"Pennar Engineered Building Systems Limited Q4 FY18 Earnings Conference Call"

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MANAGEMENT: **MR. P. V. RAO - MANAGING DIRECTOR, PENNAR ENGINEERED BUILDING SYSTEMS LIMITED**
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MODERATOR: **MR. VIKRAM SURYAVANSHI - PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Good morning, ladies and gentlemen. Welcome to the Pennar Engineered Building Systems Limited Q4 FY18 Earnings Conference Call hosted by PhillipCapital (India) Private Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. I now hand the conference over to Mr. Vikram Suryavanshi from PhillipCapital (India) Private Limited. Thank you and over to you, sir.

Vikram Suryavanshi: Good morning and very warm welcome to everyone. Thank you for being on the call of Pennar Engineered Building Systems. From management we have with us Mr. P. V. Rao - Managing Director, Mr. Shrikant Bhakkad - Chief Financial Officer. Now, I hand over the call to the management for their opening comments and then we will have the question and answer session. Over to you, sir.

P. V. Rao: Good morning, everybody. Thanks for attending this teleconference call. My name is P. V. Rao, I am the Managing Director. We ended 2017-2018 with the gross revenue of 601 crores and net revenue of 510 crores and an EBITDA of 45.59 crores and a PAT of 15.8 crores. There is an increase in the revenues in solar and structural steel and engineering services as well. These 3 segments have fared well in their last financial year and the overall order books stands at 353 crores as of now. And we have started implementing a CAPEX project at Hyderabad plant itself to increase the capacity by another 30,000 tonnes, especially to cater to structural steel. So, we are constructing a building and sourcing equipment worth about 25 crores and the total project will be completed by end of July. The 1st of August onwards we can expect revenue from that new facility in Hyderabad.

Yes, our order book has started increasing. We have got good and sizeable orders from companies like MRF, Bridgestone and Reliance. And engineering services we have started getting more enquiries through our US entity called Pennar Global and even the existing work we are doing for engineering services has also increased considerably in the last financial year compared to the previous year. And we are expecting much more increase in this financial year also. So, this is from my side.

Shrikant Bhakkad: Good morning, everyone. In terms of quarterly revenues we have grown from Rs.170 crores to Rs.175 crores and in terms of profits, we have grown from Rs.1.49 crores to Rs.6.59 crores. In terms of gross revenues we are flat in terms of Rs.570 crores to Rs.601 crores overall. And in terms of EBITDA for Q4 2017 versus Q4 2018 from Rs.3.6 crores to Rs.14.9 crores and for the year it is almost flat from Rs.45.7 crores to Rs. 45.5 crores. We have two important changes that we have done in the current financial year, which is on account of IndAS impact which is in reflected in the financial statements. The first change was in terms of accounting policy for the revenue recognition in case of certain contracts where they are linked to erection. So, the supply model has been changed to percentage completion method from AS-9(Revenue Recognition) to AS-7 (Construction Contracts). As this is more appropriate and representation of correct revenue whereas the revenue earlier was recognized based on the significant risk and rewards being transferred.

If we would have continued the earlier policy, the revenue for the year would have been higher by Rs.271 lacs and reversal of provision for future loss would have been lower by Rs.449 lacs and profit before tax for the current year would have been lower by Rs.178 lacs. The impact of these changes in the accounting policy is recognized in opening reserve on the date of transition and consequential impact is also recognized in the statement of profit and loss account. The other change is basically the ECL (Expected Credit Loss) because of the implementation of the IndAS. The adjustment to the opening reserve and for the year and for the quarter has been depicted in the annual financial results in note number 6. And also, we have given the disclosures as required under the previous GAAP versus IndAS. The two changes are predominantly on account of ECL for the bad debts because of the new policy and adjustment of revenue recognition from supply basis to percentage of completion under the Ind GAAP. The other adjustments are because of fair value of certain mutual funds and also on the fair value of actuarial valuation which have been mentioned in Note No-6 of Limited Review Results . So, that is all from my end.

P. V. Rao: We can begin the question and answer.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Vikram Suryavanshi from PhillipCapital (India) Private Limited. Please go ahead.

Vikram Suryavanshi: Can you share the revenue for the engineering division?

Shrikant Bhakkad: Engineering division, the revenues for Q4 FY18 was at Rs.3.71 crores that is up from Rs.3.4 crores and revenue for financial year 2018 has increased to Rs.14.97 crores up from Rs.10.01 crores to 49% increase in revenue year-on-year.

Vikram Suryavanshi: And how would you see for the next year and growth in this business?

P. V. Rao: Now, we are expecting a significant increase because we have started getting enquiries through our US entity Pennar Global. So, other than the company for which we are working, we have started getting good enquiries from other companies as well. So, there would be, I cannot give a number but definitely which is a significant improvement.

Vikram Suryavanshi: So, have you done any increase in the number of design engineers and all that?

P. V. Rao: Yes, we have increased previously there were about 45 people in Vishakhapatnam and 65 people in Hyderabad. Now, we are almost doubling the number because of the work load we are anticipating.

Vikram Suryavanshi: And by what time will be doubling?

