"Pennar Industries Limited Q2 FY2018 Results Conference Call"

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MODERATOR: **MS. NIKHAR JAIN - EMKAY GLOBAL FINANCIAL SERVICES**

Moderator: Ladies and gentlemen good day and welcome to the Q2 FY2018 results call of Pennar Industries Limited, hosted by Emkay Global Financial Services. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask the questions at the end of the day's presentation. Should you need assistance during the conference call please signal for an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Nikhar Jain of Emkay Global. Thank you and over to you!

Nikhar Jain: Good morning everyone. I would like to welcome the management and thank them for giving us this opportunity. We have with us today Mr. Aditya Rao – Vice Chairman and Managing Director and Mr. Krishna Prasad – Chief Financial Officer. I would now hand over the call to Mr. Rao for his opening remarks. Over to you Sir!

Aditya Rao: Thank you and welcome to all the stakeholders of Pennar Industries Limited. Welcome you to the second quarter conference call for Pennar Industries Limited. With me here today are Mr. Krishna Prasad, he is our CFO and Manoj, who is our head of our Corporate Planning Division. I will start up with an overview of the company's performance post, which we will be glad to answer any questions you may have.

For the quarter in question, we have had recorded a pretty strong quarter where we had gross revenue of 426.4 Crores for the quarter as opposed to 411 Crores for corresponding quarter last year. For the standalone company, the gross revenue was 286.6 Crores and the corresponding quarter last year it was 271.8 Crores. For the EBITDA, we had 44.8 Crores in terms of quarter EBITDA as opposed to 43.7 Crores for corresponding quarter last year, which is a growth of 2.6% on a consolidated basis. On a standalone basis; we had 27 Crores in EBITDA as opposed to 21.9 Crores for corresponding quarter last year, which is a growth of 23.3%.

Net profit for the consolidated company was 10.5 Crores compared to 9.3 Crores last year and for the standalone entity it was 7.7 Crores as opposed to 5.5 Crores, which is a growth of 41.1%. I will speak a little bit about the individual business unit's performance.

For the steel products business unit, we grew to 95.2 Crores as opposed to 78.2 Crores a growth of 21.7%. For the tubes business vertical, we grew to 49.7 Crores as opposed to 40.7 Crores, which is a growth of 22.2%. Industrial components we grew to 17.2 Crores from 12.6 Crores; a growth of 36.3%. This division outperformed in this quarter and in Systems and Projects, which comprise of railways and solar verticals we grew to 114.4 Crores as opposed to 111.2 Crores, which is a growth of 2.9%.

For the overall standalone entity, we are at 286.6 Crores as opposed to 251 Crores and consolidated sales are 426.4 Crores as opposed to 380.7 Crores.

From an EBITDA point of view the overall company, for standalone was 27 Crores. Broadly this breaks up to growth across all business verticals. We had EBITDA growth and the highest growth was in our steel products business unit because of our addition of Strips Galvanizing capabilities and also expansion of our special grade capabilities, so both of those have resulted in EBITDA increase of 28.6%, but we are double-digit growth across the board in our EBITDA.

In tubes we grew by 20%, industry components grew by 12.1% and our systems and projects in railways business vertical grew by 24.3%.

The overall consolidated EBITDA as I mentioned was 44.8, which has shown a growth over last year.

With that I would like to hand it over to the moderator for any questions you have on the individual business unit's performance or on the consolidated company's performance.

Moderator: Thank you very much Sir. Ladies and Gentlemen, we will now begin with the question and answer session. We will take the first question from the line of Vikram Suryavanshi from Philip Capital. Please go ahead.

Vikram Suryavanshi: Good morning Sir. Can you give some volume details in terms of how much was from the special grade or in steel business?

Aditya Rao: Typically, I would encourage not put a lot of stress on the volume, but we will give those numbers out. Our special grade CR business is right now on a per month rate of about 1000 to 1100 tonnes per month. For the quarter in question we recorded about 3500 tonnes in terms of total sales.

Vikram Suryavanshi: Can you give the management thought process or some more details upon this amalgamation and news we had for PEBS and Pennar?

Aditya Rao: Regarding the merger, we anticipated obviously that some questions today would be on this. Independent directors of the board have been discussing this initiative for a while, almost over a year or two. So they are taking this forward. The intent here is to create one entity as opposed to Pennar Industries and its subsidiaries; to create all of them into one entity that is the intent. So what we have done is the board has taken a decision in the last board meeting held on Friday to go ahead and after discussions with valuation advisors, fairness opinion advisors all of whom have been appointed. The entire process has been run by the independent directors. They have decided to go ahead and evaluate this merger. The valuation opinion providers have given a certain swap ratio, which we have gone public with. I think it comes to 1.77:1 for PEBS merger and 1:1 for Pennar Enviro. So, we have declared this to exchange and the next step is for SEBI to look at this and give its own approval post, which we will also go in for NCLT approval and after which we will go to all the shareholders and ask them for their opinion on this. Speaking as the promoter, we will be going with the majority non-promoter opinion. What that means as the general meetings are held, we will be looking very closely at what the non-promoter shareholder say and whatever that majority of that opinion, whatever flows with that we will go ahead and vote along with them. The reason for us to do this is that we think that this should only be done if the majority of the non-promoter shareholders agree with doing this, accordingly we will vote in that manner. Also I would like stress at this point that because of this merger while the board definitely believes this to be a value accretive to PIL and PEBS shareholders and also streamline a lot of our operations. The promoters themselves would be losing substantially in this. The entirety of the shareholding in PEBS and PIL gets removed and the PIL shareholding of the promoters actually comes down. Even though it is a substantial hit to the promoters we have had our discussion. The promoter group has decided that in the interest of the company, we would be okay with this provided all the other shareholders also obviously approve this first. So the process right now is SEBI has to approve this, then NCLT and then we will go to the shareholders and if everything goes as planned we expect to get this done in a years' time.

