“Pennar Engineered Building Systems Limited Q2 FY 2018 Results Conference Call”

November 06, 2017

MANAGEMENT: **MR. P. V. RAO - MANAGING DIRECTOR, PENNAR ENGINEERED BUILDING SYSTEMS LIMITED**
MR. ADITYA RAO -- VICE CHAIRMAN, PENNAR ENGINEERED BUILDING SYSTEMS LIMITED
MR. SHRIKANT BHAKKAD -- CHIEF FINANCIAL OFFICER, PENNAR ENGINEERED BUILDING SYSTEMS LIMITED

MODERATOR: **MR. VIKRAM SURYAVANSHI -- PHILLIPCAPITAL (INDIA) PRIVATE LIMITED.**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Pennar Engineered Building Systems Q2 FY 2018 Results 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 the operator by pressing '*' then '0' on your Touchtone Phone.

I would now like to hand the conference over to Ms. Vikram Suryavanshi from PhillipCapital (India) Private Limited. Thank you and over to you, sir!

Vikram Suryavanshi: Good Morning and a very warm welcome to everyone. Thank you for being on the call of Pennar Engineered Building Systems Limited.

From management we have with us, Mr. Aditya Rao -- Vice Chairman; Mr. P. V. Rao -- Managing Director; Mr. Shrikant Bhakkad -- Chief Financial Officer.

I hand over call to the management for their opening comments and then we will have the Question-and-Answer Sessions.

Aditya Rao: Thank you. This is Aditya Rao to all the stakeholders of PEBS we are glad to have you on our Conference Call today for the Second Quarter performance of Pennar Engineered Building Systems Limited.

Mr. P. V. Rao -- the Managing Director of the Company will be providing an overview followed by answers to any questions that you will have which will be addressed by the Management Team. We also have Shrikant, our CFO, here with us and our Investor Relations consultant Jill and they would be able to answer any questions you have.

Thank you. And I would like to hand over to Mr. P. V. Rao for introductory remarks.

P. V. Rao: Good Morning, Everybody. I would like to brief you on the Q2 performance of Pennar Engineered Building Systems.

The gross revenues were at Rs. 153 crores and the net revenues were at Rs. 133 crores. The EBITDA is at Rs. 11.41 crores and the PAT is at Rs. 3.64 crores.

The highlights are we have order book of Rs. 363 crores. Engineering Services business has grown well and the revenue increased to Rs. 4.4 crores and currently we do a per month average billing of Rs. 1.5 crores.

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The Solar business division revenue has increased to Rs. 25.73 crores as against the corresponding period of Rs. 12.97 crores.

In the order book, we have got sizeable orders from (RVNL7) - Rail Vikas Nigam Limited, the Wagon manufacturing unit through URC Constructions, an order from Alstom for a railway engines assembly unit through Tata Projects Ltd., multiple orders from TVS Infra for a warehouse building, an order from SS Developers for a warehouse building, an order from IBC Solar Projects for MMS, an order from Clean Max for MMS, an order from Taein Construction for an auto components unit, an order from SVS Warehouse Tech for a warehouse building, an order from RKV Developers for a warehouse building and an order from Satara Geo Systems for a factory building. Then we got an order from Kia Motors for their assembly building in Tadipatri in Andhra Pradesh.

These are the highlights and now I give it to Shrikant, our CFO, for his remarks and then we open the session of question-and-answers.

Shrikant Bhakkad: Good Morning, Everyone. Gross revenues grew from Rs. 134 crores to Rs. 152 crores for the quarter. In terms of H1, it increased from Rs. 242 crores to Rs. 290 crores. Predominately, the revenue came from an increase in the Solar activity which almost doubled from Rs 12.97 crores to Rs. 25.7 crores. The Engineering division saw revenues increase from Rs. 2.61 crores to Rs. 4.4 crores.

The half year balance sheet has been given. Due to an increase in the raw material prices, the inventories are little higher. Receivables have increased due to increase in sales and due to higher GST. Now Solar was under the MNRE exemption earlier but now, GST is also applicable on solar.

In terms of tonnage, we are more or less flat in PEB. Solar tonnage has increased from 990 tonnes to close to around 1,870 tonnes. I will be glad to answer any questions once we start the Q&A. Thank you.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin with the Question-and-Answer Session. We take the first question from the line of Rajesh Ravi from Centrum Broking. Please go ahead.

Rajesh Ravi: Sir, my question is regarding to the PEB segment. If you share the volume numbers and the outlook and what is the working capital situation in that business? I will check on the other businesses subsequently.

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P. V. Rao: In terms of tonnage compared to the previous corresponding quarters, it is almost flat in terms of PEB. Currently it is about 13,500 tonnes as against 12,762 tonnes in the corresponding quarters last year.

Rajesh Ravi: Last year you had mentioned around 14,600 if I recollect, right for the…

P. V. Rao: That is overall actually.

Rajesh Ravi: That includes Solar also?

P. V. Rao: Including Solar also, yes.

P. V. Rao: That is correct, yes. So, tonnage wise, PEB is flat but Solar wise yes, we have significant increase in Solar and Engineering Services. It has increased significantly compared to the last corresponding quarter.

Rajesh Ravi: And what is the outlook? How are things like what was your sales in Q1 and what is the out the outlook that you are looking in this business growth potentially?

P. V. Rao: On outlook, industries wise the enquiries is not encouraging but in terms of warehousing it is very encouraging because after the GST came into the picture, a lot of warehouse enquiries are coming up and Amazon is coming up with fulfillment centers all over India. First one we have done in Hyderabad for GMR. In Bengaluru also we are doing one project for them and then we are expecting some more orders in other places because the developers are developing and then giving it to Amazon. Amazon not itself investing in CAPEX. So the developers are developing and constructing and giving it to Amazon. So in warehousing definitely there are a lot of enquiries coming up. High rise we are able to get more enquiries. So whatever deficit is there in PEB, we are trying to cover up with structural steel jobs, high rise and warehousing jobs.

