But what was the impact of wages, if you could quantify, on the margins?

Aditya Rao: Total fixed cost went up by 33%. So, the contract and non-contract all of those if you total up, it was responsible for 17% of that.

Anirudha Agarwal: And one more question on your land sales, so earlier we used to talk that we had some plans that you could sell a huge chunk of land that we hold. So is that still on the table or have we shelved those plans as of now?

Aditya Rao: We haven't shelved them, specifically you are referring to our land assets in Patancheru which at one time used to be our largest plant, now is number four or five. And we are continuing to decongest it. So, this is something that the board is discussing, but there are nuances here, it is industrial land, we will have to convert it, there is a cost involved, we have applied to the government in order to get this done and they are in the process of taking a decision. It is a time bound process. But what I suggest we do is we send a note, or sort of brief to the stock exchange, to yourself, on a quarterly basis giving you a status update. But as of right now, you should keep in mind that this is a multi-year process, at the very least two years, for us to do this. But it is necessary for us to liquidate this, it is obviously an asset which will generate a substantial amount of money. But as of right now we have to go through the process of registrations, conversions, permission to sell and then obviously dispose off it. So, that is industrial land, it was given to us by TSIIC, Telangana State Industrial Infrastructure Corporation. We have held it for 30 years. So, we are quite confident it will come through, but it is a medium-term to long-term initiative, it is not something that you are going to see, it is not liquidatable in the next one year.

Moderator: Thank you. Our next question is from the line of Dixit Mittal from Shubhkam Ventures. Please go ahead.

Dixit Mittal: Sir, my question is on the solar asset that we sold last year. So, from balance sheet I can make out that we did around Rs. 60 crores – Rs. 65 crores on that sale. So, just to know where did we use that? Because I think that has increased further during the last year's balance sheet.

Aditya Rao: So, the total capital gains for us from the sale of solar asset was about Rs. 22 crores. Initially that has resulted in consolidated long-term debt, so the consolidate long-term debt has fallen from Rs. 180 crores, Rs. 160 crores, to I think Rs. 95 crores now. Because of the debt being repaid back plus also I think we re-raised some debt for CAPEX initiatives. Board insisted only 33% of our CAPEX be done through equity, remaining interest in long-term debt, so we are sitting on about Rs. 94 crores of long-term debt which has entirely been plugged into our revenue generating assets. As a metric, I think you should look at 7% of our gross sales being the long-term debt in the company, which is at 3.5% interest cost for the company as a whole. So, 2.8% of that will be working capital, 0.7% of that will be term debt. So, that will persist.

Dixit Mittal: Sir, I can make out that from balance sheet that we have paid off our creditors as well during last year, so were they interest bearing creditors that we paid off from the proceeds?

Aditya Rao: So, we had paid off one banker on whom the solar debt was there, then we raised it from another banker, I guess, for our CAPEX initiatives, which is consistent, that is a standard procedure.

Dixit Mittal: Secondly on retail, can you tell us like what is the product profile that you are selling through this segment?

Aditya Rao: Specifically, our building products such as structural tubes, roofing sheets, fasteners, door and window sections, those comprised the majority of our sales.

Dixit Mittal: It is B2C or basically B2B only?

Aditya Rao: B-to-micro B and C.

Dixit Mittal: And sir, lastly, for the full year are you still maintaining the margin guidance of around 10% to 11% in spite of set back in the first half?

Aditya Rao: Yes, I gave my word and we will strive to achieve that. But yes, I gave the guidance, I think there are several things which will allow us to do that, substantial increase in revenue and of course PEBS also coming back strongly. On a standalone or consolidated entity?

Dixit Mittal: On consol level.

Aditya Rao: Yes, I will commit to that.

Dixit Mittal: So, on a year-on-year basis we can be assured of flat margins, at least?

Aditya Rao: 10% above I will commit, yes.

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

Vijay Kumar: My question is regarding PEBS profitability, I mean, the top-line is also staying flat for the last four quarters or so, and then the profits are substantially coming down over the previous years.

How it will be beneficial for the merged investors who are holding Pennar Industries?

Aditya Rao: I believe, PEBS, you are right had poor performance over the last three, four quarters, poor performance is defined by very low growth or no growth, paired with a drop in profitability. What we are now confident we can commit to you, or the last few quarters I said we need some time. But we have now put our systems and controls in place, we have completely revamped our operating system for managing order booking, conversion into revenue, and also of course making sure operating profit controls are in place. As a consequence of that, we will definitely commit in this quarter itself, as of this quarter onwards and from now to the future PEBS is back on the growth path. And by growth path I mean high double-digit growth. So, in Q3 onwards you can expect, and I think on the subsidiary conference call as well, both Mr. PV Rao; the CFO, Shrikant; and others have also committed. We are now very confident of continued sustainable high growth in PEBS from a revenue point of view. And margin will follow as well. But we will absolutely ensure that PEBS as an entity continues to go. But as it stands right now also it is a debt free entity, it is sitting on Rs. 65 crores – Rs. 70 crores of cash, it is profitable. And I think obviously the market cap has taken a beating, but we will make sure that performance catches up and that happens as of this quarter itself.

