"Pennar Engineered Building Systems Limited Q3 FY17 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Q3 FY17 results call of Pennar Engineered Building Systems Limited hosted by Emkay Global Financial Services. We have with us today Mr. Aditya Rao - Vice Chairman, Mr. P.V. Rao - Managing Director, and Mr. Shrikant Bhakkad - Chief Financial Officer. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Nikhar Jain of Emkay Global. Thank you and over to you madam!

Nikhar Jain: Good evening everyone. I would like to welcome the management and thank them for giving us this opportunity. I would now hand over the call to Mr. Rao for his opening remarks. Over to you Sir!

Aditya Rao: To all the stakeholders of Pennar Engineered Building Systems, thank you for joining us on the Q3 conference call on our results. We have with us today the Managing Director, Mr. P.V. Rao and also our CFO, Shrikant Bhakkad. We will start off with an overview of the performance for this quarter, after which we will have a financial overview as well given by Shrikant and then we will open up for questions. For the quarter in question, we had about 20% growth in sales. Our EBITDA was flattish and there was decline in profit primarily owing to higher interest cost. We will endeavor to give you as much clarity as we can over the reasons for the performance of this quarter. With that, I would like to hand it over to Mr. P.V. Rao to take you through the performance.

P.V. Rao: Thank you Aditya. Good evening everybody. With regards to the business highlights of Q3, we received new orders from Shahi Exports, Greenko, Hindustan Coca-Cola and Technico-Vithalapur in Gujarat and we got repeat orders from TATA projects, Toyo Engineering, Solar Developers, RCC Infra, SC Pharma. The current order book stands at around INR 410 crores as on 31 December 2016. We already began venturing into high-rise buildings two years ago. We are currently executing six residential towers in Hyderabad, four residential apartments and one commercial tower of 20 floors in Hyderabad. Additionally, the company is in various stages of discussions with a few companies for buildings ranging from 20 to 30 floors and we have tied up with a design agency in Hyderabad which is headed by a person from IIT Madras. He is experienced in high-rise building designs and we have tied up with him for the estimation as well as design of high-rise buildings.

With regards to telecom towers, which we have been doing for the last four years, the second phase of Jio Infocomm is coming up now and we are working with Reliance Jio Infocomm on

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designs for various models. We are in the process of signing a MoU with Denmark-based MNC called Ramboll; they specialize in designing towers.

In the engineering division, the company initiated an asset purchase and assignment agreement for acquiring assets of an US entity. The new engineering facility and the software export promotion program of AP government is in progress with the state government and they are hoping to get office space in Visakhapatnam as part of the scheme. We developed models for some toilet buildings using steel structures for Thane Municipal Corporation and we secured orders of about 50 toilet blocks. We received the Industry Excellence Award from Institution of Engineers. This is the fourth consecutive year we are getting this award. The engineering services business continues to scale out well in terms of numbers of hours, sales, and billing per hour. The number of hours increased by 2,500 man-hours and the revenue also increased by 16% compared to the corresponding period in the last year.

With regards to the capex, we are going to increase the capacity at both Hyderabad as well as Baroda by putting up some machines, and we will incur INR 3.5 crores as capex in the coming three to four months. The asset purchase and assignment agreement which is under US entity will also incur some expenditure on that. As and when it happens, we will come to know the exact amount. That is all as of now and I request Shrikant to go through the financials.

Shrikant Bhakkad: Thank you Sir. Q3-FY17 financial highlights, we have gone up in terms of gross revenues at INR 156 crores now, which is up 17% YoY and net revenue is INR 138 crores which is up 19% YoY. In terms of EBITDA, we are more or less at a flattish kind of thing and it stands at INR 14.5(including other income) crores at 10.48%. PAT is slightly negative in terms of where we were in compared to the previous year Q3 and it stands at 6.46%. Nine-month FY17 financials, we have almost reached INR 400 crores in terms of top line which is a growth of 12%. Net revenue is around INR 352 crores which is a growth of 14%. The consolidated EBITDA for the nine months stands at INR 42 crores and PAT stands at close to around INR 15.6 crores. Those are the main highlights. If you have any questions, we would give you clarification as much as we can in order to resolve any of the financial number queries that you would have. We can hand over to the moderator for any questions.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone. If you wish to remove yourself from the question queue, you may press "*" and "2". Participants are requested to use handsets only while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles. Thank you. The first question is from the line of Saurabh Patwa from HDFC Mutual Fund. Please go ahead.