Rajesh Ravi: Okay. And sir this warehousing and high rise in the Annual Report also, you have articulated the high rise you are looking at a higher potential Rs. 100 crores for this financial year, revenue is coming from that. So how is that in terms of last two quarters your experience and is the marginal profile better in the high rise and similarly, for the warehousing segment because you are getting

P. V. Rao: The margin profile I would say is almost similar to industrial also. The high-rise people always compare pricing with the concrete pricing, the steel shell versus the concrete shell. So margin

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wise we are able to get similar contribution in both high rise as well as in the warehousing segment.

Rajesh Ravi: Okay.

P. V. Rao: Yes.

Rajesh Ravi: And what has been the growth like, do you expect that Rs. 100 crores from the high rise could be achieved based on the first half performance?

P. V. Rao: Projects are coming up from various places in India. We expect to do at least Rs. 70 crores to Rs. 80 crores in this financial year in high-rise buildings**.**

Rajesh Ravi: Okay. So you will be able to match with the FY 2017 sales that you have done Rs. 70 crores you did in around FY 2017 from the high rise?

P. V. Rao: Yes, exactly. But warehousing definitely there is significant growth.

Rajesh Ravi: Okay. So first-half like in the Solar was the total volume off-take and in the PEB? First-half total off take volume?

P. V. Rao: In the first-half, PEB is around 25,000 tonnes and Solar is about 3,500 tonnes**.**

Rajesh Ravi: Okay. In the Solar also, you have been quite bullish in the Annual Report and in the first-half at least you are there on target.

P. V. Rao: We expect to do Rs. 90 crores to Rs. 100 crores in this financial year. We have order backlog also in Solar. And there are a lot of projects coming up in Solar because we started doing civil works foundations and the erection of structures and we have a very talented design team. So we are expecting a lot of potential in Solar.

Rajesh Ravi: Okay. So about Rs. 90 crores to Rs. 100 crores you expect to be achieved this year.In the first-half also the revenue mix has significantly improved for this business.

P. V. Rao: Exactly.

Rajesh Ravi: In terms of two things, on the GST impact on this Solar what is the GST overall impact**?**

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P. V. Rao: 18%.

Rajesh Ravi: 18%. So earlier till Q1 what the total tax that was going out excise and VAT?

P. V. Rao: VAT of 5% only or 2% of CST.

Rajesh Ravi: So increase in the tax rate over there you are seeing?

P. V. Rao: Yes, earlier we were paying on the 5% VAT/CST as applicable.

Rajesh Ravi: Okay. So how is that being absorbed at the customer end? Has that dented demand?

P. V. Rao: As of now we are not seeing any dent in the demand.

Rajesh Ravi: Okay. So it is totally pass through in the customer, the order inflow is not getting impacted.

P. V. Rao: Yes.

Rajesh Ravi: Okay. Secondly, margins also if you could just enumerate the way you have given the revenue break-up for this solar business?

P. V. Rao: Normally, product-wise EBITDA break-up product we do not give.

Rajesh Ravi: For understanding, revenue we do not give the absolute

P. V. Rao: Contribution are low for Solar but volumes are good and actually we have gained some good volumes.

Rajesh Ravi: Okay. So it will be more revenue driven growth that you would see.

P. V. Rao: Yes. The fixed cost are also less in that business as big as PEB. So even the contribution is less but overall EBITDA wise it is good. The fixed cost is not as much as PEB.

Rajesh Ravi: Okay. And lastly, on this working capital cycle like almost in this quarter if I see on a trailing 12 months sales this is almost for 150 days of cash conversion cycle now versus 100 days in March. So, inventory days remains high at around 150 days. So, what are the thoughts like is the sustainable thing or there are scope and when would that be able to be achieved?

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P. V. Rao: If you see the revenue also has grown compared to the six months of previous year. The revenue has also gone up compared to this corresponding period. And yes, there are some projects where the deferred payment comes up there and then raw material price escalation is also there that is also an issue which you are addressing because the reason why we are maintaining more inventories is a huge volatility on raw material pricing around 6,000 to 9,000 the volatility happened in the last quarter. So these are the reasons we have to maintain more inventory. And yes, working capital we definitely try to improve on that and then we do not have any long-term debt whatever we have is working capital

Rajesh Ravi: Around working capital. And these payable days is also like you were earlier doing more than 100 days of payables that has come down to below that is almost 90 days to 93 days now. So any structural changes which is there in terms of your is it or is it just one off in this quarter?

Shrikant Bhakkad: Yes, predominately the payables include in terms of LC payments as we have and like other certain days we able to do 120 days, I think over a period of time the intent is to reduce in terms of interest cost and the LC period we are trying to shorten from 120 days to 90 days, so that the overall the working capital cycle improves.

Rajesh Ravi: Okay. Great, sir. Any outlook in terms of what sort of CAPEX the company would be requiring across all the three business segments?

P. V. Rao: CAPEX cycle we are working on some projects. Currently we have invested about Rs. 2 crores, we got approval from the board of about C sections and some higher sections and all required for Solar. So earlier we were sourcing Solar structures from Pennar Industries our parent company now we started doing ourselves.. So we are having our own machines to improve the contribution level. So that is one thing. And second thing is some new products also we want to add currently.

Rajesh Ravi: In the Solar only?

P. V. Rao: Not Solar. In Ramboll towers for example, the telecom towers for Reliance, we got the approval from Ramboll as a supplier. There is a huge demand we are expecting from Reliance Phase-II Jio Infocomm and we have the advantage of Ramboll towers. And we have the advantage of Ramboll towers in terms of easy and installation and less foundation cast. Reliance Jio is preferring to go for Ramboll towers in a big number. In South India there is nobody for them to Ramboll approved vendor. So we got the approval on that. So there is some CAPEX that is

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required for fixture and all and some equipment that is required for Ramboll and all they came and report to**.**

Rajesh Ravi: How much will that CAPEX be, sir?

P. V. Rao: Second thing is our industrial banking systems also we are now planning. Third one is cold formed buildings high rise building up to ground plus 3 so they are not having much load and we can do with cold formed section. The technology also we are now developing more is using IIT guys advisory casting capacity. So we would definitely in the time to come may be in the next board meeting, we are trying to put CAPEX proposals worth about around Rs. 15 crores - Rs. 20 crores to improve both revenue as well as profitability.

