“Pennar Industries Limited Q2 FY20 Earnings Conference Call”

November 13, 2019

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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 Q2 FY20 Earnings 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 call, please signal an operator by pressing '*' and 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, sir.

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 really happy to have with us Pennar Industries' management for today's question and answer session with the investment community. The management is represented by Mr Aditya Rao – Vice Chairman and Managing Director; Mr P. V. Rao – Joint MD; Mr Shrikant Bhakkad – VP, Finance; J. Krishna Prasad – CFO; Mr Manoj – Head, Corporate Affairs and Mr K. M. Sunil.

Before starting 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 the second quarter investor conference call. For the second quarter in question, we had a decent quarter compared to our previous quarter performance, where we had around 11% growth in our PBT. Our PAT growth looks a lot higher. That is primarily due to the change in the taxation structure that applies to us. We have expectations for quarter 3 in terms of meeting the addressable market decline that we have seen. We have got several challenges frankly to overcome in Q3 to show growth, and at this point, our base case is that we are expecting a flat quarter 3. So, the addressable market declines in the automotive sectors, in the tube sectors and others have resulted in us having a significant challenge in the third quarter to have growth, to record the growth we have seen in the previous quarters.

We are confident, however, that the long term and even the medium-term growth story that we are on remains intact and we want to continue with certain CAPEX projects, capacity increases and also, we are looking very closely at acquisitions. We also believe that our P/E multiple should be higher than what it is right now. Accordingly, the board met yesterday and has unanimously decided to initiate a buyback, so we have made the necessary filings, and we are quite confident that we will be able to have a successful buyback. We plan to spend Rs.50 crores on the buyback, including all-season transactions such as taxes, merchant banker fees, and others. We expect, therefore the actual share buying that will leave us with around Rs.40 crores and the target price for us or the price that until which we will buy the peak price is about Rs. 45, which would give us at that point, it is at 9 or 8 to 9 P/E multiple, which we think still would be at a value that the company will generate significant value. So, we are quite confident that it is a good price to initiate to have a buyback.

So, to summarise, we had a decent Q2 about 11% growth in our PBT. The PAT growth is far higher owing to changes in taxation. Q3, we expect several challenges because of that said significant decreases in the addressable market. Be that as it may, be we intend to continue with our growth plans and be ready for when the market turns around which includes capacity improvements, capital reform initiatives and we are also looking at some acquisitions.

Lastly, the buyback is something we have initiated at Rs.50 crores, all-inclusive value buyback, Rs.40 crores available for the purchase of shares and the peak price we will buy at Rs. 45.

With that, I will hand over to Mr P. V. Rao, our Joint Managing Director to brief you on the company's performance in the quarter.

P. V. Rao: Thanks, Aditya. A warm welcome to all shareholders. I will brief financials about quarter 2. The net revenue is Rs.580 crores compared to the net revenue of Rs.518.17 crores in Q2 FY19, so there is an increase of 11.92% year-on-year. EBITDA is Rs. 53.16 crores compared to EBITDA of Rs.42 crores in the corresponding quarter last year, so there is an EBITDA margin of 9.17%. PAT after minority interest is Rs.23.5 crores compared to PAT last year of Rs. 12.7 crores. That is an increase of 85.62 year-on-year.

If you look at the half-yearly highlights, the net revenue is Rs. 1,117.78 crores compared to Rs. 980.4 crores in the corresponding period last year, so there is an increase of 14.01%. EBITDA is Rs.108.3 crores compared to Rs 87.59 in the corresponding period last year, so there is an increase of 9.69% and PAT after minority interest is Rs.40.02 crores compared to the corresponding period last year 27.05 which is 47.95 year-on-year growth. We received steady orders across business verticals such as building products, tubes, railways, industrial components and, pre-engineered buildings.

