"Pennar Industries Limited Q2 FY16 Earnings Conference Call"

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MODERATOR: **MR. VIKRAM SURYAVANSHI – VICE PRESIDENT, EQUITY RESEARCH, PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and Gentlemen, Good Day and Welcome to Pennar Industries Q2 FY16 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Vikram Suryavanshi – Vice President, Equity Research from PhillipCapital. Thank you and over to you, sir.

Vikram Suryavanshi: Good afternoon to everyone. Thank you for being on the call of Pennar Industries. From management we have with us Mr. Aditya Rao – Vice Chairman, Mr. Krishna Prasad – CFO. I now hand over the conference to management for their opening remark.

Aditya Rao: Hello. Thank you and warm welcome to all the stakeholders of Pennar Industries. I am Aditya Rao – the Managing Director of Pennar Industries and I am joined by our CFO – Mr. Krishna Prasad and also our COO of Operations – Mr. Dayasagar.

Second quarter FY16 we are glad to announce that we have had good growth across all of our major verticals. We have grown our gross sales number from 349 crores last year to 389 crores for the second quarter which is a growth of about 11.2%. More encouragingly, our EBITDA margins have grown by larger number from 25 crores in the second quarter of last year to 34.2 crores which is a growth of about 36.7% and the net profit for the company has grown from 5.8 crores to 8.9 crores after minority interest which is a growth of 52.5%.

From a segmental perspective, we are just coming off the call from Pennar Engineered Building Systems which as a listed entity had its first earnings conference call before us and I just could not attend that call because of an emergency but we would be glad to take any questions you have on that business as well.

Moving onto the systems and projects business - as always, it has been a major contributor to our margins. The railways business, specifically ICF revenue has been scaled up on a large scale because of our ability to expand capacity from a manufacturer of sidewalls, it is from 4 and 8 in a quarter to close to 16 and 18 in the quarter, we expect to do about 18 this month as well and this growth rate is going to continue and persist with the fourth quarter hopefully ending with a capacity that is again substantially higher than what we are at right now. Furthermore, repeat orders were received from Integral Coach Factory, BEML and others, Southern Railway and Central Railway, Texmaco, Besco and HEI are other companies where we typically receive wagon orders and we are expecting more orders in this quarter from them.

We expanded our capability and capacity at our Chennai plant for this business and we are quite eager to see further scale up in revenue and margins in this business. We are positioning this vertical, specifically the coach business, for rapid growth and we will have more to say on this on our next quarter conference call. We are looking at opportunities where we can make significant investments and look at potentially turning it into a major driver of profitability next year. Even Raebareli remains a great opportunity for us and we also have our Head of Operations here, I would also request him to brief you a little bit about the progress in terms of our adding capacity in railways and also our plans over the next few quarters in terms of capacity additions.

Solar continues to be a great vertical for us in terms of growth. We currently have and are executing orders from Sterling and Wilson, Larsen & Toubro, Mahindra, SunEdison, ACME Power, Tata Power and others. We believe that this growth rate will persist, the total installed capacity for solar in India is about 4 gigawatts and it is our belief that in this financial year itself we are looking at very significant additions, perhaps 2 to 3 gigawatts will be added in this financial year itself.

Industrial components, our next business division, has done well in this quarter. We have added orders for our hydraulic cylinders, we have increased our order book from Bailey, our customer in the US and new products such as deck plates, rotor cups, hydraulic cylinders for other companies and yolks have been added. Going forward, the hydraulic cylinder business would be the major driver of revenue growth in this vertical, but we are glad to say we have also picked up a lot of export orders from our customers such as Xylem, Yamaha and others in this vertical.

While the business itself is one of the smallest business verticals we have in Pennar Industries, it is going to exhibit fast growth, and more importantly it has margins which are in double-digits, 20% EBITDA. So any scale up in this business will allow us to have a disproportionate impact on the bottom-line.

On Tubes, we are as per our plan, we are proceeding well, we have managed to add more customers in the automotive and engineering sectors and we are going to exhibit good growth this year in this business division compared to last year. While on a revenue basis, you may not see a lot of growth, what is happening is that we are in the process of replacing our commodity revenue which is ERW Tube revenue with CDW Tube revenue. In fact for the quarter in question i.e. Q2, our CDW Tube business was twice the size of what it was last year and since CDW tube business is at a very high EBITDA margin, we are confident and hopeful that this will ensure that the tubes business continues to grow its profitability.

The steel products business is the commodity business of the company, comprising of our cold rolled steel strips and the cold-roll formed steel section. That business division also has grown specifically in the CRFS segment, we have added new customers such as KC Cottrell and Clyde Bergemann and in the CRFS segment we have new customers such as Rockworth, Factor Engineering, AP Explosives and VB Industries. We have also added a new component, a break shoe component during the quarter.

For PEBS, if you have joined us in the conference call preceding this one, we would have given you a complete breakup and detail of how our business has progressed but the company has had a stellar quarter and done really well in terms of picking up new orders and also ensuring that the margin expansion continues. So this business vertical had a ~20% growth in terms of top-line and alongside, bottom-line growth was also very high because of the margin expansion that came in.