Rajesh Ravi: So total Rs. 15 crores to Rs. 20 crores and I mean, this would be another Rs. 5 crores - Rs. 10 crores annual?

P. V. Rao: We are expecting Rs. 100 crores - Rs. 125 crores like that.

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

Neil Bahal: I just wanted to ask you what is the growth rate for the PEBS industry in India and also globally right now?

P. V. Rao: PEBS market growth, I would say it has been stable for the last six months.

Neil Bahal: Would you know what is the growth rate like, what is the industry growing at?

P. V. Rao: I would say in the flat. In the last six months it is flat because the industrial units coming up are less compared to the warehousing potential. Warehousing is compensating to some extent the deficit in industrial units coming up. So I would say in the last six months our study says that it is flat.

Neil Bahal: Okay. And globally what would it be?

P. V. Rao: Globally, we are studying markets around India only. For example, Middle East is there, then we have Africa, then we have Asian countries, these countries, China they have their own domestic players normally PEBS do not get exported to China mostly. So they have their own

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in-house capability in China. So we are seeing that in other areas also it is flat. It is not much I would say neither come down or increased.

Neil Bahal: Okay. And also, you said your order book is Rs. 363 crores as of right now, is that correct?

Aditya Rao: Yes.

Neil Bahal: What was it last quarter?

P. V. Rao: Last quarter it was around Rs. 390 crores, if I remember correctly.

Neil Bahal: Rs. 390 crores. So the new order that you have got this quarter, I thought the order book would have increased a lot from last quarter.

P. V. Rao: It is sizeable and the size of this is also important.

Neil Bahal: Okay. And what do you expect your order book to be around same time next year?

P. V. Rao: I would expect it to improve.

Neil Bahal: 450.

P. V. Rao: Yes, approximately around it, because of extended rainy season also some customers are postponing. Even end of October also it was raining very heavily in South as well as in some parts of the Western India. Then Structural Steel also we have started consolidating and structural steel jobs and we are expecting also to increase in the coming one or two quarters definitely.

Moderator: Thank you. We take the next question from the line of Vetri Raju from Equity Analyst Private Limited. Please go ahead.

Vetri Raju: Can you elaborate on the margin profile now and what is the reason for this fall in margins?

P. V. Rao: On margins I have addressed in the previous conversation also that there is raw material volatility of around Rs. 6,000 to almost Rs. 9,000 Sheeting and Purlins as well as in Plates also as well though we are maintaining inventory to hedge the increase in the price. But problem is that all the customers may not be able to because there are some jobs where the drawings are approved, the customer has made the payments, so in such a case we have to bear that difference in

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whatever escalation and then there was one price. So that has dented us to some extend otherwise, if you look at our contribution margins and all it is the reason why it is a little 1% or 2% dip is only because of that. Otherwise fixed costs and all, it is almost like compared to last time increase which normally every year happens that does not happen but otherwise we would maintain definitely the same profit profile because the raw material prices have not increased.

Vetri Raju: So what is the outlook internally in the company in terms of raw material prices going forward?

P. V. Rao: It is very difficult to predict. People say that it is shortage of coal, coking coals and iron ore, but we are expecting next two months - three months to be flat and normally every time the increase happens after January, March - January, February and then it reduces in the rainy season. But this time, it increased in the rainy seasons this financial year

Vetri Raju: Okay. And it was good to know that the warehousing activity is picking up, I do not know may be it is due to GST or something. But do you see, you mentioned some names primarily they were all like Amazon is an online e-Commerce player, do you see this warehousing across all industries including infrastructure industry, steel things like that?

P. V. Rao: Warehousing is increasing, we are seeing increase in Chennai area, Bengaluru (Bangalore) and Bombay, Pune, in North India…

Vetri Raju: Outside of e-Commerce too.

P. V. Rao: It is because of GST only. Certain increase in quotation activity of warehousing is because of the GST. For example, you take TVS Infra is constructing warehouses all over India.

Vetri Raju: Okay. Now last quarter or one or two quarters back, you said that some pharma industry, some pharma companies were expanding so you saw some traction there. Now is there any industry which is kind of flat or what is kind of de-growing compared to the past?

P. V. Rao: Pharma in the last quarter I would say it is flat. Earlier we got orders from Hetero, Mylan, Glen Pharma, Sun Pharma. I have seen increase in the projects activity - in fact there are constant enquiries coming up.

Vetri Raju: Okay. And do you see now that there is trust in affording housing or something do you see any high-rise structures enquiries coming from the affordable housing space developers?

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P. V. Rao: No, as of now. I would say no as of now. They are coming basically in commercial projects these steel buildings are economical in our opinion, in our experience also. But in the residential segment I have my own concern so being economical in terms of design, in terms of weight.

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

Rajat Sethia: Sir, on the margins once again, you mentioned because of raw material prices, we are facing headwinds on margins. So In the four quarters our margins have been continuously declining the EBITDA margins. So, would you say the last four quarters were in aberration because of raw material or what would you say about it? And at what level of margin would you say these margins are sustainable and what circumstances would you achieve those margins?

P. V. Rao: Raw material price increase has definitely affected. But if you look at manufacturing segment the imperial levels have come down but of course, it has not compensated because of increase in the volumes in warehousing as well as in high rise segment. So there is definitely if you look at gross capital formation also in India, if you look at the reports and all not that much. But what we have done is we have made a strategy we should concentrate and focus on the areas where the potential is more like warehousing and high rise and solar for example and engineering services. So here the margin levels we want to improve upon the margin level because engineering services is a high margin level. So you see the growth on engineering services it is significant growth. Last year we did about Rs. 10 crores and we are planning to do double in this year. So that is high EBITDA business and we want to grow, opened an office in the U. S., we have started a company called Pennar Global which is joint venture 50-50 between Pennar Industries and Pennar Engineered Building Systems and we have hired one senior professional from a very large PEB company. And we now want to do business in structural steel detailing also in the U. S. and we want to make these revenues grow faster. So that you know any dip in local EBITDA will be compensated suitably by high EBITDA business in engineering services.