The order book position for pre-engineered building segment is about Rs.452 crores as of now. The order book position for water treatment and chemicals is Rs.101 crore, and the order book for railways division stood at Rs.220 crores as on September 30, 2019. As indicated by Aditya, we have certain CAPEX plans. Currently, we are taking land at Raebareli in Uttar Pradesh, North India to have manufacturing plants for railways and pre-engineered buildings and we have plans abroad also but not yet taken shape as of now, so we will let you know when they take proper shape. That is all from me now. Now, we open to questions.

Moderator: Sure. Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We take the first from the line of Mitul Jani, the individual investor. Please go ahead.

Mitul Jani: My question pertains to the governance relating to the board, what does the board has to say about the performance of the company last fiscal and this recent half-yearly and what were their opinions or guidance overall for the management performance? And the second part, did all board members went ahead with the buyback, agreeing or approval of it, I mean 100% or major 80% of it? And the last part, the buyback option, was this the first option in line for the management to go ahead or what other things were considered and what evolutions were made before coming to this decision, considering you had some funds available? Thanks.

Aditya Rao: I think your questions were, if I understand, on the governance of the board and the board's opinion of the management?

Mitul Jani: Yes, true and secondly did 100% of all went ahead with the buyback?

Aditya Rao: 100% what?

Mitul Jani: I mean you had the board meeting yesterday, so all the members were there and all of them agreed with the buyback that is what I am asking?

Aditya Rao: I don't think internal board deliberations are something that we will discuss on this call right now. The board has taken a decision, and I am at liberty to say that both the management and the board jointly support this decision. That is what I can say. As far as the board's opinion on corporate governance, I will put it this way, it is something that we consider to be very important for the executive part of the board and the infinite part of the board, and there are several other initiatives we want to internally take as well, which will help us improve on this. As we evolve as a company, this is very important for us, I would say, and we intend to meet higher and higher standards for ourselves.

Mitul Jani: And the last thing, what other options you were thinking before coming to this buyback decision? You had the cash of Rs.40 crores, and whatever the plus amount was available, you must have considered or was it this like we want to go with this option in this quarter? That is what I am asking?

Aditya Rao: I am not sure I am fully comfortable discussing as I said internal board deliberations, but we have considered multiple options, and we believe this to be an appropriate response. I can say that much sir. It is not appropriate for me to comment further.

Moderator: Thank you. We take the next question from the line of Vaibhav from Ashmore. Please go ahead.

Ashwini: This is Ashwini here. Thank you and congratulations for considering the buyback, which I think should hopefully result in better price discovery of the stock, but having said this, I want to understand what the process from here and by when do you expect to complete this buyback is?

Aditya Rao: They are very well-formed guidelines that SEBI provides us for buyback process, so from our rough milestone point of view, I will hand it over to our Joint CFO – Mr Shrikant to brief you on the major milestones.

Shrikant Bhakkad: Ashwini, from here after the two days is after the board meeting, will have to make a mandatory public announcement. So that public announcement will come tomorrow and post one week to 15 days is what we have for sending out all this communication. So, November 25th onwards, the buyback would begin, and we have six months to complete the buyback process. Depending upon the price and other things, we will engage ourselves in times and the timelines by which it can be completed, somewhere June 10 after all the numbers have closed, we will have to close it by June. That is the maximum period that is allowed.

Ashwini: Aditya next question is for you. You know in your opening comments, you said that demand for automobile components is weak and that is quite understandable looking at the auto data, would you also sort of outline how your other major businesses are faring specifically railways, the work that you do on fabrication for solar, other exports and some of the other businesses that you have?