Pennar Enviro had a good quarter as a comparison for last year, but quite frankly it was not up to our own internal expectations. We had expected to do about 30 crores in it the last time we had spoken and unfortunately we ended up at around 14 crores. The reason for this was failures in our ability to streamline our supply chain in a quick enough matter, these are issues that are fixed now, so we retain our aggressive growth target this year for Pennar Enviro. We believe that we will perform exceedingly well in this financial year, we have a very good order book in Pennar Enviro in excess of 260 crores sourced from some of the best companies. And in Q2 itself, we have booked orders from Biological E Limited , L&T building and factories division for Kannur Airport, the total water management for Kannur Airport, from SNK Petrochemicals, JSW Energy and others. We believe that we are on the right path, and while this quarter the numbers look high in terms of growth rate, it is still off of a very low base. So our goal to scale up revenue and profitability at Pennar Enviro remains intact but if you would indulge us, we would show these results in Q3.

That concludes a brief overview of our six business divisions for Pennar Industries consolidated. I would now like to open up the line for any questions you may have for us. Thank you.

Moderator: Thank you very much. We will now begin with the question-and-answer session. Our first question is from the line of Rahul Agarwal from Banyan Capital. Please go ahead.

Rahul Agarwal: Aditya, I have one question regarding Pennar Engineered Building System. The salable number there is around 173 crores, so can you please throw some light on that, why this is so high and how much of this is more than six months old and how much for last quarter?

Aditya Rao: I assume you are asking about the accounts receivable number, 173 crores for PEBS, that's the number right?

Rahul Agarwal: Yes.

Aditya Rao: So 173 crores is a very high number, the reason for our accounts receivable being so high in PEBS is the fact that in Q2 we had fairly maximum amount of growth which came in the last month, so typically we have even months in a quarter where we have the first month, then the second month and third months being more or less even, but in this case specifically the last 40 days there was a fair amount of shipments and that has resulted in accounts receivable picture were a little higher. But we are very confident, these are very secure orders and out of the total 173 crores orders that you see, the more than six months number, 180 days number is very-very small on the order of low single-digit, I will get that exact number for you but we would not sound the alarm right now on account receivables, we think we are quite stable and the high number is a direct consequence of our revenue having gone up in the last 40 days. What we expect you will see in the end of next quarter is a stabilization where we move to a higher growth platform, let our collections also catch up since we have a two-month operating cycle and that will allow us to stabilize somewhere around a little more than 100 crores in terms of account receivables, that is our target right now.

Rahul Agarwal: But still the revenue for last quarter was 110 crores, so even if most of it happens in last 40 days then too I am not able to understand how is that 173 against the revenue of 110.

Aditya Rao: Let's assume that if you have revenue, our gross revenue is about 122 crores and all of our account receivable mentioned are gross revenue numbers, so let's work with gross for now. So when you have the last month having a lot of sales, it does not give you enough time for collections to catch up, typically a lot of our payments are a mix of LC payments which you get the payment immediately after invoicing and some other payments which you get a month, month and half, two months later. So because of this mix if you tend to have a lot of revenue on the last which is waited towards the last next… we are close to 70%, 75% of our revenue coming in the last 40 days, you do not have time for the LC collections to come in, we take a balance sheet picture, we take a number which is at that time. Even as we speak, the accounts receivable has come down. So if you have revenue coming in later then you have accounts receivable growing because your collections, your LCs discounting, all of that, does not quite happen in the same period of time.

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

Anil Sarin: I wanted to know the breakup of revenue, also in the first quarter that I have been able to see from the results, the first quarter revenue was lower than the first quarter revenue of the previous year, so what was the reason for a decline in revenue during the same season across these two years and what is the outlook for the full year? So I have asked basically two main questions, one is the reason for the first quarter not being so good and the second is outlook for the full year.

Aditya Rao: So let me first mention, hope so what I am saying holds true for both PIL and PEBS, but it is more relevant to PIL because the operating margins for PIL or rather the raw material cost forms a much higher proportion of revenue for PIL. Now what has happened if you were to compare Q1 to Q1 or quite frankly Q2 to Q2, from where our raw material cost would have been 1.5 years ago or 1 year ago to now, we had a close to 25% to 30% drop in raw material prices. Now when raw material comprises of significant proportion of your expense and in the case of PIL, it is close to about 65% to 70% while in the case of PEBS, it is about 50%, this does have an impact in terms of revenue. So yes, you are right in terms of Q1 we did have a lower revenue number, this was completely on the back of the raw material price having come down which affected our total price. These typically have a positive impact or no impact quite frankly over the medium-term on our profitability, consequently EBITDA you would not have seen having problem, you would have seen it grow. More importantly, I would also like to identify a trend that is ongoing across all of our verticals where we consciously remove the lowest margin revenue that we have in any quarter. So our commodity business which has cold rolled steel strips currently it is at a level where on a per month basis we do about 20 crores, a year ago it was 30 crores, so we have reduced it by a factor of close to 33%, however you do not see anything near that drop in terms of revenue but certainly in terms of EBITDA, that’s because a good fraction of that has been replaced by a higher margin businesses, our growth in railways, our growth in ICF revenue, our growth in solar and also industrial components. Consequently, I would not like to give guidance but what I can tell you is that over the last few quarters we have consistently been prepping all of our business units for growth and for this financial year question we would have absolutely no hesitation in saying that we are quite confident of high growth across all of our verticals. And more importantly than revenue growth, which we will also bring in, but I am much more confident of our margin growth because everything that is growing at Pennar right now is growing in higher margin businesses. The first part of your question was a revenue breakup, so for the second quarter the revenue breakup is in steel products 92.2 crores, in our tubes business 34.2 crores, these are all net sales numbers, industrial component 16.7 crores, our systems and projects business 63.7 crores and scrap sales of 10.7 crores comprising 217.5 crores for the standalone company, for PEBS we are 110 crores in net sales and for Pennar Enviro we are 13.4 crores in net sales. That is the complete breakup in terms of our performance for the quarter and on an overall basis that comes to about 339 crores in net sales and 389 crores in terms of gross sales. With the exception of our steel products business, every business unit has grown revenue and without exception all of our business units have grown in terms of margin and profitability.