Rajat Sethia: Sir, one of the internal factors which you talked about the other is external which is largely steel prices, so what kind of steel, is it good for you to have a steel price in a certain range or is it like you cannot make 10% to 12% kind of EBITDA margin at the current steel prices no matter you stay at these levels for another couple of years?

Aditya Rao: No. I think, it is in the steel price level that matters I think Mr. P. V. Rao is alluding to is to steel price volatility. So, when you have 20% impact on our steel prices with raw material price escalations were two or three quarter, this is something that has been happening for the last year

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then that puts a lot of pressure on us from a margin point of view because price increases have to be compensated for by the increase in working capital which is inwarding more inventory and also, will not be able to inward exactly the amount we need. Supply chain management will have its own issues. So there will be a certain amount left over. That in fact, you have seen in terms of decline in margins. So we have seen our margins go from as Mr. P. V. Rao said .. So going forward, there is a lot of work substantial work going on behind the scenes while you see a quarter that is flattish, I think there is a lot of work going on in terms of improving our engineering services revenue which is a higher margin growth profile. In terms of preparing when this volatility dies down you cannot have constant volatility all the time. It tends to die down and once that does happen we have the capabilities to take advantage of that we fully expect our margins to bring back over time. Plus a growth of higher margin verticals and the CAPEX project which Mr. P. V. Rao also spoke about, will result continue revenue on contribution growth. So we are debt free corporate. We have a very low leverage, we have reasonable amount of control on our current assets, in terms of both our accounts receivable and our inventories. Our inventory is higher obviously because it is a necessary response to an increased steel price. But to answer the spirit of your question which is what going to happen to margins in this company. I think, steady state margin of 10% what we aim at and we definitely have gun power to make sure we achieve that.

Rajat Sethia: So assuming the steel prices remain at where they are today then achieving those margins will become much easier, right?

Aditya Rao: Yes, that is correct.

Rajat Sethia: Okay. And if the steel prices go down then probably higher margins?

Aditya Rao: Yes.

Rajat Sethia: And only inventory side that you mentioned…

Aditya Rao: We have to answer your question another way. If there was no steel price increase impact, if you get your steel price by 25% reduced revenue, revenue by 14% then you would see our EBITDA margins being at higher than what they are right now closer to 10% more than that perhaps. So if there is definitely a steel price increase impact and that is the reason for the margin decline that is very demonstrable.

Rajat Sethia: Because there is a little bit of conflicting data that I have. If you look at your gross margins for the last four quarters, your gross margins have been 47%, 55%, 52%, 45%, so despite having

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55% gross margin our EBITDA was declining. So that I could not understand; while in this quarter…

Shrikant Bhakkad : In comparison when you look at our gross margin it is a blend of several verticals which includes solar which tends to be lower contribution, but a little higher EBITDA was a lower fixed cost and the PEB business which hasdifferent gross margin which is margin after variable and high rise buildings which also has a different cost structure. It is mix, so the more appropriate comparison would be I think, EBITDA frankly or you were drilling all the way down to PAT and written on capital employed or probably the most important numbers per se but our gross margin level absolutely there will be difference you may see a substantial sync on quarter-on-quarter gross margin also. But what we aim at, at each business doing a certain amount of contribution. It has its fixed cost. So it ends up at a certain amount of EBITDA. Erection services are higher and gross margin are lower. divisional contribution to get an idea about the market is doing**.**

Rajat Sethia: Got it. See, other thing you mentioned about was inventory I think Mr. P. V. Rao mentioned that because of high raw material prices, we are carrying higher inventory. Assuming prices just hypothetical scenario I wanted to understand, if we assume prices to remain in a range bound kind of a scenario then what kind of inventory levels do you see for yourself in couple of quarters I mean 1.5 months to 2 months?

P. V. Rao: Normally 2.5 months to 3 months.

Rajat Sethia: 3 months?

P. V. Rao: Yes. This PEB industry people maintain 2.5 months to 3 months normally.

Rajat Sethia: So for example right now I think we are maintaining an inventory of around I think 155 days.

P. V. Rao: Yes.

Rajat Sethia: So it can come down to 90 days?

Shrikant Bhakkad: So yes, 90 days to 100 days.

Moderator: Thank you. We take the next question from the line of Sunil Jain from Nirmal Bang. Please go ahead.

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Sunil Jain: My question relates to more of this high rise building wherein you said that you can do similar revenue as compared to last year what was the revenue in this quarter?

Aditya Rao: Segmental revenue we are not disclosing I believe. Around roughly around Rs. 20 crores - Rs. 25 crores I would say.

Shrikant Bhakkad: High rise we are not demarking

Aditya Rao: Yes, we are not demarking, it's part of steel structure.

Sunil Jain: Okay. And sir, considering the scenario where steel prices are also increasing and as compared to the concrete building how this high-rise building are placed?

Aditya Rao: cement price are also increasing.

Sunil Jain: Yes. But we had seen only commercial buildings are going in that right now and that to very limited. So there must be a lot of cost difference because of this pick-up is not coming.

Aditya Rao: In concrete building also you have TMT Bars, steel is used there also in concrete building, the cement prices are also increasing there. So, there is a corresponding increase in that segment as well you know in our concrete segment as well.

Sunil Jain: So you see stake like-to-like, is there any difference in the cost or not?

Aditya Rao: Normally they compare shell-to-shell because we do not surprise the full building, se supply the steel column, steel beams, and back panels. So when the developers announce they compare like-to-like. So normally what happens is that some customers, see there is importance given to the timelines then definitely they are going for the steel building because steel is much faster construction compared to the concrete and with a lot of shortage skilled workers also which is bothering the concrete industry.

Sunil Jain: Okay. So as such cost may be more but the timeline….

Aditya Rao: In some cases we matched, in some cases it is coming around 5% more than the concrete like that. But still people are preferring because earliest they occupy the building, earliest is the revenue generation for them.

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Sunil Jain: Okay, fine. Like what we see that in commercial building the cost per square feet is around 3,500 to 4,000 levels. So in this case it will be near about that only or it may be even higher?