Aditya Rao: Ashwini, when we look at our businesses, we look at addressable markets. Our addressable markets cover as you had mentioned automotive components, railways, pre-engineered buildings, building construction, the infrastructure you can say and engineering services and our export markets. As of right now, we see a slowdown primarily in the automotive sector itself. Solar has also been subdued to the extent that one of them is just MMS component, one of them is MMS project, so that in Q2 we have not really seen a big decline in some of those, but on an overall basis, automotive seems to be the one that seems to be reducing our addressable market by a lot. Railways, I think we have given out the order book. We are quite happy with what is happening, we don't anticipate a decline in that, and I think Mr P. V. Rao has also mentioned that looking at the Raebareli plant that has been greenlit by the board, which has been for the land, we are quite happy to be making those CAPEXEs as we think that will be operating profit accretive very quickly. But automotive is poor, and process industries are a little poor. EB is doing quite well actually. I would say our order books are the highest that ever been but again it is more decision by the company that we want to maintain a certain order book, we are not. Performance of PEBS team has been quite exemplary as well, so railways doing well, PEBS is doing well, industrial components surprisingly is doing well because significant portion of that is automotive components, so automotive components, exports, our international business is doing well as well as environment division is doing very well, but the rest of it seems quite bad frankly like 20-30% down for the rest of it, so overall we are thinking flat right now.

Ashwini: Flat on a quarter-to-quarter basis in the sense that the Rs.580 crores that you have reported for the September quarter should be the run rate in the December quarter as well or are you saying flat over the December last year?

Aditya Rao: I think they are pretty much staying flat on last year December to this, but I think you will find there is not much difference between last year Q3 and this year Q2, you are not going to find too much difference but effectively, what I am saying sir is flattish on December last year to this year.

Ashwini: But margin profile should be stable because you do not see any extraordinary pressure on cost. Would that be correct?

Aditya Rao: We are not guiding to a margin decline; we are a growth company. Our vision is to grow consistently at a double-digit rate as an engineering company. For the first time and a very long time, that seems to be addressed because of a reasonably massive slowdown in the general Indian manufacturing and automotive segment. That being said, on overall basis margins, we don't expect a decline.

Ashwini: And the last question is, what is your revised CAPEX plan for the current financial year, including the Raebareli investments?

Aditya Rao: We will get back to you on that, Ashwini. We are reviewing all of our CAPEX plans. The board also had a pretty good discussion on this. We will get back to you on this. We haven't completed the work of reviving the CAPEX plans yet. It is less but maybe not massively less because we think the medium-term story looks good, it is bad for a quarter or two or three, but I think next year, we think it will be quite decent. So, we don't want to curtail our CAPEX plans right now. We think it is a good market for the CAPEX plans, but we are much more circumspect, on CAPEX right now.

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

Ashwin Reddy: Can you talk a bit more about the land acquisition that you briefly mentioned, in which area, and what is the gap that you are trying to sell and what is the maximum scope or maximum size of the acquisition that you are looking?

Aditya Rao: Unfortunately, a lot of these are under discussion right now, some of them were on term sheet status, a lot of them have started due diligence, so I will not be able to comment on exact specifics, but on a broad sense the acquisitions are in precision castings, precision machining, and surface treatment and then engineering services. From a value point of view, I think what we have on the burner right now, all of which we may not approve, we will only take some of them forward, and the board has to approve them. The board has approved evaluation and due diligence and term sheets. Once we have SPAs, then I will give an exact number, but right now we don't have a number to share with you.

Ashwin Reddy: Okay fair enough, but are these in India or are these abroad?

Aditya Rao: Some are in India, some are abroad.

Ashwin Reddy: And also, in the opening comments, I heard Mr Rao mentioned briefly about the manufacturing facilities abroad, is there any plan to put up on your own Greenfield as well or?

Aditya Rao: We do have plans, but once they are fructified, we will share them with you. As of right now, the timing of it is once the board approves the CAPEX, once we have gone ahead and take in a foundation on it, we will inform you, but we are exploring all others. As of right now, we have nothing to share, but we are exploring, yes. Mr P. V. Rao comments that we are exploring these opportunities in international markets, yes.

Moderator: Thank you. The next question is from the line of Anirudh Agarwal from AAA Investment. Please go ahead.

Anirudh Agarwal: My first question was actually, can we have some segmental split of the numbers, I mean a few quarters back you used to give a very detailed segment-wise outlook and now we are not giving it since a few quarters, so?