P. V. Rao: Manpower?

Vikram Suryavanshi: Yes.

P. V. Rao: Billing also we expect similarly.

Vikram Suryavanshi: And second question sir, regarding the volumes. So, can you share how was the broadly volumes growth?

P. V. Rao: Volumes are basically flat. It in the PEB segment there is 6% reduction in the PEB segment but it will compensated by solar and structural steel.Overall Volumes were increased from Rs.569Crs to Rs.601Crs.

Moderator: Thank you. We will move on to the next question that is from the line of Subhankar Ojha from SKS Capital. Please go ahead.

Subhankar Ojha: So, two questions I have. One, what is the CAPEX for this Hyderabad plant …

Shrikant Bhakkad: CAPEX is approximately 25 crores.

Subhankar Ojha: And what is the timeline of this and what is …

P.V.Rao: We are already in the mid-way of CAPEX implementation. By end of July it will be on, the building construction is going on, the equipment have been ordered already and we are expecting to start commercial production from 1st of August.

Subhankar Ojha: What is the capacity post the expansion?

P.V.Rao: Capacity 30,000 tonnes increase. Earlier it was 90,000 tonnes, now we are making it 120,000 tonnes.

Subhankar Ojha: And sir secondly, what is the update on this merger with …

Shrikant Bhakkad: Merger we got approval from Stock Exchanges and SEBI. Now, we are applying to NCLT. We do not know how much time it will take but we are in the process of applying to NCLT

Moderator: Thank you. The next question is from the line of Yash Agarwal from Crest Capital. Please go ahead.

Yash Agarwal: Sir, what was the volume for the full year on the 90,000 tonnes capacity?

P. V. Rao: Volume for the full year last year was around 61,000 tonnes and in current year it is around 57000 tonnes

Yash Agarwal: So sir, what is the rational to put this Hyderabad capacity, because we are already running at…

P. V. Rao: Predominantly we are getting more orders in South and West. So, we had earlier facility in Baroda but because that was facility belonging to Aster Building Systems. With Aster Building gone into liquidation, so they asked us to vacate. So, we have orders predominantly from Reliance Jio, we are getting more and then some JSW cements and paints. They are expanding in Bellary and Dolvi. So, those orders also we are getting. So, we thought that we should expand in Hyderabad itself. We have land available. So, in the existing land itself we are constructing around 14,000 square meters building. That would suffice for additional capacity expansion for structural steel and in the existing building we are adding one more beam line. So that the whole, overall we are expecting around 30,000 tonnes increase compared to the existing capacity.

Yash Agarwal: And sir, how is the order book grown? You said 353 crores order book but what was it last quarter sir, the order book?

P. V. Rao: Last quarter order intake you mean to say?

Yash Agarwal: Yes.

P. V. Rao: Order intake and almost shipment was same almost. Shipment and revenues around 173 crores and order intake was also similar fashion.

Yash Agarwal: So sir, how do you see the, like the volumes and revenue growing for FY19?

P. V. Rao: Now, we are expecting significant increase because we are expecting some good orders from Reliance and then we have expecting some more orders from MRF already we got the order. Bridgestone we already got the order and we got another order from company called URC for construction of railway engine facility at Vishakhapatnam and then engineering services we are expecting a good increase because we started getting more enquiries from our US entity Pennar Global. So, then we got GMR Hyderabad, they are expanding their capacity in Hyderabad, passenger capacity terminal. So, we got one order from GMR also. So, one export order we got from Shapoorji Pallonji for Rwanda. We are quite encouraged and we got one solar order also from Bosch.

Yash Agarwal: So sir, is it safe to say that we can see a 20% to 25% volume growth given that we are expanding capacity also?

P. V. Rao: Cannot confirm, but we will have double digit growth.

Yash Agarwal: And sir, like what is the stable EBITDA margin? I mean, I see you are doing EBITDA per ton of Rs. 5,000 to Rs. 6,000 right now EBITDA per ton. So, do you see that increase in the EBITDA per ton?

P. V. Rao: Yes, because if the revenue increases we are not increasing linearly the fixed cost. So, it should increase that is what we are expecting.

Yash Agarwal: And sir, how we dealing with the raw material, I think steel would be your major cost and steel…

P. V. Rao: We are maintaining inventory and then we are having a tie-up with JSW Steel and Tata Steel. Of course, sheeting and Purlins we have to buy anyway and depending on the market pricing but predominantly around 65% to 70% of our orders are related to plates only. So, HR plates we are tying up with JSW Steel and Tata Steel and also we are maintaining some inventory also.

Yash Agarwal: So, it is a pass through?

P. V. Rao: Yes, it is more or less it is a pass through.

Yash Agarwal: And sir what is the net debt position right now?

Shrikant Bhakkad: Net debt close to around Rs.76 crores is what we have in terms of debt.

Yash Agarwal: The gross or the net debt, sir? Is there?

Shrikant Bhakkad: It is a gross debt.

Yash Agarwal: And the net would be? There is some cash also, right with the company, I think?

P. V. Rao: Yes, we are sitting on mutual funds that are close to around 46 crores.

Yash Agarwal: Net debt is 50 odd cores, sir?