Vikram Suryavanshi: Thank you very much Sir, and just last question Sir, can you just give us more about the outlook in terms of systems and project business?

Aditya Rao: The system and project comprise of two verticals, railways vertical and our solar business. Railways as you would know has grown very well this year and we expect this growth trend to continue, as compared to last year and both standalone and consolidated revenues for solar we expect to have very high double-digit growth and even in the first half of the year itself we have seen this it is extremely high. For railways, we are very bullish. I think our order books from ICF we expect them go up further. ICF is now moving to kit wise order placement strategy as opposed to the regular where the individual subsystems that where held out and do all separately, roof separately and frames separately, so we have been one of the first beneficiaries of this, so we have now started receiving orders for the entire kits and more and more I think ICF will be preferring this mechanism. So output of all of this is our order book has seen a substantial increase. We are right now looking at close to 200 Crores in terms of just coach order book. Wagons on the other end are not doing well, so we are projecting a big decrease in our wagon revenues this year compared to last year. I have warned about this on our last two calls as well as that we do not have a lot of clarity on what is happening in wagons, but on an overall basis railways the growth in coaches will more than outstrip the fall in revenue there and we expect to have very strong growth year, on an overall railway basis and on solar basis as well.

Vikram Suryavanshi: Thank you very much.

Moderator: Thank you. We take the next question from the line of Pawan Bharadia from Equitree Capital. Please go ahead.

Pawan Bharadia: Good morning Sir. My first question was with regards to the debt on the book, so in the previous concall you had mentioned that there would be a reduction in debt overall, so wanted to understand on that?

Aditya Rao: The reduction on debt refers to the sale of our subsidiary Pennar Renewables. We have gone ahead and executed an agreement to sell this to Greenko. We are currently fulfilling the condition subsequent and conditions, so once that is done we expect reduction of about 100 Crores in our total debt. In this balance sheet, we are not able to finish it because it is as of September 30, 2017 while the agreement was executed, the shares were not transferred, but you will definitely see this happen. In fact we have already seen a substantial decrease. Once the CPs and CSS are completed in the next few weeks, we should be looking at a 100 Crores reduction very soon, but we have already had close to 20 to 30 Crores reduction based on money that has already come in.

Pawan Bharadia: My second question is with regards to Pennar Enviro business, so could you say the numbers on the revenues and order book on that?

Aditya Rao: Pennar Enviro, I can give you last year’s numbers, which are a matter of record, but we are not giving out quarterly Pennar Enviro numbers. Last year we had sales of 117 Crores for Pennar Enviro. The order book as it stands right now is over 200 Crores.

Pawan Bharadia: So you had around 250 Crores of order book as of FY2017 is right?

Aditya Rao: Yes.

Pawan Bharadia: So how is the visibility in this business in Pennar Enviro because the overall market has also huge?

Aditya Rao: The market that we go up in Pennar Enviro as you would probably know, industrial water, wastewater, process insudtry technologies, fuel additives and others. So I think the market looks quite good. Our order books are quite strong. Month-on-month we are seeing well I will not be able to give you a number because we have not gone public with that as yet. It is doing quite well I would say from a growth point of view quarter-on-quarter numbers are up and I think with the addition of certain capabilities we are bringing in our process engineering capabilities. I am pretty sure addressable market that also will continue to grow. So certainly I do not see a reduction in revenue or EBITDA for PEL.

Pawan Bharadia: Thanks a lot.

Moderator: Thank you. We will take the next question from the line of Rajat Sethia an Individual Investor. Please go ahead.

Rajat Sethia: One question on the debt part, what is current gross debt on the books?

Aditya Rao: I will just refer you to our CFO right now. He will give you the exact debt number.

Krishna Prasad: Total debt as of now is around 350 Crores.

Rajat Sethia: 350 Crores?

Krishna Prasad: 350 Crores includes the renewables, so once the deal is over it will come down by another 100 Crores.

Rajat Sethia: It will come down by how much.

Krishna Prasad: 100 Crores.

Rajat Sethia: 100 Crores and this is net of cash I believe, this could be net debt right?

Aditya Rao: No, it is overall debt. It is not net of debt. The cash portion would be separate. If you look at net the net will be lower by for a consolidated entity by 150 Crores you have to remove.

Rajat Sethia: Alright because 150 Crores of long-term borrowings and 217 Crores of short-term borrowings is already there is in the balance sheet, so that goes about 350 Crores already and there would be some portion of current maturities of the long-term debt, so that is why I thought?

Aditya Rao: What do you mean by current maturity?

Rajat Sethia: Other than liabilities and components?

Aditya Rao: Yes, that would not be a very high number frankly, but.

Rajat Sethia: This would have been March numbers or this would be September numbers?

Aditya Rao: This is September numbers. Once you see that that is definitely not net debt. Once you see the renewables cash flow come in, which will happen in the next few I would say weeks. You would say reduction in total debt of about 100 Crores on that, some part of this 100 has already come in quite frankly and the agreement has been executed already, so remainder will come in very, very soon and post that also you have our cash reserve, mutual fund investments and all this, which also would be over 100 Crores.

Rajat Sethia: You expect this debt to come down in this financial year itself?

Aditya Rao: In this month itself. I think I can safely commit that.

Rajat Sethia: And what kind of interest cost we are incurring on that debt?

Aditya Rao: The coupon on that is about 10%.

Rajat Sethia: To that extent our interest cost should definitely come down for the full financial year FY2019?