Aditya Rao: I had mentioned in the previous calls, we are in the process of shifting our revenue attribution into 3 specific verticals which I had mentioned are project business, manufacturing business, and engineering services. So, until this process is complete and that I mean we allocate revenues, allocate our cost accordingly to that, allocate capital employed and all of those, we will not be able to give a segmental breakup, but we can go up to order book for specific verticals. So, on that, I think Mr P. V. Rao has covered, and I do apologise for this, I know we have a duty to inform you segmentally so that you have much more sunlight on what each segment is doing, but right now we are not giving that, and I hope to be able to give you the breakup on those 3 segments that I mention soon, but we are not able to do it right now, sorry.

Anirudh Agarwal: But the thing is that I think we have been speaking about this for the last 4 or 5 quarters, right, I mean it is taking a lot of time, so what is really hindering us over there?

Aditya Rao: Good question. I think we have been dividing the precise divisions making sure that it lines up well with our addressable market growth. There is a strategy session internally that we have had to go through, and we have got this. On the surface, you would see us, we have not been able to give you much, but inside the company there has been a pretty dramatic change in terms of the way we view addressable markets, the way we view strategy and growth and progress has been made, and we will try to get this to you as soon as possible, but you are right that we have taken longer, I agree.

Anirudh Agarwal: And then secondly, judging by the numbers that we have, PEBS has done really well this quarter, but on the other segments, understandably tubes would not have done well because of the auto slowdown. But PEBS, even the margins look very good, so am I reading that right?

Aditya Rao: That is accurate, yes.

Anirudh Agarwal: And what would be the reason for that?

P. V. Rao: Reason is though manufacturing is not as expected, the e-commerce business has increased a lot in India because of which a lot of warehousing requirement has come. So, that is one reason. Another one is we are able to get good margin expansion in engineering services business also abroad, which we are exporting actually to the US. So, those two things and then, we are able to have a good backlog of warehousing jobs all over India which are coming up and retail stores as well and then even the aircraft hangers also. So, that is the reason why we are able to manage the order book well.

Anirudh Agarwal: Understood. And the Rs.450 crores order book that you have right now, over the next how many quarters would that be executed?

Aditya Rao: 2 to 3 quarters.

Anirudh Agarwal: And in terms of engineering services, how has the growth been over there, and how sustainable do you see that going ahead?

P. V. Rao: There is double-digit growth in it already, and we have not gone through the detail in terms of the segmental as Aditya told we are in the first dividing into 3 buckets, manufacturing and engineering services as well as projects. So, this division will take little time, and we will come back to you with details very soon.

Anirudh Agarwal: And on the solar verticals, till a couple of quarters back, you were quite negative on this business, but is it fair to say that there has been some recovery like could you give us some outlook now going ahead on the solar vertical?

Aditya Rao: We will do moderately all right; I do not think it is as bad as it was, and we also had several other revenue verticals. We do not just make MMS products anymore wherein we look at rooftop solar, we have strong capabilities in that as well, EPC as well. So, we would cautiously revise it to a sector that we are paying focused to, and we think it has a place in the longer-term, but at least a medium growth strategy right now. So, it should be decent. we are reasonably okay with the performance of solar that we expect in this quarter and next quarter, especially with the increased addressable market size for

Anirudh Agarwal: Understood. And one more question was on the railway side. So, like could you indicatively tell us how much revenues in that vertical would have grown and now, what is the capacity utilisation over there and so on like on that vertical?

Aditya Rao: Specific to railways division, I will give you while this is not a segmental breakup, but we are quite bullish on railways like Mr P. V. Rao said, we have Raebareli expansion coming up. So, capacity utilisation is quite high right now, so we have to expand. And we are quite happy with the division's performance, yes.

Anirudh Agarwal: And one final question was, are the promoters also going to be participating in the buyback?

Aditya Rao: No, promoters are not participating.

Moderator: Thank you. We take the next question from the line of Vaibhav from Ashmore. Please go ahead.