Aditya Rao: Shell does not cost that much. Shell maximum 700 to 900 per square feet. The foundation anyway has to be done in concrete. The slab concreting has to done anyway in concrete also. The walls anyway have to build in concrete only. So they we will only compare the steel shell versus concrete shell.

Sunil Jain: So what we see the trend in the U. S. that a lot of buildings are made up of steel only. What I was looking at where we are and whether the trend can pick-up in future?

P.V. Rao: In the U. S. market, why the steel buildings are more is because of very expensive labour for doing in concrete that is the reason why it has been traditionally high-rise buildings are steel buildings if you say New York World Trade Center building which has fallen down they are steel buildings basically. This culture has started in India, it is picking more into the commercial segment and 20 floors - 30 floors buildings are coming up in Bombay (Mumbai), Thiruvananthapuram, Kochi (Cochin), Hyderabad, like that I am expecting that to grow up a lot.

Sunil Jain: Okay. And sir, about this industrial side, you had said that the things are stable. But when you see the pick-up? Are you seeing any green shoots right now or still there is some time?

Aditya Rao: The domestic consumption has to increase and two, exports have to increase. We are expecting that to happen because a little decrease in the interest rate and many people will come forward to expand their units or to start new industries.

Sunil Jain: Any particular type of industry which are seeing some initial pick-up?

P.V.Rao: Auto is doing well. Auto we are getting a lot of enquires. Auto ancillaries we are getting enquiries, Tyres we are getting enquiries. Every Tyre manufacturer is expanding left and right. Kia Motors, we got the order. Similarly, Maruti is expanding, Ashok Leyland is expanding, Bajaj is expanding, everybody, every auto guy is expanding.

Moderator: Thank you. We take the next question from the line of Rajesh Ravi from Centrum Broking. Please go ahead.

Rajesh Ravi: Just discussing on this working capital thing only if I see your short-term borrowing this quarter number is Rs. 93 odd crores which historically has been Rs. 50 crores - Rs. 55 crores type levels.

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So is it because any particular structural change in the revenue mix which is driving this or it is just some one-off thing and it may get normalized?

P. V. Rao: Yes, this is one-off thing we had certain procurement of raw material and other things where we have taken this temporary overdraft facility. I think, it will be between 55 to 65.

Rajesh Ravi: Sorry, which facility you are talking about, sir?

P. V. Rao: Temporary overdraft facility.

Rajesh Ravi: So subsequent quarter this should come down to those levels only?

P. V. Rao: Yes.

Rajesh Ravi: And this Solar we have such high outstanding in terms of debtor days and all or they are more execution based, you get your money in time and all.

P. V. Rao: No, in Solar we do not have much.

Aditya Rao: It is more of retention money after once the projects are executed we give the performance bank guarantees to them f the money which get stuck after the completion of the project once we handover the project that moneys will come back. So there is no pure money retention per se but it is only 2 months - 2.5 month hardly amount that we have.

Rajesh Ravi: Okay. And in terms of your revenue mix for FY 2019 of FY 2020 perspective, how would that look, sir? Because we have guiding in your Annual Report that PEB may be a steady state growth and you see the solar and the high rise within PEB, high rise is growing in very fast pace and solar also is growing at a fast pace and the smaller business – the Engineering Services which was earlier 2% of top-line is now 3%. And similarly, your Solar revenue from 10%-odd is now 20% of top-line. So how would the revenue mix look in FY 2020?

P. V. Rao: Revenue mix I would say, we are now concentrating on new products also. We will be coming to board in the next quarter. We are working on some proposals, I cannot disclose them right now. But some revenue generating and profit generating proposals are being under discussion now. So definitely in the time to come I would say Solar will definitely increase. Then Engineering Services will definitely increase because we have started the office in the U. S. also. And structural steel we want to increase a lot. Currently structural steel enquiries are more and high rise definitely as I was telling it is more. So I would say that in terms of ratio of contribution

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to the profitability I would say that PEB will be leading anyway up to 60% or the other 40% will be by various other products.

Rajesh Ravi: And this Baroda facility if you can just throw, is it still an own-leased unit or we have acquired into it?

P. V. Rao: No, Baroda facility we have actually taken on a job work basis Baroda facility.

Rajesh Ravi: Right. So it remains at job work basis only?

P. V. Rao: That will remain in job work basis only. We have not invested anything in that.

Rajesh Ravi: Right. So would that be leading to your margin dilution in overall PEB segment also reported PEB basis?

P. V. Rao: No, it will not.

Rajesh Ravi: No, just because you would be purchasing and then you would be showing them at sales. Most of the activities are being outsourced to that unit.

P. V. Rao: We are just using that facility for job work basis and that is all.

Aditya Rao: Your question was dilution in margin because of Baroda facility?

Rajesh Ravi: Yes. Because had it been your own facility that would have been in-house production.

P. V. Rao: It is getting to segments in north and as well as Gujarat and Rajasthan type of areas. So if we need to supply from Hyderabad the transportation cost is high. So to the extent that we are supplying from Baroda the transportation cost will come down.

Rajesh Ravi: Okay. And at what utilization is that running for you, sir?

P. V. Rao: It is around 60%.

Rajesh Ravi: And overall your 90,000 total capacity?

P. V. Rao: Here in Hyderabad we are also at 65% only.

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Moderator: Thank you. We take the next question from the line of Lala Ram from Vibrant Securities. Please go ahead.

Lala Ram: My question on the margin front, so you have said that on the steady state basis this business can generate 10% EBITDA margins. So does that incorporate only the PEB business or this is for the overall company?

P. V. Rao: Overall blend I would say.

Lala Ram: I am surprised because considering that we are growing our Engineering Services business which is an extremely high margin business. Still going forward, we will be making only 10% margins?

P. V. Rao: See, if our Engineering Services business is increasing definitely the EBITDA will increase.

Lala Ram: No. So basically, what is the margin probability of the core PEBS business, PEB, is it 10% or less?