Aditya Rao: Absolutely, I mean we will have other, the way you look at interest cost should be bank charges plus our actual CC fund cost so overall that number; yes we will see a decrease.

Rajat Sethia: Do you also expect to take your debt levels down using your internal cash flows or do you think debt should remain at the similar level?

Aditya Rao: Our policy is that we take the profit from our business and invest it back into those businesses. Most of our debt is short-term, is working capital debt and as we grow that is what we would need, so if a business needs to grow and internal accruals are not sufficient to meet the debt then we need to meet the capital expenditure then we would actually re-raise it, but our goal here is not to become completely debt free. It is to make sure that whatever free cash flow we get from our operations is used to grow the business and that will continue, so we will not be mixing our free cash flow and reducing debt per se. This renewable sale is an extraordinary event, it is the sale of a subsidiary. So whatever debt is corresponds to that that obviously we want to remove, but a typical mechanism, a typical process would be whatever profits we get from our business verticals we will reinvest it back into that business in capex not in terms of working capital or reduction in debt.

Rajat Sethia: Also I think the interest finance expenses related to LCBG are also quite high and do you think there could be a reduction in those expenses as well or they will increase from this levels?

Aditya Rao: I would guide you to an increase as long as our revenue is increasing, so please treat them in proportion to our revenue, so if you see our interest cost increasing by 20% then you should have to see a better than 20% increase in our revenue. So in proportion to our revenue our bank charges, interest cost, LC usage will increase I am afraid that is unavoidable.

Rajat Sethia: The other question was on our systems and projects revenue growth, this quarter we have grown by just 2% to 3%, although quarterly growth could be quite lumpy, so just wanted to understand?

Aditya Rao: This is a complicated question to answer. In actual fact our revenue growth is actually, substantially I would say much higher than what is being shown in these numbers. The reason for this discrepancy is that we are comparing GST numbers now to numbers that were non-GST a year ago, so excise duty. If you look at our P&L also there is also an excise duty component that has been added, which is zero for this year, but it is a substantial number, so what we are seeing gross sales and net sales for last year are inclusive of excise duty, which is reasonably high number.

Rajat Sethia: So what kind of growth if you do it on a comparative basis as we seen?

Aditya Rao: We would have 30 Crores more, would have added another 10% to 12% in terms of overall growth on net sales in addition to what we have right now.

Rajat Sethia: Just one quick question on our total outstanding shareholding in this company now after all the merger and all, would it be around 19 Crores?

Aditya Rao: Could you say that again?

Rajat Sethia: Pennar Industries shareholding, I mean outstanding shares in Pennar Industries after the merger is complete would that be?

Aditya Rao: You mean equity share capital, it would be about 15 Crores.

Rajat Sethia: So some shares would be nullified?

Aditya Rao: Yes, so Pennar already owns 54% of Pennar Engineering Building Systems and it owns 51% of Pennar Enviro, so this shareholding gets nullified. So you will go from 12 Crores shares to 15 Crores share. Yes, correct at a par value of Rs.5.

Rajat Sethia: And also wanted to take your view on the steel prices going ahead given China's policy of curbing production in their county till March 2018, do you have any comment, any view on this how can this affect steel prices and finally us?

Aditya Rao: We are very clear that we do not take exposure to steel prices to the best of our ability, sometimes it is absolutely unavoidable. We are aware that the China is planning to bench 40% of their steel capacity. We are also aware of the supply situation also being a little constraint, but all of that does not lead to the picture, which it traditionally should which is a massive increase in steel prices. I think currently what we are seeing for this month is a decline in steel prices and for the next few quarters usually Q4 is a strong quarter, so may be an increase in the next quarter, but this quarter we do not, at least what I have been guided to by my supply chain managers or supply chain heads are that we do not anticipate a further increase in this month in spite of the China capacity being shuttered, so that is the way we are, but obviously if there were to be an increase or not we would hurry up immediately to hedge that and we have the ability to do that.

Rajat Sethia: Sir, basically if the prices go up in the global markets above our minimum in both price levels so do you think that MRP can go up or no basically?

Aditya Rao: I would think MRP will go up. I think the government is heading in the other direction both cement and steel prices are looking at a substantial decline in this month. I think the government has been very clear that there might be it will not be increased or reimposed to this. Currently, there is a safeguard duty. There is a minimum import price and there is another duty, which has been imposed, so the combination of all of this still makes exports and imports viable, but if the international prices are to firm up a little bit then we would be depend more on a domestic suppliers such as JSW and Tata.

Rajat Sethia: Just one last question, any plan of land monetization?

Aditya Rao: We have initiated that process, we will have more for you on this later, we have hold on to substantial land assets, we will look at giving you clarity on that very soon, but as of right now I think better for me to commit a plan than to give you general feelings, but yes we have land assets, we are working on a plan to monetize them that is correct. We will get our plans across to you soon.

Rajat Sethia: Thank you so much for the detailed answers. Thank you so much.

Moderator: Thank you. We take the next question from the line of Gautam Bahal from Mauryan Capital. Please go ahead.

Gautam Bahal: Aditya, Good morning.

Aditya Rao: Gautam, how are you?

Gautam Bahal: Good. Aditya, I am struggling to understand the rationale for this merger really from a PEBS standpoint. The IPO was two years ago at 178 and now the implied takeout price effectively are on 120, which is at the time where PEBS margins had a cyclical low, pretty much the all time low since the company was founded right and I imagine that this probably make sense from a strategic viewpoint, but I struggle to understand the swap ratio being 35% below the IPO prices two years ago, just some clarity on that would be great?