Ashwini: This is Ashwini once again. Could you just help me understand the cash flows because you have given a very abridged version for the cash flows? So, your free cash flow profile was fairly good during the quarter, and how our cash flows looking, that is question number one. And question number two is in the auto cycle, what is the lead-lag that you see in orders placed on you/ if auto sales were to start improving on a year-on-year basis?

Aditya Rao: I will answer the auto sector and hand over to Shrikant for the precise description of our cash flows, operating cash flow and free cash flow what we had for the quarter. So, as far as the automotive sector is concerned, we have a pessimistic and an optimistic view. Some aspects of the optimistic view are that we see based on the lead time, we see new orders coming in, especially with the new BS-VI standards coming in. Q4, auto sector coming back, and our base case right now is that it recovers about a year from now. So, that is what we are assuming because what we see right now is a long-term cyclical change. In the auto sector, we have done very well for a very long time and or perhaps that is something that is related to the larger credit issues in the Indian economy right now, but we do not think it is something. Our base case right now is that it is not going to get resolved in our view. So, we would not get auto orders until our customers in the automotive sector start doing well, and we do not see them doing well for at least a few quarters.

Shrikant Bhakkad: In terms of cash flows, the operating profit before the working capital changes is close to Rs.98 crores, and if you see the net cash flow from the operating activity until Rs.72 crores. Predominant of this money has been used in CAPEX activities which we are planning. We were doing over a year, close to around/ if you see the net effect for this quarter it is close to around Rs.32 crores have been used on a consolidated basis in terms of CAPEX. And predominant other money has gone in financing activity which is repayment of certain term loans and the finance cost there. So, overall, there has not been a substantial change in terms of cash flows that we were there last time to now.

Ashwini: And your net debt number, what would that be?

Shrikant Bhakkad: If you see the long-term borrowing, it is increased by around Rs.25 crores, and the working capital part of it has also decreased in terms of the borrowings, But if you compare the finance it is flattish.

Ashwini: So, it is Rs.400 crores give, or take is your net debt position because there is not much cash that is there with you at this point?

Aditya Rao: Predominantly because we use CC limits, so you see the fluctuation only in borrowings and current liabilities.

Ashwini: And OCL is also a fairly small number which I think part of it would be

Aditya Rao: OCL, almost we do not have anything and the borrowings that you see, actually have decreased from Rs.310 odd crores to Rs.285 crores now.

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

Vikram Suryavanshi: Sir, basically you are talking about some of the export opportunities in tubes, particularly with the duties on Chinese products in the USA. So, how is that playing out?

Aditya Rao: Not well. There are imposed duties on Indian tube products as well. So, our tubes CDW exports to the US have declined a lot, produced to be at the peak of about 600-700 tonnes a month, Currently, I think it is about 100-200 tonnes, so not well.

Vikram Suryavanshi: And how is the production of this special grade steels and all and experience of this retail outlet for the steel?

Aditya Rao: Special grade steel, which is the first one manganese chromium alloys, vanadium chromium alloys, actually high carbon steels are the majority of that is the automotive sector, 70% automotive sector. So, that too has come down in Q3 compared to Q1, but it is part of the larger story any business vertical we have which depends on the automotive sector is right now with the few exceptions is not doing well. Hydrolysis is still doing really well, and industrial components are still doing really well. But with the exception of those two, CDW was down, and special grade CR is down. So, that is it.

Vikram Suryavanshi: And is there any impact on this our retails steel sales also, these steel products and all that?

Aditya Rao: As we had mentioned, retail is flat. So, it is about the same as what it was quarter-on-quarter, year-on-year also.

Vikram Suryavanshi: And what would be our order book in solar?

Aditya Rao: We are not giving that right now.

Moderator: Thank you. We take the next question from the line of Anirudh Agarwal from AAA Investment. Please go ahead.

Anirudh Agarwal: So, my question was actually around the Enviro business. So, I mean this business should be doing well, right. So, if you can give some outlook in terms of what exactly, what products are we dealing in over a year and how your experience has been, and can we scale this up going ahead?