Anil Sarin: No, see there was some confusion, Pennar Industries is anyway given in your Press Release the details and obviously each and every division has done very well, so congratulations on that. I was more curious on the PEBS business and let me add over here one more question is that, last year we did 450 crores of revenue in PEBS, this year for it to be meaningfully larger the first half has not shown that kind of a trend, so I am just without getting into specifics and I am only asking about PEBS at this point in time I mean is there some momentum that one can expect in the coming half, in the second half of fiscal 2016 for PEBS only?

Aditya Rao: For PEBS in question, the last year's net sales number 450 crores is accurate, in this financial year we will not be giving guidance but I would be very confident in telling you that we fully expect double-digit growth, we do not have any hesitation in saying that is going to happen. As far as what happened in Q2 is concerned, there is 20% growth in PEBS numbers alone in terms of the net sales number. If you were to look at H1 the growth is flattish and the reason for that is that raw material price impact which came in for PEBS affecting that. Plus, there have been also a lot of transference of demand from Q1, Q2 to Q3. Typically in PEBS, what happens is whatever we do until the month of November, we double that in terms of revenue and quite frankly even profit. So my feeling, my understanding of what is going to happen in PEBS now is we have a very strong order book and we are well set up to ensure that we execute the vast majority of in this financial year and Q3 and Q4 should be quarters which are traditionally and have always been significantly larger than Q1 and Q2. So in order to achieve, in terms of achieving and surpassing last year's number and to have meaningful growth, that was your original question, we are quite confident. As I said we will not be giving guidance but we would have no doubt in telling you right now that PEBS this year will have double-digit growth, in terms of revenue yes but also in terms of bottom-line and EBITDA and other margins as well.

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

Pawan Kumar: The breakup of orders in the rail segment and the solar segment which you given projection systems research and also give the comparative figures during Q1.

Aditya Rao: Actually, I did not get the first part of that question but if I understand your question you want a breakup of railway order book and solar order book, was that accurate?

Pawan Kumar: Comparison from projects and systems, right?

Aditya Rao: Sorry?

Pawan Kumar: That portion railways and solar both add up to your projects and systems, right?

Aditya Rao: That’s correct, yes. So the order book for railways ICF is close to about 110 crores right now and we will be expecting a lot of wagon orders in Q3 which would significantly alter this, maybe increase it by about 35% - 40%. And our solar order book right now stands at close to about 70 crores and while this would not be a number which would give you a lot of idea on what we are going to do in this financial year, what we are going to see happening in terms of revenue in the next three months, in the next three months we are expecting 65 crores in revenue. So in this financial year, solar will be quite big, so again we will not give guidance but you will see very high double-digit growth over last year's performance and I think last year's performance in solar itself was about 65 crores. So we will see very heavy growth on top of that.

Pawan Kumar: Can we expect say 20% growth in projects and systems as a whole?

Aditya Rao: We would have much higher growth than that, we are projecting higher growth than that. And even if you were to look at our last quarter itself we had an excess of that growth, we have had 31% growth in our systems and projects business from the corresponding period last quarter. And please do bear in mind that that’s on top of a very high raw material price decrease, so the actual growth you are looking at is actually much higher.

Pawan Kumar: And in the tubes business as you said, though there is a significant improvement especially on the EBITDA margins front, can we expect also some revenue growth going forward?

Aditya Rao: Tubes, so part of the thing is I think we need to do a better job of explaining what we are doing in tubes. We do have growth targets in tubes in terms of revenue but how we measure our success in the tubes business is scaling up the CDW tube business which is a high margin, high precision product business. That has an EBITDA margin in excess of 15% and that is a business unit in tubes that we want to scale up. So if you were to look at last year to this year, you are looking at reasonably flat growth, 33 crores to 34 crores, very-very flattish growth, it looks like it. But in actual fact what has happened is we have been functioning in an environment where the core raw material expense which is a good portion of the revenue has fallen by 20%, 25% plus in some cases in some grades of steel and we have also had transference of revenue from our ERW business to CDW tube business which is exactly what we want to see. So we will have revenue growth this year in terms of tubes, but we are into a variety of these factors and there is also additional factors in terms of a slight delay in GP coil line coming online, so that will result in our revenue growth not being very high, we will have growth but not very high growth but our EBITDA and bottom-line growth will be significantly higher in the tubes business.

Pawan Kumar: And lastly, I wanted to understand about your commodity steel product business, from what I say in your note was you are talking more about supplies to players like Thermax and other capital goods manufacturers and also some auto components like break shoes, so is it like it is becoming more of a forging kind of a business rather than supplying normal cold rolled products?

Aditya Rao: I would not say that, it is very different from a forging business, for physical process we follow we take HR steel, make it go through a process of pickling, skin passing, cold rolling, cut length, annealing of course in the middle and ultimately provide these either in finished CR coils or in strips to our customers and these customers are Toshiba, they are Alp Engineering, they are Ashok Leyland and several others, Vijaya Electricals and others. So I would not call it similar to forging business, the future of cold rolling for us is getting into what we call special grade CRs. So the forgings are I mean grades such as 16 MNCR, these 16 are getting converted into special grade steel, so we would actually see a ramp up of this business, of the cold rolling special grade business and with the new capacity that is coming that is coming on line in the second week of December, we expect in Q4 very significant growth in this business to the tune of adding 1500 tons of further around 2000 tons, so close to about over 100 crores a year will be added in this business at an EBITDA of 10%.