Aditya Rao: Gautam thanks. I think it is an excellent question and not just yourself several of the other shareholders of PEBS have also indicated that they are struggling with understanding this from a rationale point of view and also in the number point of view. The 120 number, which is 30%, I would say inaccurate, I think the actual number is something that is substantially higher, we can only give a swap ratio right now, we will only able to comment on that once SEBI has come forward. If you look at the swap ratio, the maths if you do it then as per current trend it is looking substantially higher than that, but you are right in one thing whatever that price it would be lower than the Rs.170 it had IPO at, so no argument there. Now as I mentioned before this merger is something that the board has considered for a very long time and they believe it to be value accretive to all shareholders PIL and PEBS over a period of time. They do believe that there has to be a practical transparent process by which the valuation is done and they have gone ahead and appointed valuation advisors, fairness opinion providers. We ourselves as promoters are not allowed. We were not even privy to those meetings. This is the process that is being entirely led by the independent directors and will pass or not pass in its own merits. As I mentioned before the promoter group will vote along with the major non-promoter shareholders, so whatever the majority of that shareholding will vote along with that on this. From a board point of view, I can definitely communicate that the rationale behind doing this is to create a unified base where we can have the same corporate structure, which allows us to implement to reduce intercompany transactions, to make sure that the company as a whole can be run with one CEO, one management team, one board, one operations team and procurement can becomes more efficient and there is certainly an element of cost optimization, but I think that is the logic that they came by. Also there is a significant holding company discount for Pennar Industries and a lot of them felt that Pennar Industries' share price does not accurately reflect its true value and the primary reason for that is because the subsidiary structure does not allow proper value recognition. So these are the lot of the reasons why they have gone ahead and implemented this, but I do want to stress that I understand what you are saying and a lot of PEBS shareholders share this, but my suggestion would be let the numbers come out, let SEBI approval come in hopefully very soon or in the time that they will need to take, let the NCLT process go through and when it does happen, I think let us look at it based on its merits. I mean that it is something that is going to be value accretive to PEB shareholders. I believe so, but let the numbers talk. From a promoter point of view, we are getting hit pretty badly because of this, I mean virtually our shareholding as I had mentioned before in PEBS disappears and Enviro disappears and the total overall shareholding in Pennar Industries comes down. We are doing this with the intent that we do what the board says. We are a board run company and the board feels this is the right step they want to take this to the shareholders and if the shareholders approve it then absolutely we as promoters will back this up and make sure that the combined entity scales in revenue and profitability, but that is the best answer I have for you. I may not have answered your question completely, but that is I guess that is what I have right now.

Gautam Bahal: It is clearly a spectacular deal for Pennar Industries in my opinion at least, the clear question to be answered on this really would be if some outside shareholder comes and offers you big price for Pennar PEBS as a promoter you would always say no right, I mean this is too cheap that is the main question, as a PEBS shareholder I am not very happy, I guess, but will we reach out separately I guess we will talk about this.

Aditya Rao: Absolutely Gautam. I think we will talk about this further. This is a long process. This is not something that is going to be done very soon. There are several approval stages and we absolutely will go to the members both PIL and PEBS both have to approve this, so that is absolutely necessary, so we will talk, we will make sure that all shareholders are comfortable with this, if not comfortable at least they are fully informed with what the metrics and the numbers are finally. So once we get the final numbers in let us discuss and see how we feel, but one thing is for sure both companies are poised for good growth, they will continue to grow. PEBS may have had some challenges over the last couple of years primarily because of the raw material price volatility and some pressure on the capital goods segment, but it is fundamentally a strong debt free company with good margins and good business verticals, which can see scale and an excellent management team, which can take it forward, so let us keep talking and see how where this leads, I think, but I do not want to stress again both PIL and PEBS shareholders are both need to approve this and it is a process we need to go through, let us go through that process.

Gautam Bahal: Thanks.

Moderator: Thank you. We will take the next question from the line of Ashwin Agarwal of Ashmore India. Please go ahead.

Ashwin Agarwal: Good morning. Congratulations on good set of numbers and I just had one question. I was a little confused on the interest cost comment you made. On a standalone basis, interest cost will decline, is the sense I had, but you also said that bank charges will go up in proportion to the revenues, which can make sense, but I was just wondering that on a combined basis interest cost plus bank charges last year were in the region of 33 Crores to 34 Crores somewhere there. My own sense was that that number should come down because you are now getting some savings on the interest cost and at the same time I was under the impression that your bank charges and guarantee costs, etc., are also coming down as we gain scale and your balance sheet get stronger, so would you help me think through what this number will look like in fiscal 2018?

Aditya Rao: Thank you. It is an excellent question and you are right. There is an element of ambiguity in the previous communication. You are absolutely right. The interest plus bank charge of Rs.33 Crores will decline this year. The primary reason it will decline as with the sale of the subsidiary and with the reduction of overall shall we say the per contract bank charge per opening charges. Because of the combination of the rate decreases and also the sale of the subsidiary, the overall debt of the company comes down. Correspondingly even for the standalone entity because standalone entity holds some debt, which has been deployed into the subsidiary, which will be repaid now, but ultimately the standalone entity is the one that gets the money from the sale of the subsidiary, so they will repay their debt and it will also result in a reduction in the consolidated entity debt. So you will see a decline in that. What I meant to say is going forward, we have I would say aggressive expansion plans. We expect our profitability and our revenue to scale at double-digit rates for all of our business units over the next three quarters. When growth comes in on this manner, it comes in as a response to capex, which we will invest, which we will cover by ourselves, but there is also an element of working capital increase. Typically you work on two-month and three-month working capital cycle, so over time while you will see a decline this year what you should get comfortable with is the percentage of working capital cost or working capital interest cost as a percentage of revenue, you should see that holding steady not increasing and not heavily declining, but holding steady may be a little bit of bias on a little bit on rationalization because of the economies of scale, so that is what I wanted to guide towards. That as we grow and as our working capital increase correspondingly our interest cost will over time increase, but in response to good growth and revenue what you will not see is moderate growth and revenue and a high increase in interest cost, that is something I can absolutely commit to.