Aditya Rao: So, Enviro consists of a water treatment business, fuel, and chemical additives business and standard plant business. It has done well over the past 3, 4, 5 years period if you see, it has increased revenue, the CAGR has been quite good, well above 20%-30% over the 4-5-year period. As of right now, the order book is quite strong. We are over Rs.100 crores in the order book in Pennar Enviro and doing quite well, and we have plans to expand the business further. It uses very little working capital; it uses very little capital per se. So, while it is not immensely profitable, on a revenue base that you have, you would expect typically operating margins of about 15% which is not the best that we have right now. ROCE is decent. So, we think that if you look at companies such as Ion Exchange and others, they have done a reasonably good job and we computed everything Ion Exchange does, comparison. So, everything Enviro does, Ion Exchange does.

Anirudh Agarwal: But do you think that this should have scaled a lot more, A couple of years back if I recall correctly, we had some very large plans for this business, and maybe it is not worked out as we had initially envisaged and why would that have happened?

Aditya Rao: You are correct. We wanted to take this into a larger process industry vertical business, but we have since revised those plans because the addressable market for those businesses has moderated somewhat. That we said, we are still looking at the nuclear power market and so the precision, high purity water segment quite strongly because this capability we want to build. So, yes, I think what we wanted to have happened to this business over the years is certainly has not happened, but we still think that the addressable market is attractive. We have a very strong management team, some of them from the best companies around India in the environment space. So, we are quite bullish about this business. So, we would give little more time, So, we are going to persist with Enviro and its growth.

Anirudh Agarwal: Right. So, what would be the total addressable market size and out of which, we would say be around Rs 100 crores or so, but what would be the total market?

Aditya Rao: For Enviro?

Anirudh Agarwal: About Rs.10,000 to Rs.12,000 crores. So, our market share is very small.

Moderator: Thank you. We take the next question from the line of Ashwin Reddy from Samatva Investment. Please go ahead.

Ashwin Reddy: Just a follow-up. Can you let me know what is the operating cash flow in the first half and what is the CAPEX during the first half?

Aditya Rao: The first-half numbers are not ready; I have this quarter numbers only. I would be able to send it out to you separately.

Moderator: Thank you. The next question is from the line of Mitul Jani, Individual Investor. Please go ahead.

Mitul Jani: Raising money is not an issue for any of the marketers, at least most of the able ones in current time and you have some money or funds in your pocket. Given the returns and margins you are operating at, if I look at the decade's average, it is not above, but below the average. So, any advantages you see where Pennar can guard itself against all the costs and competition moving around? And you mentioned earlier that you are a growth company, it is good you are growing revenue-wise and asset wise, but before the train left the station, I guess profitability also needs to be considered. So, any steps which like to share with us like the management is taking in that direction?

Shrikant Bhakkad: I think the best way for me to answer your question sir is to look at what we prioritise as a company. So, these four metrics are to be reviewed from the bottom to the board level, right. The forecast is out for 3-4 years. So, the metrics we monitor are revenue growth. We look at ROC, ROCE, and ROE both for the numbers, margin growth as well as the percentage of our revenue, which is high margin and international business, you can call it export, but we call it international business. So, these four metrics are the ones that we monitor. We have benchmarks for each of them, and I would say one of the largest benchmarks is that we have ROCE of 20% and above, and ROE of at least 14%-15% and above. That is what we intend to achieve. Because of the nature of our business that uses a lot of cash especially in the current asset side especially on the noncash side, we use a lot of working capital. We need to have both ROC and ROE as metrics and ensure that our ROE goes up. So, any investment we make, the impact it has on those numbers is what is look. From the strategy side, we believe our addressable markets going forward are in precision engineering and high-end manufacturing. So, anything those markets entail, we want to get into. It does not necessarily have to be steel based; it does not necessarily have to be component or automotive-based or solar-based, but precision engineering and precision manufacturing, we have defined as a sector. So, we will go ahead and keep building up our revenue-generating assets in these fields. Over time, if we do our job right, ROC and ROE both will take care of each other and margins will persistently be high and our share of business from India and our international business will be in good proportion so that we are derisking from any sudden downturn in any one geography. That is, I guess this is the answer I have to say.