Pawan Kumar: Can I know what your present capacity is and what the capacity expected to go after the expansion?

Aditya Rao: So current capacity is for entire field of cold rolling which is close to about 200,000 and we barely use 30%, 35% of that, heavily underutilized. But special grade CR we will have a total capacity addition of close to about 2,000 tons a month is our sales, we can say about 2,500 will be the capacity, but we will be very near, we will be maxing out the capacity for that very soon for special grade CR.

Pawan Kumar: If I can squeeze in one last question, I wanted to understand since the revenues have picked up significantly in this quarter in our steel products business, is it sustainable given the lower commodity price cycle where there is commodity cycle that is presently prevalent?

Aditya Rao: Actually we have had de-growth in this business, I mean this quarter, in 100 crores we have done 92.2 crores specifically in the commodity business of the company it is directly impacted by raw material price, in fact it is a valuation we do here is not very high, so it is very close to the raw material. So consequently with raw material prices falling down revenue has taken a beating, margin has not changed much but going forward we will see this business increase revenue but any differential revenue that is added will be 10% and I would say about 100 crores per year is what we will add, 100 crores more in a year is what we will add but it will steady state that way. We are not saying that this business will go to 600 crores, 700 crores, our intention, our intent and all the CAPEX we are making, all of our moves are to ensure that more than revenue we scale up margins, we would like our EBITDA margin to move up quarter-on-quarter with special grade CR and others as well. So you would see this business expand by about 100 crores per year next year, but I would not focus on this too much because for us this is more legacy business with the company, we are not focusing a lot of man hours or definitely capital in terms of growing this business, most of our efforts are going into industrial components, systems and projects and the CDW tube business and of course our PEBS and environment business. I will also like to hand it over for a little bit to our head of operations Mr. Dayasagar who sees the manufacture of these components to add his thoughts on special grade CR.

Dayasagar Rao Neelagiri: Actually, you are saying the right things - some of the components are getting converted into steel with modified chemistries and improved mechanical properties and they are all special steels. So for the last couple of years, I think they are concentrating on those areas, so we are doing some expansion also in that particular area with hydrogen annealing and higher gauge thickness material handling and with thickness also, we were having electromechanical controls which we are converting into auto gauge, completely hydraulics. CAPEX is also getting added and definitely I think we are expecting a better contribution from this particular segment in terms of volume and profit.

Pawan Kumar: What is the capacity that is being added in special grade?

Dayasagar Rao Neelagiri: Between 1,500 to 2,000 tons per month.

Moderator: Thank you. Our next question is from the line of Ankit Shah from Vallum Capital. Please go ahead.

Ankit Shah: My first question was regarding the railway segment, what I would like to know is product portfolio in railway segment, has it changed more drastically since back in 2011-12 and currently because back then the margins were around 17% if I am not mistaken.

Aditya Rao: The product portfolio is very different from what it was in 2011-12. FY11, FY12 the revenue on railways was dominated by wagons with wagons contributing well over 350 crores in gross sales, close to 400 crores in fact in gross sales for us. Right now the picture has reversed, I see our coach business will contribute close to 120 crores we expect in this financial year and our order books are also geared up to ensure that we achieve that number. But more importantly the wagon business has contracted over the last three years quite heavily and this year we expect to do about 45 crores, this is not so much guidance, I would ask you to take it as what we see happening in terms of this financial year. From a margin point of view, ICF is a large sustainable cash flow generator for the company and quite frankly one of the areas we intend to develop over the long-term. Wagon margins are moving back up after having tapered three years ago, so we are at about 15% to 18% in terms of margin in wagons and coaches are much higher than that. In terms of our breakup of our revenue right now from railways business, I would say about 70% would be coaches and about 30% would be wagons. Mr. Dayasagar also directly overseas the entire railways business including he is the business unit head for our railways business, so I would also ask him to add his comments to this.

Dayasagar Rao Neelagiri: As Aditya was explaining, I think the market has shifted from wagon to coach and at the same time, ICF is also changing. They are also going for coach modernization in a big way. So as a part of that, I think they will be replacing all these mild steel coaches, cotton steel coaches with stainless steel and building the stainless coaches is a little tough task but I think they are gearing up and along with them I think we are also gearing up to support them. They are banking largely on Pennar for their new modernized stainless coaches and also targeting high-speed coaches. So in parallel, Raebareli is also coming up with a big way. We started this business sometime in 2009-10, all those capacities what we have installed in those days are coming to maximum utilization and last year, we have added some CAPEX and all this additional CAPEX, whatever we invested, is also giving a good result. Down the line I think Raebareli is also coming up in a big way so we have just proposed a plan to the management to have a plant somewhere near Raebareli, I think that will be the future expansion that we are seeing in 2016-17.

Ankit Shah: So say financial year 2012 has largely contributed due to the competition or the product thing?

Aditya Rao: So you are asking about wagons?

Ankit Shah: Sir my question was basically the margins have fallen right, so it was largely contributed because of the change in this product diversification that you have been trying to say, as in…

Aditya Rao: You are asking about margin contraction from FY11 to our current fiscal?

Ankit Shah: What is the major contributor to it, because the competition what you say because the product has been changed slightly.