Ashwin Agarwal: The other question I had was post the sale of this subsidiary and the reorganization, you will have very limited amount of debt on your books including working capital debt even if we take capex into account you will have a very limited amount of leverage. The company's dividend policy is something I would like you to comment on? How should we expect it from a two to three year perspective?

Aditya Rao: This would be a decision for the board to take. From what the previous communication on this have been, there are substantial cash, positive cash that is thrown up month on month by this company. Typically, before it ends up in capex, we intend to put in mutual funds, so we definitely expect to have more cash than capex this year. So that free cash flow can be used for either a corporate action, which is a dividend or a buyback. Personally, my feel of is that the board prefers a buyback as opposed to a dividend because it is more tax effective and I think it is more efficient from a point of view of delivering investor value. That is the board's belief on this, but I think once we get closer to the end of the year, I will be able to comment on this. But we are not opposed to either of those corporate actions. I feel we prefer buybacks and we are going to be throwing up enough cash, free cash flow will be quite strong and instead of hiding it in mutual funds and waiting for capex, it is certainly a good use of money to do either a buy back or dividend with it and the board will take a call on that.

Ashwin Agarwal: Thank you so much. All the best.

Moderator: Thank you. We take the next question is from the line of Manish Bhandari from Vallum Capital. Please go ahead.

Manish Bhandari: Aditya and team. I am a bit perplexed at this whole reorganization exercise and the wisdom when you raised the IPO, was this clearly discussed about the merits and demerits of PEBS and finally now we are folding it back, so there would be a lot of cost involved as well as may be some shareholder dissatisfaction on the PEBS side, so I am just wondering that is there a synergy between both these businesses have been well laid out and do you have some quantifiable numbers on what kind of synergies could happen once we fold this business back in?

Aditya Rao: We will actually get a note across on the impact that the merger has not from a shareholding point of view more from an operating efficiency point of view. Most of the operating efficiencies will come in because of raw material procurement being rationalized because they use very similar kinds of raw material. Some corporate overheads being rationalized is also something that will definitely happen, but the combined picture you should see is that the strategy and management team and the boards as they are right now they will be able to manage the companies better. As of right now with three subsidiaries with three operating units Pennar Industries, PEBS, and PEL and common directors across all every quarter calls for three board meetings, three audit committee meetings, three internal audit meetings, three strategy meetings, three budget sessions, so while this is necessary and PBES and the IPO declares that PBES has a right to exist as a separate company the independent directors strongly feel and the independent directors on the boards of PIL and PEBS, there is some commonality as well, so they do have the experience of looking at both boards and looking at both structures. We also have separate independent directors and shareholder directors who do not have that opinion as well, so this is a decision that should be taken with everyone being fully involved. Any step like this, it is natural that there would be some element of confusion, what is the swap ratio, what happens to be with shareholding, what would happen to the share price, but this is a process that the independent directors, we have considered this for almost two years and while a lot of shareholders even on PEBS side have indicated some problem. There have been several things were also indicated in the positive, including some shareholders who have been with us for a very long time even before the IPO, so these are non-promoter shareholders also supported. My sense of this and my suggestion would be we wait, we understand in its entirety over what is going to happen, what does SEBI say about this, what would all the shareholders say about this, but again I want to reiterate that this is something that does not add value for promoters. Promoter shareholding goes down, but what does need to happen is both PIL public shareholders and PEBS public share holders need to sign off on this. So I believe that we as a board and as management will make the case. If they feel that there is merit in this they will go ahead with this. If they feel not then obviously and it is a decision that needs to be taken by the public shareholders and we will go through the process of informing them of everything and I feel that once all the numbers in then I think everyone can take an informed decision.

Manish Bhandari: I appreciate it. How you value Pennar Enviro at what market cap you have valued Pennar Environment?

Aditya Rao: The market cap I will not be able to comment on, the swap ratios 1:1 for PEBS shares.

Manish Bhandari: I mean the Pennar Enviro and not PEBS?

Aditya Rao: PEL shares to PIL shares is 1:1, but if you look at current market prices, the way they are floating is valued at less 8% of Pennar Industries current market cap, but again these are numbers that SEBI will have to approve.

Manish Bhandari: You mean to Rs.60 Crores to Rs.70 Crores? I am just looking at the data in what you have put in the public, so you mean to say Rs.70 Crores to Rs.80 Crores is the market value of the business value of the Pennar Enviro is what you have valued it?

Aditya Rao: Less than that. As I said, I cannot give you the number, but it is less than that, but there were a couple of mechanisms followed in the valuation process. One was obviously what the market and comparable companies are, but that was brought down by the fact that valuation we wanted to be conservative on this. The shareholding there is promoters, so that is the reason they wanted to ensure that they take a conservative viewpoint. We will be floating this valuation metrics across to you, but it is lesser than the number that you have just said and as I said the promoter group itself isn't very happy about this, but we will full support this if all other shareholders feel it is an interest of the company.

Manish Bhandari: My last question is as a shareholder of Pennar Industries, we have struggled to see the value creation in the business for the last couple of years and what we are now seeing is a financial engineering where PEBS gets floated out, then it goes back, it folds in, then Pennar Enviro now is getting fold back into the system, which I am quite happy about it, so what is the metrics, which will create a value we have been talking about improvement in ROCE, so is this is a business environment and is depressed enough for us to see value creation or there is something else, which is lacking in the system or maybe we have to reorganize our team at the business side level or maybe you are better placed to give us some idea that what is real value creation metrics, which is holding this back?