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Saurabh Patwa: Thanks for taking my question Sir and congratulations on a decent set of numbers. I think the gross margin in this quarter has been lower than the last two or three quarters, though it has been in line with what it used to be in the first two to three quarters of FY16 and similar to FY15, so I just wanted to know were the last three quarters' margin better? Have we had some exceptional projects or what would be the normal range of margins which you would expect?

Shrikant Bhakkad: The main reason is the raw material prices have shot up by almost INR 9000 per tonne in the last two to two-and-a-half months. From September onwards, it has been on the increase and the increase is significant, though we have covered significant part of our inventory by way of placing orders with opening LCs and all, but still our order book is around INR 400 crores. We will have some orders, which are uncovered. That is the reason why this margin shrinkage has happened in this quarter.

Saurabh Patwa: So, what are the total volumes this quarter in terms of tonnage?

Shrikant Bhakkad: 20,000 tonnes roughly.

Saurabh Patwa: The volume was significantly higher than the last two to three quarters.

Shrikant Bhakkad: Yes, the volume is higher definitely.

Saurabh Patwa: EBITDA part has actually fallen down very sharply, if I am not wrong?

Shrikant Bhakkad: The other reason is that there are some jobs that are highly complex jobs that we have taken last year, which have a heavy contribution compared to the normal contribution levels. That is one reason. Those types of jobs have come down in this year. Normally our contributions vary from 20% to 23% in this business at the gross margin level. Also, some jobs where we get higher margins are highly complex in nature, so not every year we can get those type of jobs, but normally at contribution levels, we normally do about 20% to 23% gross margin levels in this business.

Saurabh Patwa: So, what is the kind of EBITDA per tonne, which can be sustained over a longer term or a medium term?

Shrikant Bhakkad: Typically, the EBITDA per tonne is not something we measure because tonnage is an expression of hot rolled steel or solar module mounting systems, erection revenue and engineering services, so EBITDA per tonne on the overall numbers would not be perhaps the most relevant number, but also there was an error, this 20,000 includes the solar MMI systems which is also not a site activity. The comparable number would be 14,000 tonnes.

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Saurabh Patwa: It is not 20, it is 14. Then it sounds in line with I think what we have been doing in the last few quarters?

Shrikant Bhakkad: Correct, but there has been in fact a decline on EBITDA per tonne. Our margins are lower primarily because of two reasons. One is the scale effect; if the raw material price goes up even if you pass on your spread.

Saurabh Patwa: So, that is why I was talking about EBITDA per tonne, which seems to be around 9000 to 9200?

Shrikant Bhakkad: That is flattish but also still a little lower.

Saurabh Patwa: Okay, and what are debt levels if you can share?

Shrikant Bhakkad: Debt level more or less remains the same as the previous year, but the reason that you see increase in the finance cost is because of the nonfund rate limits. Nonfund rate limits on account of two reasons; one increase in terms of bank guarantees that we have when compared to the last year. Second is the increase in the LC interest cost basically for the raw materials that we are procuring and there is a high interest cost that we are incurring. Almost like our inventory has doubled, now it is close to 20,000 metric tonnes; the inventory what we have with us is because we need to cover the raw material and the prices were shooting upwards, so we have covered the predominant raw material. So, on this raw material we are incurring the finance cost. Those are the two reasons why the finance costs have significantly shot up. Last year, one more reason why it was lower is that we had the money that was received on account of IPO and the working capital was almost squared off. Now, due to increase in the top line you also have a little usage of the working capital. These are the three reasons why the finance costs have actually gone up.

Saurabh Patwa: Sir I had just one more question from the strategy point of view. You believe in having a larger inventory compared to our peers and I think partly you are rightly doing that to mitigate the raw material risk, but at the same time this is leading to very high interest cost, so at EBITDA level though we are making a decent amount of money, but by the time it comes down to PBT level…

Shrikant Bhakkad: The other thing, which we never expected, is almost 25% increase in the raw material price. If you look at the history for the last three to four years, this much of jump suddenly was not there at all. The contracts being fixed price contracts, we tied up with VSW Steel for buying raw material and there is a quarterly pricing as well, but we have covered almost INR 170 to 180 crores of inventory already.

Saurabh Patwa: We will be following the same strategy? What is the kind of inventory levels in number of days?

Shrikant Bhakkad: It is two-and-a-half months normally, now it is almost four-and-a-half months.

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Saurabh Patwa: Last quarter also, I think you mentioned that we have been maintaining higher level inventory compared to the past, but still the impact on margins has been high?