Vijay Kumar: And just a follow-up on that, when the merged entity happens by whatever reasons we have allowed the merger ratio, it looks like a raw deal for the existing Pennar shareholders, but looks like a great deal for PEBs. So, is there any possibility of looking into the merger ratio, or is it already a done deal?

Aditya Rao: So, there are certain process to the merger which involves that the swap ratio or the valuation of
the respective company's pre-merger is determined by an independent valuation agency, and that has to go in for a round of approvals. Now, as it so happens, since the valuation was done till now they obviously look to be significant changes in the performance or divergence in the performance of both companies. There is no mechanism for us to adjust valuation now, what can happen is that you look at during the merger process you are asked to take into account the previous performance, future performance and expectation of how the companies will respectively do, and whether the valuation seems fair or viable or good to do or not. On that basis I suggest that all the shareholders of PIL and PEB should take a call. But as of right now there is no mechanism to adjust the valuation. And as mentioned previously also, as promoters we will completely be recusing ourselves, we will vote along with the majority o the non-promoter shareholders. In effect, they are saying that we are basically the remaining 40% in PEBS, the remaining non-promoter

shareholders in PIL, if you remove our 35%, we will decide. And we will be glad to follow whatever they decide. But as of right now there is no valuation change that can be brought in. It is a decision, whether it is fair or not, or whether it is viable or not, or

whether we want to do it or not is a decision for other non-promoter shareholders to take. And we should know their decision pretty soon, three to four weeks.

Moderator: Thank you. Our next question is from the line of Sachin Khera from Smart Equities. Please go ahead.

Sachin Khera: Sir, could you mention a little bit on the detail of the capital work in progress?

Aditya Rao: The capital work in progress for retail is not high, typically we spend about 15 lakhs per store. So, if you are saying that capital block that is invested in the stores…..

Sachin Khera: No, the figure in the balance sheet, the capital work in progress, the Rs. 84 crores figure if I am not mistaken. So, that is not retail, that has much more to do with our plant expansion at Velchal, we are currently building the largest plant we have every built at Velchal, it has strong capabilities in hot dip, in strip galvanizing, in light-cage building structures, in stainless steel and other products. And we are also going to be expanding our CDW tubes capacity there soon. So, all of that CAPEX is flowing in to that. And I think a significant chunk of that would be capitalized in this financial year. So, Rs. 84 crores plus a little bit more amount, about Rs. 6 crores, entirety of it will be capitalized in this financial year and will become revenue generating in this financial year in the next few months, with the corresponding impacts on revenue and profitability.

Sachin Khera: And have we financed this through debt or equity, or a mix of both?

Aditya Rao: Mix of both, 33% is with us and remaining is the long-term debt of Rs. 94 crores.

Moderator: Thank you. Our next question is from the line of Anirudha Agarwal from AAA Investments. Please go ahead.

Anirudha Agarwal: My question, again, on the land parcel. So, could you give us an approximate size of the land? And
what in your view could be the valuation? Irrespective of the time period it could take a few years, but yet in your view what is the valuation of this land parcel?

Aditya Rao: What I can give you are statements of fact, valuation of the land is a floating number, so I will not be able to comment. I can tell you it is 55 acres of contagious block which is there within the city limits of the city of Hyderabad. That is what I can tell you. Valuation is something that I would not be able to comment on, I actually do not know what it is. We concentrate on running our business, whatever the value we get at a time that is liquidatable, we will get it. But as of right now, I don't know.

Anirudha Agarwal: And on the special grade steel business, we were looking to do earlier about Rs. 100 crores or so, if I am not wrong. So, are we on track to do that?

Aditya Rao: We have exceeded that number, 1400 – 1500 tons in special grade CR. We have actually exceeded that target and it will continue to grow, we are doing further investments in it, so we have crossed Rs. 100 crores in CR special grade.

Anirudha Agarwal: And in terms of inventory, so as soon as we get an order do we cover the inventory back to back or do we leave any exposure open at all?

Aditya Rao: Different businesses have a different mechanism to address it. But on the whole, we will control our inventory between 1.5 to 2 months. The range is because sometimes we see a steel price coming so we want to take a little more exposure on steel prices because of the benefit that it gets. But effectively, as a risk management venture, whenever we book orders we try to book raw materials. In some cases it is possible, but like in PEBS for example it is not possible, because we maintain a four, five month order book in that business. So, what we have decided to do now to remove that risk is we will cover raw material in PEBS for about 2 – 2.5 months. Remaining we will book through a quarterly contract, so we do not face a working capital cost on it. Beyond that, for the last two months, if there is a dramatic price increase, we will go back and ask for a price increase. I do not know if it is the most ethical to do or not, but I do not see that I have a choice, we have to make the business model stable, so we have decided to do that.

Moderator: Thank you. Ladies & gentlemen, that was our last question for today. I now hand the conference over to the management for their closing comments. Over to you, sir.

Aditya Rao: Thank you for joining us. We intend to continue on our growth path. And I am thankful to all of you for your support as we look to grow Pennar Industries. Thank you very much.

Moderator: Thank you very much, sir. Ladies & gentlemen, on behalf of Phillip Capital (India) Private
Limited, that concludes this conference call. Thank you for joining us. And you may now disconnect your lines.