Aditya Rao: The way I see this and the way the board sees this real value is created when EPS grows, when ROCE improves, when EBITDA margins are sustainable and growing and that has been my attempt for the last three years. When I had come in the share price of the company was Rs.20. The PAT was at Rs.11 Crores. The market cap was about Rs.250 Crores, so not because of me because of the fantastic team that we have setup and the fundamentals of the company, the foundations of the company have been so well built, we have quadrupled our profit on a standalone basis and more than that also. We have quadrupled our market cap. We have doubled our revenue. All of this has happened because of the structuring that we bought in place. This year as it was last year, we had highest consolidated sales our highest EBITDA and this year also we expect to have similar numbers the highest EBITDA and a higher consolidated sales higher than last year. So we will continue to focus on EPS growth. ROCE is very important metric for us. We continue to throw up a lot of free cash. The company is sitting on a lot of mutual fund investment. The net debt as other callers have noted is much lesser than it was three years ago, so I would disagree with you that there has been no fundamental improvement. The merger announcement is something that lot of shareholders are also asking for and the independent board feels they want to explore it, so it is simply that. It is simply that would a combined entity result in better shareholder value for both PIL and PEBS and would it improve operating efficiencies to deliver even for the group. That is the question we are trying to answer. It is a decision that has to be taken not by myself or by the Board of Pennar Industries. It is a decision that has to be taken by the non-promoter shareholders of the PIL and PEBS, so let us see what they have to say is my suggestion.

Manish Bhandari: No, I appreciate your disagreement, but if you recall the last three to four years since we have been the shareholder in the company, I was the one who completely disagreed on the IPO for the PEBS and I said there will be a value shift, which could happen in between as a holding company discount as well as in terms of business reorganization and I am sure I do not know in terms of the collective wisdom of the board we decided for an IPO and certainly exactly two and a half years down the line, so I am just looking at the strategic move of the company and I am completely disheartened by the timeframe of three years when we have to do a roll out an IPO and then we have to again take back, so I am sure in some changing landscape or business landscape you would have seen something now, which would giving you a synergistic value, so maybe I am trying to see through that is what something we missed when we did an IPO and we are rolling back an IPO may be we would be doing the same thing in the next three years down the line, so this is what debate in my mind and maybe we will wait for your all other metrics just to flow through and make an informed decision. Thanks a lot.

Aditya Rao: Thanks Manish. I appreciate your thoughts.

Moderator: Thank you. We take the next question is from the line of Sachin Kasera from Lucky Investment managers. Please go ahead.

Sachin Kasera: Good morning everybody and congrats for a good set of numbers. Just again to take that point has been debated on interest and financial charges, just again if you can give a clarification now that we are also proposing a merger, what is the consolidated gross debt and the consolidated debt that is point number one? Secondly you mentioned that while the term loans could come down, the interest and financial charges in terms of working capital and some LC charges could go up, so in that case should we look at your finance cost more as a percentage of sales and how do you see that in the next two to three years?

Aditya Rao: The consolidated gross debt of the company is Rs.350 Crores. Consolidated net debt after removal of free cash reserves and right now as of September 30, 2017, which is the numbers we have gone ahead with, would be lower by about Rs.100 Crores. Now with the sale of the subsidiary being completed that will come down by another Rs.100 Crores, which you would only see that I guess by the end of the year. With regard to your final question that percentage of our interest cost as a proportion to revenue will either be stable or decline slowly little bit, but not a massive reduction and you would not see an increase.

Sachin Kasera: Today it is approximately if I see the first half it is at approximately 4% of sales should we see that at 4% or should it trend down in the sense you have talked about reaching a billion dollar of sales growing at 25% to 30% CAGR, so should we see this 4% say trending down to closer to like 2.5% to 3% next two to three years?

Aditya Rao: I would hesitate to comment a number, but purely by the sale of the subsidiary you will absolutely see by the end of this year that 4% coming down substantially by at least between 50 to 100 basis points at a minimum.

Sachin Kasera: Once this sale is there you should be closer to 3% to 3.5% and hopefully that number should at least sustain if not go down?

Aditya Rao: That is correct.

Sachin Kasera: The second question I believe there was some article in the media quoting you having an ambitious target of $1 billion, can you comment a little bit about that what is the thought plan and what is the confidence of the management in the board to achieve that number?

Aditya Rao: So $1 billion is not a metric by which we measure our strategy and growth that was one of the comments that was made during that Q&A session, but the way we see growth is ensuring that we continue to grow up the value that we provide to our customers and we have measured that value in terms of two metrics EBITDA and ROCE. So we will continue to want to maintain a certain ROCE about 20% for the entirety of our business. We target higher for certain businesses and a little may be moderately low, but anything new that we will add, we will add more than 20%. I think the business verticals we function in are immense. The universe whether that be the railway space, whether that be the construction space, and our water treatment additive space, the market size is far higher than our revenue. So with the current consolidated sales approaching Rs.2000 Crores plus in this financial year, what we intend to do is to take the cash flows that we get in each of those businesses and to take advantage of the massive markets, which are present. Let us say for example tubes for example, tubes used to be Rs.30 Crore to Rs.40 Crores business three to four years ago. What we intend to do is use the cash flows from that business to grow it, a formula we have been following for the past few years and now it has last year reaped sales of gross sales of Rs.183 Crores. This year, it will be growth of double digit on top of that on that we are absolutely certain. We intent to replicate this in larger scales in some cases and in slightly smaller in some others across our business verticals and once you do that once you have that feedback loop of cash flows from a business being used to grow that business generating larger cash flows, which again flow back into that business and addressable market size is continuously growing then we are in a good place and that is essentially what we intend to set in place. That affectively what I have been trying to do for the last three to four years and my belief is it has worked out quite well. I think we are fundamentally a much stronger company than we were three years to four years ago and we will continue with this philosophy and with a 25% to 30% growth rate on where we are right now, we will be able to reach that billion, but that is the only metric. A billion in sales and a billion in market cap are not the only metrics. Capital efficiency, growth, value delivery is more important. You do those then that will follow.