Shrikant Bhakkad: That was due to two years. I was telling you about the other reason also that we had high margin jobs in the last year. The volumes are reduced compared to last year. Our normal contribution levels will be around 20% to 23%. This is the best that we can get in this industry.

Saurabh Patwa: Okay Sir, thank you.

Moderator: Thank you. A reminder to all the participants if you would like to ask the question you may press "*" and "1". Next question is from the line of Resham Jain from DSP Black Rock. Please go ahead.

Resham Jain: Sir, one question, most of the orders whatever we have, whatever sales we might be doing is all order books, right? Whenever we get orders, do we cover our inventory at the same time or is there any gap, like the order book might be for five months and we might be covering for three months?

Shrikant Bhakkad: Normally if it is a long-term project, usually our project sizes are about three-four months execution type of cycle. If the project is long term, for example six months, seven months or eight months' cycle of the project, that type of project immediately we will cover for the raw material, we will tie up with the raw material suppliers and we will cover. If we have INR 400 crores of order backlogs, we do not cover all the INR 400 crores because normally in this rainy season and all the pressures will come down. We have covered almost 50% of our inventory whatever is there, we have covered almost 50% of the order book. Some long-term projects are there which are already covered by us.

Resham Jain: My question is basically that against whatever order book we might be having; do we always run with unhedged position?

Shrikant Bhakkad: Some will be there to the extent of around 15 to 20%. The raw material prices have been increasing, but we also increase our cost master, so that our estimation itself is taking care of the increased raw material prices.

Resham Jain: Right. So, basically, wherever you have orders, where let us say long-term contracts you might be having an escalation clause also inbuilt into it?

Shrikant Bhakkad: Some contracts have escalation clause, some contracts do not have escalation clause, and where there is no escalation clause there we tie up immediately.

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Resham Jain: Okay, understood. So, any point of time you must be having not more than 15% to 20% of unhedged position. That was the only question. Thank you, Sir.

Moderator: Thank you. The next question is from the line of Soumil Zaveri from DMZ Partners. Please go ahead.

Soumil Zaveri: Hi Aditya! A decent set of numbers, just wanted to understand the erection expenses line item, we have seen a bit of jump there versus last year. I assume it is the nature of projects we are executing on; can you just give us a little bit of colour on that please?

Aditya Rao: The erection revenue has strung up a bit because the proportion of solar civil orders has gone up while typically the PEB portion of our order book has only 10% as its erection services. For solar, it is substantially higher so because of that we have had that back off. We are also executing the civil works and not just the erection. For the year in question, I think you can take it as going to be as per our historical numbers. You can expect it to be between the 10% to 15% range. This is a momentary quarter aberration because the solar erection revenue was high.

Soumil Zaveri: Fair enough. Just one more follow-up if I may? The engineering services businesses if you can give us a little colour on how that is tracking. I think I heard revenue was up 16% YoY. Can I get some details on that?

Aditya Rao: Compared to the last year by this year-end, we will be doubling it actually. On a QoQ comparison, it was 16%.

Soumil Zaveri: I got you, okay. Thanks.

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

Vikram Suryavanshi: I think most of the questions were answered. What are the absolute amounts of design engineering revenue?

Aditya Rao: INR 6.64 crores are for the period of nine months. I think we have almost like doubled in terms of last nine months where we are. We expect that almost it will also double up at the year-end also. We are quite well-positioned here.

Vikram Suryavanshi: In terms of employee addition, how are you going ahead in design engineering?

Aditya Rao: Employee addition, in this year, we have added almost 55 people compared to the corresponding period last year.

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Vikram Suryavanshi: Can you just give us a brief in terms of the performance in our Baroda facility?

Aditya Rao: Baroda facility we have taken on a job-work basis and we are doing roughly about 1000 metric tonnes there. For capex, we have already taken approval from the board to have one more beam line on the cutting machine to double the capacity because we need not incur anything on the building portion, so we will be putting up some equipment there so that the capacity will be doubled in another three to four months.

Vikram Suryavanshi: Okay Sir, thank you very much.

Moderator: Thank you. We have the next question from the line of Prem Thakar from Unilazer Ventures. Please go ahead.

Prem Thakar: Hi Aditya can you just help me with inventory trade receivable and trade payable absolute numbers?

Aditya Rao: Understood, inventory of 20,000 tonnes which is valued about INR 140 crores. The amount receivable is at INR 141 crores. For the trade payable, some of that is captured in the inventory as well, but I think you can take that. Only the LCs which is not paid is about INR 60 to 70 crores. Overall, the current assets to the company if you looking at, I assume you are asking for the working capital, the working capital will be as of right now very hefty - close to INR 300 crores.