Aditya Rao: You should take it as PEB plus high rise plus Solar as one because Engineering Services is so disproportionately high in terms of margin, it does not make sense to club it from a margin profile projection point of view with all the other business verticals. All the business verticals have certain EBITDA, ROC point of view whereas this is a lot higher. So obviously, let us say our Engineering Services revenue have doubled then obviously our EBITDA is going to be much higher than 10% so you are correct in that. But I think, what we are trying to do is get a lot of solar traction in that business and once we have a way of getting that shall we say Rs. 40 crores - Rs. 50 crores then would be a good time when it starts materially impacting the EBITDA very powerfully. But for the near-term this is not got guidance, but I think from an expectation point of view what I would like to communicate is we are targeting 10% for the company minus Engineering Services.

Lala Ram: So ex-Engineering Services we should plan to make 10% margins, is that correct?

Aditya Rao: That is our intent, yes. And we believe it will be an achievable target.

Lala Ram: So if I compare that number with historical numbers, I think that means that this business has deteriorated in terms of its profitability because we have made even 12%-odd margins in 2013 - 2014 and 2016 was 15%. So now we are saying that this business can make 10% that means the competitive intensity has increased or what is the reason for that?

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P. V. Rao: One to two years back certain high profitability jobs which we took, so that gave us that type of EBITDA margin.

Aditya Rao: So some job which we were higher but you do have to look at when you look at percentage margins in industries which have very high steel consumption or raw material consumption of any kind, the percentage point of view is a little difficult for us to project profit declining or margins declining because what you look at the spread going down, is our rupees per tonne going down, is our contribution going down. So the raw material prices shoot up from what it was 1.5 years - 2 years ago the raw material prices for base HR steel something we use a lot was 29,000, now that is 41,000. So we have a huge impact what you passed on is typically that percentage increase to maintain spread, so you pass on that increase which results in a margin decline which is part of what you are seeing right now in addition to obviously additional cost and some amount of inventory not being completely covered. But I do not anticipate there being a problem from a point of view of the long-term viability of these markets. I do not think competition has increased substantially and we will ensure as Mr. P. V. Rao mentioned a fixed capital formation, the gross block here, nobody is building power plant, nobody is building large factories, automotive is doing well, pharma is doing well, warehousing is doing well, solar is doing well. There are several other sectors which are underperforming anyone who looks at IIP will know. So I do not see this to be a systemic problem. I do not see this to be a long-term problem. I think, this is just a consequence of the way they are structured and the consequence of higher raw material price**.** When you see these fluctuations, it is 200 basis points pluses and minuses will happen and it is not indicative of market, markets are going off the cliff, it may be indicative of market maturing a little bit but any industry which is engineering intensive I do not think that is a problem. I do not think there has been a margin decline in the point of our margin after variable. I think we need more volume in our fixed cost has also gone up because what we had five year ago when we were just starting off is not what we have right now. We need to nurture more talents, we need to look at these diversifications within our core capabilities. So I guess what we are trying is that your conclusion should be on, is the market giving us the same spread it was before, which it is. Consequently, the market is not the issue.

Lala Ram: Okay. So if I check the historical numbers according to my calculation, the contribution comes to around Rs. 8,500 per metric tonne, is it correct or?

Aditya Rao: By EBITDA point of view, yes.

Lala Ram: Okay. So that we should be able to maintain?

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Aditya Rao: Yes, do look at the variable contribution as well which is margin after variable which I would assume is about Rs. 14,000 per tonne to Rs. 15,000 per tonne. So that has been very stable.

Lala Ram: Okay. And secondly, one of the constant issues which we have over the last two years has been a very high finance cost which is basically because of bank charges and I think, we have guided that we would plan to get it down but that is not happening, so some thoughts on that?

Shrikant Bhakkad: No, more or less the bank charges are flat in terms of where they were in terms of the last year. So overall, if you see the interest cost where we were, last year was close to around Rs. 17 crores wherein we closed at around Rs. 4.5 crores. Now, I think we are able to make at Rs. 4.25 crores. We are constantly working deploying on reducing the LC and interest cost where we can reduce overall numbers. So definitely we feel the interest cost being reduced.

Lala Ram: Okay. And we reduce our inventory levels with stability in steel prices I think it is natural that this should go down?

Shrikant Bhakkad: Yes, absolutely. And with the volumes also increasing we are still able to maintain the same finance cost. We are not increasing in terms of the volume because the same cash we are able to generate and redeploy back.

Lala Ram: Right. And one question on the broad five-year, Investor Presentation you have mentioned plan is to obviously create value for shareholders, but the first point is to build a high growth technology company. So I just want to know that do you view ourselves as a technology company or is technology a very big component, is it the competitive advantage or is it not? Can you just explain on that point? What does that mean?

P. V. Rao: If you look at our competitors most of the competitors are PEB companies they are only PEB. But whereas we have diversified into Solar, we have diversified into high rise buildings, we have diversified into Engineering Services and some more new products which will generate revenue, and which will profitability we are going to have CAPEX approved in the next quarter maybe we are proposing. So we want to have a diversification for example, no other PEB company has any Engineering Services business in the U. S. So we have started that business and we have started an office also there and it definitely in the time to come we need to look at diversification market, we do not know how the market fluctuates. If the PEB is good, then definitely we will build up another facility somewhere. But we want to add some other products to our portfolio.

Lala Ram: Okay. One last question, this CAPEX which might do for new product categories this will be funded by internal accruals or we have to go to market?

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Aditya Rao: We are sitting on a substantial reserve funds, not only do we have a no long-term debt, we also have substantial mutual fund investments which is basically we pulled a mutual fund for this CAPEX in waiting so that will generate enough, we will not be increasing our debt at all for this CAPEX.

Moderator: Thank you. We take the next question from the line of Rohit Balakrishnan, an Individual Investor. Please go ahead.

Rohit Balakrishnan: So, you mentioned that your spreads they have not really gone down if you look at from a contribution margin perspective, was that right?

P. V. Rao: Yes.

Aditya Rao: For each individual vertical for the PEB vertical, it maintains a certain spread, the high rise has a certain spread and Engineering Services has a certain spread which would be a man hours and net tonnage and Solar also. So that had not gone down.