Sachin Kasera: Sure, so just as a follow-up to that if I understand you mentioned that 20% consolidated ROCE is what you would like to target incremental maybe a little higher? From what I can see on the reported first half numbers and if I just analyze that we are running a little below that 20% run rate, so one is there any sort of target that we can look in the next three to four quarters when you intent to hit the 20% on capital and secondly regarding growth now that we are half-year is already done what is your sense of the overall consolidated growth rate for the current financial year?

Aditya Rao: What it will do is again with the sale of the subsidiaries, so asset based businesses generally do not tend to be higher than 20% ROCE. What would you see for the end of the year is an EBITDA, which is higher than last year. Last year's was Rs.172 Crores, so higher EBITDA than last year and a capital base also, which is much lower than last year, so that on whole EBIT divided by the balance sheet size let us call it will be about 20% or it will be very close to 20% as a blend. That is something that will happen I think. Not only because of the sale of the subsidiary, but going forward also whenever we add business and whenever we deploy with the capital or working capital our focus is to make sure that the ROCE is over 20% and I can commit to you that every rupee of revenue is added in the last one to two years, additional revenue has been over 20%, so overtime you will see that number keep picking up.

Sachin Kasera: Just one observation. If we go back say sometime back very before we had slow down in the economy in Pennar Industries and before last three quarters of little bit of slackness in PEBS both the businesses actually had 24% to 25% return on capital and from what I understand as far as the parent is concerned the quality of business is significantly improved in the last three to four years and we obviously are now looking at a point of time where the business is starting to get some tailwinds, so do you think that actually we should raise the benchmark and target more like a 25% return capital, which we actually have achieved in difficult times and with a little of inferior product mix rather than be a little conservative and be at 20%?

Aditya Rao: Obviously if we are committing 20% our internal target is more stringent, and I agree with you. I think we should have better targets than 20% and we look to improve that number, but as of right now we are promising that, so we will make sure we achieve and grow on that number, but it will not get worse than that number. That I can commit.

Sachin Kasera: Thank you very much and wish you all the best.

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

Vikram Suryavanshi: Sir can you just elaborate what basically led the growth in hydraulics and how do you see that segment growing going ahead?

Aditya Rao: Did you have a followup question or just the hydraulics?

Vikram Suryavanshi: That is basically what led the growth and how do you see that shaping up now?

Aditya Rao: So hydraulics, I know these are small numbers, so it will seem odd that we are devoting so much time to it, but hydraulics is very important for us. We think it can lay the ground work for the start of a lot of growth of engineering business for Pennar Industries. We have invested about four to five years ago and we bought the assets of Wayne-Burt Petro Chemicals, which was the hydraulics business division. It was at that time Rs.24 Crores; however, because of our inability to read the market properly we were not able to scale up that business vertical. Over the last three to four years since we have stated relooking at three years and trying to grow that business vertical, it has seen very high growth rates. So in this financial year, we will have Rs.12 Crores to Rs.13 Crores in terms of sales at that and about 20% EBITDA. In fact what we see going forward is a market size with an excess of thousands of Crores. The largest company in this field is Wipro Infrastructure and they do a thousand Crores of business on this. Dantal Hydraulics were Rs.170 Crores and Well Chian is at over Rs.100 Crores, so there is tremendous potential for us to grow this vertical. It sits right now in the industrial components vertical. What it also allows us to do and we have started seeing some orders in this regard as well is for us to enter certain other value added segments such as defense. We received our first defense orders with hydraulics in the last few months. We will have more on this for you later. We will not be comment detail on this, but we have special things planned for hydraulics with imposition of duty on Chinese products. Our US customer Bailey also intends to increase their revenue from us. Right now, I am completely capacity constraint by hydraulics, so we are adding capacity as quickly as we can and I am pretty sure that it will continue to grow and become one of the major contributors for industrial components, our industrial components division group.

Vikram Suryavanshi: It is mainly focused on the export or do you have decent amount of domestic business also in hydraulics?

Aditya Rao: We would be focusing on the export market.

Vikram Suryavanshi: If you remove hydraulics from industrial component, the industrial component core business what kind of growth we see going ahead?

Aditya Rao: Overall industrial components has grown at about 36% this quarter and this year also we expect pretty high growth, I think definitely high double-digit is what we would expect. That is being driven by hydraulics, but also by the growth of our businesses, which is in general engineering and automotive components, so I would say that industrial components overall last year was about Rs.70 Crores to Rs.75 Crores in terms of gross sales. We are targeting substantially higher number this year.

Vikram Suryavanshi: Thank you very much.

Moderator: Thank you. We take the next question is from the line of Ranjit Kothari from Vibrant Securities. Please go ahead.

Ranjit Kothari: Good morning. One question on the hydraulic business, so in that do we make the entire package systems also or we only make sub components like cylinders?

Aditya Rao: We currently only make cylinders, but we are going to be entering into the entire package system, which includes the power pack, it includes the walls, it includes the screens and motors as well. We have started delivering those systems, but as of right now the gross majority of the business is only the hydraulic cylinder itself.