Aditya Rao: I think the change in the product mix is the primary reason for it, if you look at our gross revenue they have not changed that much over the last three year, but frankly what happened is, a little bit of history thing but what happened was wagon revenue essentially did not die down, it just went to zero straight, so it went from 300 crores, 350 crores, 1 year to near zero because there were no new orders being signed, I think after Mamta Banerjee had come in at that point of time the entire order book for wagons became zero and this was true for us, for all of our customers, the wagon manufacturers, Texmaco, Titagarh all of them have you will see a mirror event happening for them as well. So what has happened has over the last 1.5 years or two years wagon orders have slowly started coming back up, from zero and not from low level, effectively from zero we are now looking at 45 crores, 50 crores in terms of revenues. Coach revenue has gone the other way round, now when you look at margins our margins in ICF are higher than anything we have ever had and this is sustainable and we do not believe that this picture will change too much in the next two to three years. For wagons over the last three quarters we have been in trying to increase margins and we have been successful, from 12%, 13% we have taken it up to about 18% now and we feel we can sustain these. We think wagons will continue to be a growth story for us but not as good of a growth story as coach is which we believe is quite attractive right now.

Ankit Shah: Coming back to the CDW tubes, what I would like to know is how are the other players setting up capacity, are they like Tube Investments, I mean how are they shaping up?

Aditya Rao: CDW tubes for TI is a much larger business than it is for us, so we do about 700 tons a month now and we are near capacity, TI tube investments does about 7,000 tons a month. So they are the clear market leader and we are chasing them, in terms of new capacity they have set up a new plant for large diameter tubes, that is not a segment that we are in, in the core CDW segment that we are present in, TI is the clear market leader and we are chasing them and it will be our focus over the next few quarters or next year to steal market share from there and to grow this business and we are quite confident of our ability to do that.

Ankit Shah: So going forward you would be able to sustain this kind of margins, no margin pressure on that front?

Aditya Rao: Absolutely.

Ankit Shah: And do we do exports in this CDW?

Aditya Rao: As of right now currently no, but we are exploring that, there are companies in the US including 3M and others who can potentially be customers but this is in line with the rest of the company increasing its export business, so we have picked up four customers in the US Xylem, Baillie Hydraulics, FNSS, Firestone and others and we will look at growing our export business across, the entire basket of products that Pennar Industries provides and also its group companies. So this will be the initiative that is a multi-quarter, multi-year strategy but we will also expect increased CDW tube revenue, we currently have enquiries going on in this right now for export business for CDW but it will be taken forward as a larger group level strategy.

Ankit Shah: So in the next three years what kind of size do we think we may be able to create in this segment, the CDW thing?

Aditya Rao: In the next three years we will be focusing on CDW growth itself, tubes itself we believe our target is a 500 crores business in the next three years, 3.5 years and CDW tubes will comprise 35% of that.

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

Rashi Talwar: Hi, this is Rashi Talwar. I wanted to ask you a broad question with all these parts and divisions and a changing mix, what kind of long-term three year guidance should we look at or how should we look at revenues and profits over the next three years? I am not asking immediate quarter, six months, but given that how things are changing.

Aditya Rao: Thank you. That is a very important question, and the best way I can think of to answer that is what our growth strategy is. We consider ourselves to be a diversified engineering company, we have a lot of latent skills and assets in the company in terms of, not just in terms of machinery assets, tools, product there but in terms of human capital. Well, over 600 of our employees are engineers, structural engineers, environmental engineers, mechanical engineers, electrical engineers, so there is lot of IP we retain in the company and our efforts over the next few years, next few quarters sure, but over the next our larger term strategy is for us to fully evolve ourselves into a turnkey design and engineering firm. We do have revenue targets but I would encourage you to look at us as a company that is going to scale margins and profitability, so our intermediate goal is 100 crores profit after tax consolidated, after that it is 500 crores EBITDA. These are the numbers we will be focusing on, we do not really have a top-line growth number per say as an ironclad target, we think that will become as a consequence of what we do. So we are investing heavily in capabilities of precision engineering and precision manufacturing, we already have one of the largest structural design teams in the country compared to anyone. So as we invest in these capabilities, all of the business verticals which you see are going to exhibit growth, we believe systems and projects, PEBS, Industrial Components and Pennar Enviro are major, major growth verticals and the markets we function in are universal. As I mentioned, even something like CDW tubes, the high margin business where we do about 4 crores or 5 crores a month, the market leader does a vastly larger number, 10 times of that. So our ability to bring in scale in terms of profitability and revenue also is very good, is very demonstrable quite frankly if you see what has happened over last few quarters. Our focus will be on continued to do what we are doing, consistently quarter-on-quarter improved margins and scale yes, scale revenue as well. Over the long-term, our focus on adding engineering to everything we are doing will result in, we believe tremendous scale opportunities. What PEBS has done for building components we can do for all of our business divisions just adding engineering, IP and knowhow.

Moderator: Thank you. Our next question is from the line of Keshav Garg from Equity Mechanics. Please go ahead.

Keshav Garg: Sir I wanted to understand that our company holds 51% stake in Pennar Enviro, sir so who holds the rest 49%?

Aditya Rao: Those would be the original promoters of Pennar Enviro, Pennar Enviro was created as a company which was in fuel additives and water treatment. It had existing equity structure. So when Pennar Industries entered there was an equity dilution event, the investment happened at par value, obviously the corporate governance of it was something that we looked at very closely and made sure there are valuations done, it was taken up at AGM. So at that point of time PIL had invested about an amount of 4.5 crores to 5 crores and for us it achieved 51% value. Over the last 1.5 year, 2 year since that investment has happened, Pennar Enviro has scaled up revenue last year itself from close to about from 5 crores to 30 crores was the last year's number for gross sales, this year we are expecting a much higher number, consequently we do face this question a lot and it is something we as management are thinking about what the future structure for this should be and the Independent Directors of the Board are discussing the best way forward for us because yes the cosmetics of it do not look too great for the company to hold 51% in a very fast growing business unit.