Prem Thakar: INR 300 crores, okay. So just on that trade receivables you have said that once at high margin contract we would not be executing then our trade receivables would come down, but then it looks like that they are still quite high, so can you say will they come down by Q4?

Aditya Rao: They have come down substantially from a peak of about INR 180-190 crores at about September of last year; since then, it has come down substantially. We will continue to bring improvement in the year. But if you look at our revenue for the quarter, let us say from a gross revenue basis, let us say we are doing about INR 50 crores a month. I think we are right now at little under three months; we should get that to from 2.7 which would come to two to two-and-a-half months that is ongoing. We continue to expect moderation in account receivable. We do not expect this to persist at 2.7, 2.8. We have been continuously cash flow positive, as Mr. P.V. Rao has mentioned over the last two months, so the picture gets better and better, but inventory is where the issue is quite frankly.

Prem Thakar: Right. Inventory is understood I mean that was due to pricing thing, so that you expect to normalize by the next couple of quarters?

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Aditya Rao; We do not know. Normally during the rainy season people say that prices come down, but the trend every year is like that. I think the prices as Mr. P.V. Rao mentioned went up by 9000 in this quarter, but the indications we are getting from JSW, from others is that February is a rollover, meaning the prices repeat and March maybe fall. So, in that event, I think we no longer have to take such a view on inventory, we do not need to keep holding on to four to five months of inventory and we can moderate. Our expectation right now is and of course as Mr. P.V. Rao said it depends completely on a market, but by March you will see moderation in this, but what we are giving up is about say 200 to 300 basis points in margins which is good, but we are ensuring that our margins won't get hit when there is 30% to 40% increase in raw material price.

Prem Thakar: Right, certainly. Just on the cost you said that we are doing about six residential projects in Hyderabad, so I just wanted to understand that when you compare it with your normal concrete construction which is I think about INR 1,500 per square feet where do we stand as compared to that?

P.V. Rao: It is a good question. Actually, what we do is that we do not do the civil works. When you are comparing INR 1,500 that includes the foundation,that includes the wall, the flooring and everything down the civil works. What we do in the multi-storey steel buildings is that instead of having RCC columns/concrete columns we will have steel columns. Instead of concrete beams we have steel beams and then we have decking panel fixed on every floor, so the comparison has to be a shell to shell only. It is not the full comparison for foundations or concreting and all, but even if you compare shell to shell also we are unable to match with the RCC cost/concrete cost. The other advantage is the time saving that is the reason why they preferred us.

Prem Thakar: Okay still that is the good thing even if we are able to do it in less time and at a similar cost.

P.V. Rao: That is the reason why they preferred us actually. We are now currently executing a 20-floor building also; it is coming up in Hyderabad that will be hired to Genpact, a software company. We just started erection recently on that.

Prem Thakar: Okay great, so just one final question, Aditya you expect this momentum to continue in Q4 as well?

Aditya Rao: Momentum for growth, yes, we expect very good Q4 as always absolutely.

Prem Thakar: Okay. Great, all the best. Thank you.

Moderator: Thank you. We have a follow-up question from the line of Soumil Zaveri from DMZ Partners.

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Soumil Zaveri: Sorry to just jump back on to the engineering services piece. I just wanted to get a sense if we have more traction with NCI group for any of the prefab players or their platform for more business or any major shifts in that direction?

Aditya Rao: Actually, one thing we are pursuing with them is there are some components of standings in sheeting. Recently, there is an enquiry from them, so that is looking a little positive. We have to see, because they are asking about some quantities of clips for the standings in sheeting. Similarly, we pursued about structures being exported from here but because of the time that takes six to seven weeks, though it is economical to send from India, the time gap is a big problem, transportation is about six to eight weeks, which could not materialize. But with respect to components of the standings, yes we are hopeful to get that business. This business as such is doubling in this financial year and next year we would even say we will do double than what we are doing this year. That also we can do. It is more than double I think this year, 4.7 was the last year, and this year we will be touching almost INR 10 crores.

Soumil Zaveri: Okay, thanks.

Moderator: Thank you. As there are no further questions from the participants I would now like to handover the conference to Nikhar Jain for her closing comments. Over to you madam!

Nikhar Jain: I would like to thank the management once again. Thank you all.

Aditya Rao: Thank you very much.

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

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