Mitul Jani: So, you are looking for an idea to hire any cost consultants or compensation consultants because yours is very diversified. Even though you break down into few verticals of business units, but you have so many products, so I guess is it possible that we could see something like that where the cost can be reduced and margins can be improved? So that you mentioned ROCE 20%, it could go higher, right, if you like the CAPEX and all that, so you have the money, why not think like in that sense?

Aditya Rao: You are right, and we have taken it as it is intended that you can always be better, but structurally, it is very important for any company whether it is doing well or bad frankly for that matter, could constantly cut cost. So, we have initiated a new measure where we divide our company into fixed and variable costs and fixed cost. We are mandating a percentage of cuts. This is not for adding to our margins, but to make sure that we scale up as quickly as possible because any company will have to bloat out. I would be lying to you that Pennar did not have substantial bloating, it definitely would, any company would have it. Variable cost-wise, I think there is a privy of measures where I am looking at which includes spending management controls, automation of certain processes and of course time, everything to operating profit growth which we think will allow us to ensure that costs do not go out of control, but cutting and becoming more optimised, I think we will review those. I think that is good advice. We will look at getting a cost consultant. If you have any suggestions and if you can let us know of people you think would be appropriate, please do let us know, we will review it.

Mitul Jani: Build360, you had these 10,000 square feet, average square feet the strategy Build360? So, how is that turning out, how is it like the cost and all that like the warehouse? Is it like lease or own the properties and all that where you have these warehouses?

Aditya Rao: We are not in the asset, so we are leasing the assets. I would say it is a mixed bag. We are still hopeful that we may have to learn a few more quarters. We had initially thought we could start, and we will do Rs.100-200 crores in revenue. This year, we would be substantially less than that. We would be at 60 or 70% of that, but our ROC is what we are focusing on.

Mitul Jani: Sorry to interrupt but you are like initially institutional in selling these things, and now you are going retail, so you foresee that this will like the big things for the company, it would be fruitful in some sense?

Aditya Rao: We want both addressable markets, so we want retail and institutional. Going forward, we will chase both, yes.

Moderator: Thank you. The next question is from the line of Ranjit Kothari, Individual Investor. Please go ahead.

Ranjit Kothari: My question is regarding, do you see Pennar going more efficient in terms of working capital going forward?

Shrikant Bhakkad: In terms of working capital, only when the revenue increases, I think we are taking on the working capital additional increase, otherwise increase in term would not be having significant working capital.

Ranjit Kothari: Two-three years back, when steel prices were down, and they were rising, we substantially increased the inventory in PEBS?

Shrikant Bhakkad: No, we have now taken a conscious call to buy when we have and only for a certain period. Now, it is not that we do the current asset controls and things we have and that helps us to build what the inventory levels that we should have, and we do not have stocking inventory just because the prices are low.

Ranjit Kothari: And my other question is regarding the interest cost. I remember in past con-calls you have said that you want to keep the interest at 3.5% of the net sales.

Aditya Rao: Good question, sir. So, we are not at 3.5, we are at 3.7, and one of the most important tasks for us is to get it back to 3.5 and I think we are going to ensure that we work hard on getting this done but you are right, that control has been something that we have to reduce, mostly it is all in noncash, but we will get that back really. We will get below 3.5 next quarter.

Ranjit Kothari: And my one question is regarding, it is more towards quality, I mean if you see Pennar, it is very diversified, it is into service, it is into manufacturing, and it is into many sectors, many types of businesses, so Aditya how do you see this company 5 years down the line? I mean what you see Pennar as? What do you want to make it?