Keshav Garg: So basically you are considering acquiring the rest of the stake and making it a wholly owned subsidiary, I mean is that on the table?

Aditya Rao: Considering that I also own equity in Pennar Industries, what we have done is we have identified our Independent Directors to undertake this, so we have a very strong Board and our Independent Directors will be taking a call on this, they have asked for a multitude of options, I am sure some call will be taken over the next couple of quarters but it really is up to them regarding exactly how they want to work with this.

Keshav Garg: Sir and also I wanted to understand that during FY11 our revenues were around 1,100 crores and the operating margin was around 12.5% which has now come down to around 10% EBITDA margin and the revenues have also declined by around 25%. Sir so why has this happened?

Aditya Rao: Firstly, I think that's a very important question and the gist of what you said is right, however if you will look at the gross revenue of the company or the net revenue of the company, last year there was a decline, we had our highest ever revenue last year which is March FY15 if you were to look at that number. In terms of operating margin, you are right, from 12.5% to 10% is something that has happened, however we are on the way up, if you look at what is growing in the company, what revenues coming in, that is coming in primarily on the back of the high margin businesses such as our railways business, our solar business, our pre-engineered buildings and also environment business which scale will have very good EBITDA growth. So the way to look at this is to look at it in terms of what happened over the last three years, the decline in revenue which we essentially had 400 crores of our business disappear overnight, from there the company has consistently scaled up in all of its businesses and scaled up margin as well. We see that trend continuing because all of the new order we are booking, all of the new capacity additions that are happening are in businesses with double-digit EBITDA. So what we see happening is continuing growth in what you see happening over the last few quarters, it is continuing growth in revenue and revenue was higher, there is no problem in terms of revenue, our ability to scale up cash flows, profitability is our challenge, is our goal for the next few quarters which we are quite confident we are up to that challenge. So I would say you can look forward to a margin growth, EBITDA growth and continued revenue growth as well for all of our businesses.

Keshav Garg: And sir lastly, also wanted to understand whether there is any seasonality in the business, I mean quarter wise?

Aditya Rao: There is, Q2 is always our worst quarter because of the monsoon, typically most of our services go towards the engineering, infrastructure and those kind of businesses and in the monsoon season the country's construction activity more or less shuts down. But what we are heading into right now is Q3 and Q4 which are usually the much-much stronger quarters and this is too historically, I do not believe there has been an exception to this in the last four, five years. So we are quite well prepared for the further revenue growth for Q3 and Q4. And the seasonality that you mentioned, yes, Q1 is about average for the year, Q2 is lower and Q3 and Q4 are very good, that's typically the way it goes. In this financial year it will have slight difference with Q1 being lower than Q2, but Q3 and Q4 being very good quarters is definitely something we expect.

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

Pawan Kumar: I wanted to understand about Pennar Enviro, how are we planning to execute that big order book, in the sense, how are you going to finance those working capital requirements and whether the depth of Pennar Enviro is presently reflecting on our consolidated balance sheet?

Aditya Rao: That is a good question and as any company, any division when it scales up revenue it will have working capital pressure. However, Pennar Enviro you could see it a little differently, it is not really an EPC company, it is more of a technology company, we have technology tie-ups with Total of France, one of the largest companies in the world, also with a company called Entropy which has lot of technologies in the DM and DSal space, they are also a France based company, a subsidiary Veolia and we also have a technical tie-up, exclusive tie-up with Tech Universal, an UK based company with a lot of technologies in SBR, MBR and ABBR. These are frequent technology environment in water treatment technologies. So for us Pennar Enviro has virtually no debt, to do the 30 crores revenue it did last year it used the total debt including everything, there is no long-term debt including CC debt of about 2 crores. We have not significantly increased that this year, I think the current CC, Cash Credit utilization for Pennar

Enviro is 3.5 crores. But as you mentioned, one of the very serious questions we need to answer is how to execute the 250 crores order book because there is certainly lot of pressure from our customer side, some of the customers will not be able to tell but our largest customer in that business is someone that we have the bulk of revenue this year coming in and I think this solves issues of delivery which we had in the last quarter and we only did about half as well as we thought we would do. It is still a very high growth, we went from 5 crores, 6 crores a quarter to 14 crores, so on paper it looks like very high growth and it is but what we were expecting was much higher. In this quarter we think we have solved those issues and we believe that the company will scale up very well. Because it is a technology company it typically works on, we tried to make it as much as possible a negative working capital business and to a large extent we are succeeding because we do not have a lot of debt in that company, 3 crores, 3.5 crores.

Pawan Kumar: And maybe now much debt addition expected from that side?

Aditya Rao: No, we do have no plans to add a lot of debt in Pennar Enviro, we currently have a working capital cycle of less than a month and I think we will persist with that.

Pawan Kumar: Less than a month, so it is significantly lower than whatever our present Pennar standalone or Pennar consolidated is doing, right?

Aditya Rao: That is correct. As I mentioned to you the total working capital finance which is not the same thing as working capital but the current assets of the company also if you were to look at is about 4 crores and our last quarter revenue which was actually muted by what our expectations were was 14 crores. So you are looking at about close to less than a month, slightly less than a month.

Pawan Kumar: Lastly, I wanted to understand what would be the range of EBITDA margins, what can be the expectations from this business?