Rohit Balakrishnan: Okay. So as a follow-up to that can you help me understand if my volumes are growing and if our spreads are remaining the same, why would the absolute EBITDA go down in that case then?

P. V. Rao: See there is raw material volatility also to be considered. There is an increase of around Rs. 6,000 per tonne to Rs. 9,000 per tonne in the last two quarters which brings down the spread.

Aditya Rao: Yes, so I guess, the way to put it would be there will be some element of our procurement which is not completed in time. Some orders which are left un-hedged, there we get expose to market. The reason what I was trying to communicate the answer to the last question is generally when the order that the market gives us with a certain assume steel price that spread is constant. However, due to market volatility as Mr. P. V. Rao said sometimes we are not able to be in a position to completely hedge that raw material price exposure once we book orders. That results in price shocks, that results in a decline in margin.

Rohit Balakrishnan: Got it. So essentially in such a scenario, our contribution margin goes down, right?

Aditya Rao: Yes.

P. V. Rao: Yes.

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Aditya Rao: One thing to understand our booked margins are as strong as they always were but our actual margins will be lower because while we cover a 70% - 80% of our exposure but entirely it cannot be covered. And prices for a Rs. 1,000 - Rs. 2,000 increase no problem but when raw material prices shoot up at 20% over two months - three months that is the fundamental risk in this industry to margins.

Rohit Balakrishnan: Understood. And what you are saying is essentially something which could be temporary. There is no fundamentally deterioration in the industry per se where people are undercutting or something like that?

Aditya Rao: I don't think so. At least we do not undercut. I think there is a tremendous discipline and we would rather not take orders than take them at bad margins.

Rohit Balakrishnan: Understood. The other question I had is, you are planning to add 30,000 of your own capacity, right. So can you just enumerate what is the timeline and what is the amount and what could be the revenue that you could generate from here?

P. V. Rao: We are planning to have some more products in our portfolio so for that the CAPEX plans are being worked out, the feasibility and then the market study is going on and we will be roughly planning to invest Rs. 15 crores - Rs. 20 crores which will yield a revenue of around Rs. 100 crores - Rs. 150 crores in one year time.

Rohit Balakrishnan: Okay. So Rs. 15 crores - Rs. 20 crores and revenue of about Rs. 100 crores to Rs. 120 crores in about a year's time, right?

P. V. Rao: Yes.

Rohit Balakrishnan: If I remember correctly, it was only for PEB business, right? Now has that been cancelled or the scope of that been exposed increase to other projects as well?

P. V. Rao: We will be adding another beam line also for PEB, also we have the space available and all, we can put some more equipment to increase revenues in PEB segment as well.

Rohit Balakrishnan: Okay. So you are saying PEB will be in additive to this?

P. V. Rao: Yes.

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Aditya Rao: What we call it as steady state CAPEX that can go on and response, it only takes us six months to add that capacity.

P. V. Rao: Currently we are running at 65% capacity utilization. Once the capacity utilization increases and once we see potential enquiries, good enquiries coming up then we can add up new equipment also in the same facility?

Rohit Balakrishnan: And what is the timeline for this when do you plan to put it and when you will be online?

P. V. Rao: If it is PEB then it does not take more than four months - five months to put new equipment. They are available locally near here itself in India. And if it is other new products for which once we come out with the conclusion that these are the products we are going to have and the broad approve the CAPEX there also four months - five months' time is required for building up the capability.

Rohit Balakrishnan: So from the time four months - five months…

Rohit Balakrishnan: And how does that ramp up happen, because Rs. 100 crores in one year with Rs. 15 crores - Rs. 20 crores kind of CAPEX seems very good, so how does the ramp-up actually happen if you have the demand?

Aditya Rao: The revenue to asset multiples are quite high, even if you look at our net block it must be 62 crore or something. So if you just look at last year's gross sales of about Rs. 580 crores and 62 so 7x, 8x, 9x assets multiple is not at all ordinary. So Rs. 15 crores - Rs. 30 crores giving you Rs. 120 crores is not surprising to us.

Rohit Balakrishnan: Okay. And it will take about a year's time to get that kind of number.

Aditya Rao: The capacity will get build up sooner. I think, what Mr. P. V. Rao is projecting is that we intent to have that become like a Rs. 10 crores - Rs. 12 crores per month rate which will give you a 100 - 120 per year is he is projecting.

Rohit Balakrishnan: Understood. And sir, just I mean you have various portfolio of businesses within PEB as well. So how do you track you as an owner of the business, how do you track? How is the business doing, what are the metrics that you use for each of these verticals and also as a company at the top level?

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P. V. Rao: See, normally, there are certain parameters like for example what is the industrial production, what is the personalized industrial production, grass capital formation, then what is the sales of sheeting material in the country, what is the sale of high-grade steel plates in the country. By looking at all these things you can drive the demand in PEB products.

Rohit Balakrishnan: Right, sir. So these would be largely to get a sense on the demand and the external factors?

P. V. Rao: One more thing I forgot is the quotation activity.

Rohit Balakrishnan: Okay. But what would some of the other metrics, the trajectory of the business whether it is improving or not? I understand the demand environment that you mentioned that is very good that you track all these. But from an operating parameter point of view which would be slightly more internal, what would be some of the other metrics that you would sort of really focus on as a business?

Aditya Rao: One of the chief metrics we employ is capital employed ROCE that is very important metric for us, it is very important when we make investments that we have a certain base line ROCE of 20%. So that is the metrics we use but this is more of a choice when we decide to invest into businesses. But if you are looking at market verticals what we demand from our businesses, how we look at our verticals, what is important are two things – cash generation it is very important, and CFO I am sure is tracking upon this is very important for us business to throw up free cash flow which we always. And the second metric I would use is the growth from a market point of point. If the growth is not quite where it is like it has been then we immediately at ways to increase the addressable market size that can be through horizontal additions or certain capabilities, it can be backward integration to increase margins, it can also be forward integration to increase another addressable market size. We have a certain worked out strategic method by which we look at growth, by which we look at not just revenue but also most importantly in cash and ROCE and that is the philosophy we have been following and it has worked well I think in the past. It was not existing seven year ago we have had a pretty good growth rate. I think, going forward we have had a couple of years maybe which did not have the highest amount of growth but we are in a good place, I think we are financially quite well place to take advantage of any opportunities that come our away in next few years.