Aditya Rao: I would say that if we want to be a big company, we need to have a big addressable market. So, all the diversification that you see is primarily about looking at markets that we feel are big, and we want to operate in those markets. Going forward, five years from now, we will continue to search out for big addressable markets which is why we are looking at international business, and we will do it very responsibly. We have an international business already. We do about $11-$12 million already in international business. So, I think going forward 5 years from now, I can promise you a company that is capital efficient that is conscious about what our investors want, our returns have been very poor from a market cap point of view, 3-4 years is something that I take very seriously, it is something we have to improve and most importantly from our addressable market point of view, precision engineering, and high-end manufacturing, those are the two capabilities which we want to build up and whichever markets that take us to we will go there, we don't differentiate between markets, we look at what do our capabilities allow us to do. That is what we do, and we do our revenue planning.

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

Vijay Kumar: I would like to understand the interest outflow that is about Rs.75 crores last year, the run rate is looking like Rs.80 to Rs.90 crores this year, and the net debt is around Rs.400 crores and Rs.90 crores of interest outflow, is what are we getting our financers with the best possible trades? What is your outlook on that? And the second thing is our interest coverage with respect to our EBITDA is probably looking one of the lowest in the last many years, so we used to have 3.5 to 4 times coverage, and that is now looking at 2.5 times and with more pressure coming in from buyback, our equity portion might also reduce, so debt-equity is also something that might look vulnerable, so what is your take on that please?

Aditya Rao: I would like to break the questions into two parts, one is in terms of working capital, and second is in terms of interest. Working capital usage, as I said it is little high and then we are constantly ensuring that the working capital will come down by Q3 and mostly by the year-end and the working capital would increase only if the proportionate revenue increases. The second is in terms of the interest cost. Interest has two parts to it. One is in terms of the interest which is on borrowings and second is in terms of the bank charges which is predominantly on non-fund base limits like BGs and the LCs that we use. So, if you see the total interest cost, the high component of that is towards the non-fund base usage of limits also, and that is where you see in terms of the interest percentage as the percentage of borrowing is little high, but if you take out the portion separately in terms of the bank charges, it is relatively lower, and the working capital amount is more or less in line with the revenue increase. The next question that you had was on the terms of debt-equity ratio. Overall we had the equity of Rs.600 crores, and even if the entire amount we give it just Rs.50 crores and this amount will anyways we have the profits in the next two quarters to come, so we do not see the debt-equity ratio being worse by the year-end to come.

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

Ashwini: What is the impact of IndAS on your EBITDA interest and depreciation for this first half?

Aditya Rao: The total impact during the quarter and half year-end is in terms of interest expenses around Rs.1.15 crores and Rs.2.08 crores, and the depreciation impact is around Rs.1.49 and Rs.2.8 crores.

Ashwini: So, this Rs.2.8 crores is for consolidated?

Aditya Rao: Yes, half-year and for the consolidated numbers.

Ashwini: So, your EBITDA is higher by around Rs.4.8 crores.

Shrikant Bakkad: Rs. 1.15 Crore for the quarter and Rs.2.08 crore for the half-year.

Ashwini: So, the stated EBITDA is higher by Rs.2.08 crores for the first half?

Shrikant Bakkad: No, lower. If you see note number 6, which we have included in the UFR presentation, you will find that, and this was recorded in the books. So, to that extent, the EBIT will be increased.

Ashwini: So, let us assume that your stated EBITDA is around Rs.53 crores, so you are saying that if the regime were as it was in the last year, the EBITDA would have been Rs.55 crores?

Shrikant Bakkad: Correct, Rs.53 crore is for the quarter.

Aditya Rao: Rs.53 crore is for the quarter so that it will be Rs 54 crore or something.

Ashwini: So, this is because your users are in the second half currently?

Aditya Rao: Yes.

Moderator: Thank you. Ladies and gentlemen that was the last question for today. I would now like to hand the floor back to the management for closing comments.

P. V. Rao: Thank you very much for all the participants and we will continue to have good interaction with the investors in the times to come, and we will continue to address the concerns which were faced by the investors during the conference call and thank you one and all.

Moderator: Thank you very much. On behalf of PhillipCapital (India) Private Limited, we conclude today's conference. Thank you all for joining us. You may disconnect your lines now.