Aditya Rao: The order book that we have right now is currently at what we quote is a contribution, a margin after variable that is currently at about 15%. But the actual EBITDA will be a big function of what orders will get executed and I wish I could give you more clarity on this but quite frankly we have orders in that business which are in excess of 50% margin and we also have orders which are at 10%. So the end result will be a blend, but double-digit I think is we can comfortably promise.

Pawan Kumar: Double-digit EBITDA?

Aditya Rao: Double-digit EBITDA we can promise provided we are able to execute and every company will be able to, I know we gave sort of guidance last quarter, we did only half of that but we believe one time set up problems and we think we have solved those issues. So Q3 will come back to you with, again being careful I will not give you guidance, but definitely better numbers than Q2.

Moderator: Thank you. Our next question is from the line of Rahul Agarwal from Banyan Capital. Please go ahead.

Rahul Agarwal: I have one more follow-up question on solar structure business, so what is the revenue we booked in Q2, what was it in terms of tonnage and what is the capacity we have there?

Aditya Rao: It is a good question, in terms of revenue the solar business was in the standalone entity, solar is done in standalone and also in PEBS and it is two completely independent businesses. So the standalone business was about 35 crores solar revenue and did you ask for the tonnage?

Rahul Agarwal: Yes.

Aditya Rao: So that is a slightly more complicated picture especially at consolidated basis because the work we undertake for solar includes the design, the manufacture and the erection of module mounting systems, it also includes the AC side, the electrical, design and the other aspects as well. So the significant amount of knowledge and IP that is going into this, so we do not, the entire revenue is not a function of tonnage is what I am trying to say, but if you want us to give you a tonnage number it would typically be about 5,000 tons.

Rahul Agarwal: And how much installed capacity you have?

Aditya Rao: For production alone, not including engineering capacity and other capacity which are man hours based, for production of capacity alone I think we are 3,500 per month and we have the ability to rapidly scale this up as well, in fact I will ask Mr. Dayasagar to add in as well, there is certain technologies that we had implemented including automated fast punch technologies which drastically reduce the manpower required and which increase our profit. In fact I will just ask him to comment further on it.

Rahul Agarwal: So Aditya, one more question, more generic, in fact on the segments that we have. So what I feel that your margins in almost all the segments are higher than the respective industries, so how do you guys achieve this and how do you plan to sustain these margins?

Aditya Rao: My feeling is let's look at segment wise, in terms of our coach business I think we are on par, you will have to compare us to a lot of, I mean they are not listed entities, really there is no one as large as railways in the ICF, so you cannot really compare that but other people who do it also make a similar margin. In terms of solar, there are certain fundamental advantages which we have which result in a higher margin and that primarily has to do with the fact of MNRE credit. Now with GST being delayed that is actually a big boost to us, a little perversely we actually do very well if GST does not come, the reason for that is all of our products are excise duty exempt, all of our solar products but the way that works in practice is you pass on the input credit you get on the remaining sales that you have. So net-net what it comes to is, for every crores of solar revenue we do we need about 4 crores of additional other revenue, other business revenue. So because we are the largest roll former in India, because we are the largest in this field in India it is not possible for other MMS suppliers to have the same margins that we have. So straight-straight that 10% EBITDA is the bonus that we have, I am not saying we do not pass some of it on, we do pass some of it on but we have the ability and not just from a finance point of view, also from an ability to realize margin, cash flow point of view we have a steady advantage and as long as GST does not come in that will persist. If GST comes in it becomes a level playing field again, that’s for solar margins, for tubes the margins are absolutely as per industry standards, we meet the exact rupees per ton contribution that TI does on CDW sales. Now TI has other sales as well which are lower margins, so that could comprise the difference but if you were to look at on operating margin we are on par with our competitors, industrial components also the same thing, we are having on par. PEBS, our operating margin of contribution is on the same margin, 20% for us, the largest company in India Kirby makes a similar margin but our fixed cost is vastly lower, that is the reason why we actually have higher margins than they do. If you look at our operating margins contribution and our competitors margins, they will be exactly the same but the difference in EBITDA comes in because our engineering manpower team is larger so the complexity of projects we are undertaking is larger. So we have fewer sites than them, few fixed cost, lesser fixed cost than them and we are able to do much more with that and since our engineering team is larger also we are able to persist with this advantage, so that is the reason broadly in terms of margin breakup. For most businesses we are at margin, so we are at market margins, for the business of solar there is a unique advantage which we have which we believe will persist but we have to see.

Rahul Agarwal: I am sorry I did not get this last point for PEBS, so what kind of fixed cost benefit you have?

Aditya Rao: So PEBS on a lower fixed cost base we do a lot more revenue than our competitors. So though our operating margins are the same which is 20%, we are able to do a lot more because of the technologies we employ, because of having engineering services, because of us doing lesser number of projects, more value projects, our average value size is larger, our fixed cost is lower. I would not want to comment on Kirby's fixed cost but what you could do is and I would encourage you to do is to take Kirby's profit and loss statement, our P&L statement and other competitors in the pre-engineered building space as well and you will find there is near uniformity, maybe they are 2%, 3% better off in terms of operating margin but the rest of it is all fixed cost base, our costs are vastly lower and because they have very strong engineering team and because of the nature of projects we undertake we believe this advantage will persist, that is the reason for PEBS margins being strong over the last three, four years and why we believe this advantage will persist.

Rahul Agarwal: So in PEBS what is a general tenure of the projects?

Aditya Rao: Tenure of the project is that what you said?