Rohit Balakrishnan: Understood, sir. I just had two more questions, just to follow what you just said. So one on your internal benchmark of 20% return on capital, I wanted to actually ask this question about in terms of return on equity which as a shareholder and as a promoter you would also be tracking. So

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when do you think we can sort of reach 17% - 18% or you think the business has the ingredients to reach that level in the next few years once the demand turns?

Aditya Rao: Absolutely. Return on equity assuming you to do on the balance sheet size which will be about Rs. 200 crores right now, a 20% return on equity translates to a Rs. 40 crores PAT number or the cash back number which is what I think may be relevant in this depreciation and all. So that is a number we are not very far away from. It is a number we will hit, we are definitely below that right now from ROE point of view. But as you said, as we keep growing, as we look at adding, Rs. 100 crores - Rs. 200 crores of revenue and we look at Engineering Services growing, we will hit those numbers certainly and I think it is an important question what you raised but we are good with ROCE, we are sort of not doing great ROE right now, but it is an addressable problem.

Rohit Balakrishnan: Sure, that is heartening to hear, sir. And one last question and I would like to comment also that your focus on cash flows is commendable. But I just wanted to know like last year also and I would believe in the first-half again the cash flows will be negative. So does that sort of worry you or just wanted your comments on that.

Aditya Rao: No, I think actually you can count on it we will be cash flows positive, so we have been cash flows positive this quarter. So the way we will define this cash flows positive after working capital changes versus cash flows positive from operations. Operations we absolutely always are. The golden metric we would use is cash flows after working capital changes and after CAPEX. So that has to be positive. That means you are returning cash flows business, so on that metric because of these working capital swings that has been a little iffy if you compare it on a year-on-year basis but again, it is a logical gap for this. Our inventory is not going to shoot up to one-year inventory or something like that. So very-very soon it catches up, very-very soon the price falls and then once the inventory gets liquidated then your cash flows generation covers up.

Rohit Balakrishnan: But sir, in FY 2017 I think, if I remember correct, as per the reported numbers cash flows from operations after working capital changes were also negative?

Aditya Rao: Exactly, what I was saying. So FY 2017 the problem started in October-November when you had to ramp up on working capital. So if you remove working capital changes we are obviously or absolutely positive. But once you put working capital changes in because of this volatility because we have ramp up our inventory that is affecting it but it has to moderate very soon this is my opinion.

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Rohit Balakrishnan: Understood. So essentially if I interpret your statement you are saying this is more anomaly rather than steady state of businesses, right?

Aditya Rao: Yes. It is part of the cycle once the cycle turns I think we are quite…..

Moderator: Thank you. We take the next question from the line of Rohit Gupta, an Individual Investor. Please go ahead.

Rohit Gupta: Sir, I just have one question. Even the debtor amount has also moved up at the end of FY 2017 to now, so can you comment on that?

Shrikant Bhakkad: Overall, I think, we are able to maintain the debtors in the period of 2 months to 2.5 months to predominantly increases because of the increase in revenue activity also and in terms of Solar projects now attracts GST. So that amount is also added. But overall, if we see it is 2.5 months only.

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

Rajat Sethia: Just couple of questions. In the Annual Report you have mentioned that you are venturing into low-cost housing. Can you just talk a little bit about it? What exactly is it and what kind of business and returns margins you see from there?

P. V. Rao: Low-cost housing is a priority for State Governments as well as Central Government, so some models are being shared with us by the local Telangana Government and Andhra Pradesh Government as well as the Central Government. So we are working on the models because they are basically concrete building models that has been given us and we are asked to develop steel solutions for them and we are working out solution for them and in some cases we are finding it difficult to match their budget figures and all but in some cases we got to use some technology like cold formed beams, that is one of the CAPEX proposal which we are going to make in times to come to take board's approval. So we are trying to optimize the design in such a way that we are within the budget given by the State Government and Central Governments. And yes, the margins I would say it would not be like that, PEB 20% contribution. But in terms of revenue size and all definitely we will get increase because the potential is too high so maybe with lower margins and high growth revenue we have to work in that bracket actually.

Rajat Sethia: Okay. So by when do you think this business can take off?

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P. V. Rao: I think, it will take at least five months - six months for us because prototype model has to be tested and all. So we are doing R&D in that and let us see.

Rajat Sethia: Okay. And would you need to put up new capacity for this or from the existing plants you can start doing it?

P. V. Rao: Some parts can be done with the existing capacity, for some parts of the building we have to put up CAPEX but not much.

Rajat Sethia: Okay, got it. And sir, there is a steep decline in the erection cost in this quarter, if you can elaborate what exactly is the erection cost I mean it has been going up.

P. V. Rao: Erection cost is depending on the type of this we have to do the billing as per the increments with the customers. So sometimes it will be higher, sometimes it will be lower, it depends on the progress of the works at site, rainy season and so all these things also to be counted.

Rajat Sethia: Is it related to certain vertical or it is for all the vertical?

P. V. Rao: PEB, Solar and structural steel.

Rajat Sethia: Okay, got it. And sir, for Engineering Services what kind of revenues are we seeing in this year or the next year?

P. V. Rao: We have done Rs. 10 crores last year. We are trying to double it this year. And probably double in the coming year because we started office in the U. S. called Pennar Global and we are concentrating on that because we are seeing good profit margins in that because we have to go with structural steel using various engineering platforms and we are quite bullish on that.

Rajat Sethia: Sure. And sir, just one last question on your tower business, do you expect the momentum coming up again because of Reliance deal?

P. V. Rao: No, we started getting enquiries now, the Phase-II has started Jio Infocomm. So we are expecting their orders in the coming week itself I would say.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital (India) Private Limited for closing comments.

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Vikram Suryavanshi: I thank management for taking time out and interacting with the stakeholders. We wish you a very good year ahead and thank you all for being on the call.

P. V. Rao: Thank you very much.

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

(This document has been edited for readability purposes)

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