Ranjit Kothari: These are all export-oriented as of now?

Aditya Rao: Correct.

Ranjit Kothari: Can you help us understand that based on what is the kind of switching cost, which is involved by the customer because I believe it is a critical component in the entire system, so how can a new player like us get wallet share from the customer or what is the strategy, which we have to follow to may be take market share fromn the competitors?

Aditya Rao: I believe the market is quite vast. I think as I mentioned we have more orders than we can deliver right now, so that itself is a clear call that we have to increase capacity and obviously, which means that revenue increase can be looked forward to. What makes me confident about hydraulics is quite frankly we also have a US base now in Pennar Global, which is an entity, which has been setup purely to increase the export business of Pennar Industries and for PEBS, so my focus on this really would be to look at getting more and more customers. There are a lot of them in the US. Bailey is one of them. Prince Hydraulics is another company, which will be opening up and their procurements are in the tens of millions of dollars each. So addressable market size is my confidence for saying that hydraulics will continue to increase along with my order book being higher than what I can deliver right now.

Ranjit Kothari: Moving forward on that are we focusing on the mobile market or the industrial segment of hydraulics?

Aditya Rao: We are mostly on the mobile market, but we have solutions for industrial as well, but as of right now it has mostly been mobile. We are adding telescopic cylinders. We think most of the opportunity is over there.

Ranjit Kothari: Our value add would be just the lower cost, same quality at a lower cost is that what it is as of now?

Aditya Rao: I am not a big believer in undercutting and getting orders. We have very good center setup. We have a very good testing platform. We have obviously the cylinder manufacturing. We have honing. We have skiving. We have every production process, which has been added after a lot of thought. I believe it will not be cost cutting. It will be I think shifting from existing high cost customers such as China because of duties, so it will add some revenue. But purely by merit of being present in the value ad engineering space metal engineering space for a long time, we will get some orders. I think in this case, I think there is plenty of room for everyone to grow.

Ranjit Kothari: Secondly on the tubes business can you break up the growth by CDW and ERW if you can?

Aditya Rao: CDW is currently at a 1000 tonnes per month. We used to be at 700 tonnes, so from a revenue point of view in CDW we are doing about shall we say about Rs.10 Crores and ERW is also close to about 2000 tonnes, but a slightly lower price per tonne or a substantially lower price per tonne, so overall it is a 50:50 breakup between ERW and CDW.

Ranjit Kothari: You expect the growth high 20 plus to continue?

Aditya Rao: Absolutely, I think all my competitors are bigger than me in tubes. So we have TIA, which has 7000 tonnes of CDW. As I mentioned I am at a 1000 tonnes. We have Good Luck, who does 2000 tonnes. We have several others. I think as I said in tubes also I am capacity constraint I think. We export tubes as well to the US. We have Salem Steel as a customer. We have others who are Compton Knox and others who are being built up, so I do not see tubes slowing down.

Ranjit Kothari: Our EPC business, there we have introduced new products, which has improved the margins. At the same time, I think over the last four to six quarters, we were seeing a degrowth in the business, but it has now turned around in terms of growth also and even margins? Can we expect the same to continue going forward with marginal single-digit growth with decent 600% margins, is it reasonable to expect?

Aditya Rao: Which business are we talking about?

Ranjit Kothari: We call it steels at core, business the CFR and CRSS business?

Aditya Rao: I think we may have some pleasant surprises for your there. So special grade has grown to be stronger than we thought it would be, so we are at capacity with special grade. We are adding capacity there, hydrogen-annealing capabilities further. So from non-existing it has come to about 1100 to 1200 tonnes a month, which corresponds to something approaching say Rs.80 Crores a year. We think we can replicate that again and increase that further and as I mentioned before any addition we do, we will do it at a differential EBITDA over 10% and a differential ROCE over 20%. I think that plus our retail operations having been started, so we have commenced operations in retail side of business where we are actually sending a lot of our products to retail stores. Revenue numbers will be muted this year. We have already about 1 Crore per month in terms of run rate. We expect that to reach Rs.3 Crores, Rs.4 Crores, and Rs.5 Crores per month, but as I said I think next year you can expect this business vertical to grow further from a revenue point of view. Now from a margin point of view, I would suggest you give this division a pass until next year. As that retail business grows, you will see both revenue and margins catch up, but as of right now you should definitely expect further growth in what we call as steel tube.

Ranjit Kothari: Any update on stainless steel tubes product introduction, which you are expecting?

Aditya Rao: We wanted to have that commissioned by November. We expect it will take November end of November or the first week of December end we will start, but in this quarter, we will be starting off with sales in that business unit. That we are quite confident.

Ranjit Kothari: Any light on the target customer here? Is it like the power plants or what is it or is it process industries what is the target customer for us here?

Aditya Rao: There are two customer segments of stainless steel. One is the pharmaceutical sector, which we think would be close to 50% of the volume. The other 50% will be our railways business.

Ranjit Kothari: Finally in the Enviro business have we increased the share capital over the last two to three years or no?

Aditya Rao: No.

Ranjit Kothari: Thank you. All the best.

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

Aditya Rao: Thank you everybody for being on the call. Obviously lot of questions on the company performance as well as the merger process as well. We promise a lot of transparency and clarity as we work through this, but I want to reiterate that this is a decision to be taken by PIL and PEBS public shareholders. Let us follow the process and see where that lead us, but I thank you again for your questions. I thank you for your comments and look forward to touching base with all of your in the future. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, on behalf of Emkay Global Financial Services that concludes this conference. Thank you for joining us. You may now disconnect your lines.

(This document has been edited for readability)

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