Rahul Agarwal: That from starting to end how much time does it take?

Aditya Rao: Typically three to six months, for example one of the projects we have executed for Indian Oil which is the largest building in India, 14 million square feet we have done that in a period of about six months.

Moderator: Thank you. Our next question is from the line of Keshav Garg from Equity Mechanics. Please go ahead.

Keshav Garg: Sir just wanted to understand like you elaborated about your focus on margin, sir so similarly sir is there anything in your mind about the working capital because right now on standalone basis our working capital cycle is around 120 days, so any plans to reduce this?

Aditya Rao: The working capital cycle on a standalone basis would not be 120 days, our average per month on a standalone basis is close to about, if you take the last quarter it is about 80 crores a month. And our total current assets if you were to look at it is close to about 200 crores, so it is definitely not 120 days, it is more like 60, 65 I think is the exact number.

Keshav Garg: Sorry, I was looking at consolidated numbers. Sir so any plans to further reduce this?

Aditya Rao: Absolutely, I think the reason you are seeing such a larger number 120 days which I think is monstrous is completely because of the PEBS revenue scale up in the last month and a half, and it was planned, we knew it was going to happen and we have anticipated for it, so you will see this decreasing. Overall for the entire company consolidated and standalone we will target a two month operating cycle and we will achieve that.

Keshav Garg: And also sir can you tell us something that how much of your total standalone business comes from tendering?

Aditya Rao: About 15% of our total revenue is tender based comparatively.

Keshav Garg: And sir all of this is railways?

Aditya Rao: Railways and solar and… let me just get back to you on this number, I think it is a good question, only standalone are you asking?

Keshav Garg: Yes sir.

Aditya Rao: I think 20% would be a reasonably accurate number but we will actually do the math and give you exact numbers.

Keshav Garg: So basically whatever this number is, the segments are railways and solar?

Aditya Rao: Railways and solar, correct, other than that we do not have that many project businesses, so you are absolutely right.

Keshav Garg: And also sir in the rest of your businesses, how is the pricing determined sir, like for example let's say in your tubes business or industrial component business, so I mean the pricing with the customer is it like quarterly price revision or formula based prices or fixed price contract yearly itself. So which of these?

Aditya Rao: Let me correct what I said, we just spoke in here a bit and looked through the numbers, I think what you were asking was how much of it is comparative tender based and that is only 150 crores, solar is not comparative tender based for us, so 50% we will retain from response to your last question. And in terms of price discovery, it is a blend, most of it is raw material based, we have a very good idea of what our raw material cost at any point of time, not just current but also for the next two three months trend, in a sense it comprises a good proportion of our revenue, we have to be very smart in terms of understanding it and that skill we do have, we built that over period of decades, we have no problem with that. So whatever that cost is, 50%, 60%, 70% we estimate a certain contribution and we quote on top of that and more often than not we do not respond to reductions below certain price, so we have margin expectation and we make sure we meet that.

Keshav Garg: Sir so for example, now steel prices have gone down sir, so will you experience an increase in margins or it is neutral for us?

Aditya Rao: So now steel prices have stabilized a bit I would say in the last one, two months and not more than Rs.500 a ton decrease, it is more or less this and we typically pass it on, we pass on whatever decrease is there. So in the last one year if you see we have passed on majority, so in this short-term you will see some improvement during steel price falls because we do not immediately pass it on because any orders that we are negotiating anything we get then if the steel price decrease we do not immediately pass on, it is temporary phenomenon and we do not count on that as a sustainable margin, if you look at quarter-on-quarter it gets averaged.

Keshav Garg: And sir finally, what is your capacity utilization across segments on standalone entity?

Aditya Rao: About 60% to 65% but it varies from 35% to in some business 100% because especially in railways we will add capacity as quickly as we can, solar also we will add capacity as quickly as we can. So with the business that are growing, yes we are at near peak capacity and we are constantly adding capacity but for let's say the legacy cold rolling business we do not have very high capacity utilization, it should be taken individually.

Moderator: Thank you. Our next question is from the line of Ankit Shah from **Vallum Capital**. Please go ahead.

Ankit Shah: I just wanted a quick update around the design and engineering services that have been fairing under PEBS?

Aditya Rao: It has done really well, it has done really well, it is very high growth rate over last year, but again last year was very small. But I am told I cannot give you an exact number on this but what I can do is tell you that we expect this to contribute very significantly to this year's margin in PEBS. So we are expecting 10% of our EBITDA this year in PEBS to come from this business and next year it will be same.

Ankit Shah: 10% right?

Aditya Rao: yes.

Ankit Shah: How much would it be sir, roughly?

Aditya Rao: I cannot give you an EBITDA target but I think what I can tell you is that we expect last year's gross sales of about 503 crores in PEBS, net sales is more relevant right now, 540 crores, we expect good growth on that and we expect EBITDA margin growth. And whatever that thing is, about 10% of that we expect would be engineering services, we have seen good growth, we are near our expectations, exactly where we end up we still have three, four months to go so we will….

Ankit Shah: Be in line of your expectations, the internal expectations?

Aditya Rao: Yes. It is in line with our expectations, yes.

Moderator: Thank you. Ladies and Gentlemen, that was our last question. I would now like to hand the floor over to Mr. Vikram Suryavanshi for closing comments.

Vikram Suryavanshi: Thank you once again to all. On behalf of PhillipCapital I would like to acknowledge management for taking time out for the call and share the information with the investors. We wish you all a very happy and prosperous Diwali.

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

(This document has been edited for readability purposes)