P. V. Rao: Yes, like less than 50, it is like Rs.30 crores.

P. V. Rao: We do not have any long term debt. It is whatever we have is like working capital. So, whatever CAPEX is there we are now going ahead with the internal accruals only.

Moderator: Thank you. The next question is from the line of Rajat Sethia from Vridhi Capital. Please go ahead.

Rajat Sethia: Could you please give us the break-up of the other income in this year. We have other income of around 12 crores. If you can give us the break-up?

Shrikant Bhakkad: Yes, predominantly the other income comprises of the revenues that we have got on the mutual funds an profit of sale of mutual funds is what predominant and other incomes also consist of there are certain IndAS adjustments on account of the actuarial financial that we have done and provision for the onerous contract. So, put together is Rs.11.90 Crores.

Rajat Sethia: So, would you have the number breakup for that?

Shrikant Bhakkad: Yes, predominantly, the dividend from the mutual fund is close to around Rs.0.26crores. There was a gain on financial assets which have measured through in terms of profit and loss account is close to around Rs.2.19crores. And around Rs. 4.50 crores is from the reversal of provision for onerous contracts. Interest income is around Rs.2.58Crs and Other Miscellaneous income is Rs.2.37Crs

Rajat Sethia: And the volume spec you mention is 57,000tonnes in this year, if we can have the break up for the same in which vertical, what is the volume?

P.V Rao: It is about 50,000 tonnes from PEB and solar roughly about 7,000 tonnes is solar,

Rajat Sethia: And this PEB would have high rise and warehouses and everything else?

P.V. Rao: PEB means industrial building, warehousing, high rise buildings even that includes structural steel also.

Rajat Sethia: And sir, you mentioned about the CAPEX, why we are doing it and you are seeing a lot of optimism from your client side. But the same is not getting reflected in the order book?

P. V. Rao: We have in the Rs.353 crores order book we have structural steel orders, we have PEB orders, we have solar orders.

Rajat Sethia: So, in the last 5-6 quarters it has been pretty much around the same level, in fact we had higher order book couple of years back. So, my point is we are putting up more CAPEX and you also gave a very good commentary around that we are seeing growth from your client's end and you are expecting volume growth. But I am saying this order book is still the same. So, it is not reflecting that optimism?

P. V. Rao: See, in the order book, if you look at the composition of order book, the more focus has been on structural steel in recent days as we are getting more orders of structural steel. So, structural steel requires a different fabrication facility compared to the PEB. So, what we are doing is that in the existing facility we were adding another beam line to supplement the PEB capability and then we are constructing a new building for structural steel. Because Reliance towers are there, GBM towers, it occupies a lot of space both for raw material, work in progress and finished goods also. So, that are continuous orders we are getting from Reliance. So, we are expecting some more also from Reliance because they are expanding Phase-II in a very big way. So, the indications are that the orders will be coming that is why we are building up a new capability, basically for structural steel.

Rajat Sethia: So, you have not received the orders yet but you are expecting the orders to come?

P. V. Rao: We got confirmation , formal PO's are expected that is all from Reliance. That is about Rs.70 crores-72 crores jobs we are expecting and almost negotiations have been done, only we are expecting orders..

Rajat Sethia: And sir, one more thing about this order book. So, we keep releasing notification on the BSE about few orders that we have received. It could be really helpful if we can also mention the time period during which we have received the order?

P. V. Rao: Yes, we will do that. No problem.

Rajat Sethia: That will be helpful because you do not know whether there is any kind of overlapping happening or not.

P. V. Rao: We will do that, no problem.

Rajat Sethia: And also another question is around, in this quarter despite higher sales compared to the last quarter, our other expenses have gone down drastically so what explains that?

Shrikant Bhakkad: There is a lot of Baroda work contract expenses which we outsourced last year. So, close to around Rs.12 crores to 15 crores to subcontract. This predominantly we are doing in house. So, that is one of the reasons and another reason was we had provisions for doubtful debts last year close to around Rs.9 crores- in terms of provision for doubtful debt, which was correspondingly not there now because of the ECL provision that is coming to the picture.

Rajat Sethia: One you mentioned is Baroda expenses, so they were part of the other expenses and second you mentioned the provision for doubtful debts, where they were in the last quarter?

Shrikant Bhakkad: Yes.

Rajat Sethia: Around 9 crores you said?

Shrikant Bhakkad: For the year, for the full financial year, I am saying.

Rajat Sethia: And the reversal has happened for the same, right?

Shrikant Bhakkad: Now it is under ECL provision. So, the provisions are not reversed per se. The provision for the last year you had provision for doubtful debts correspondingly there is no increase in provision for doubtful debts in the current financial year.

Rajat Sethia: And sir just one thing that this Rs.9 crores number or it is all looks pretty high for our receivables going back. Now, if we look at our profits of around Rs.20 crores-25 crores of PBT, so this number looks pretty high. So, is there something?

Shrikant Bhakkad: Yes, there was also reversal of provision on account of onerous contracts for the change in the method of accounting. That was close to around 3.5 crores of impact on that.

Rajat Sethia: So, if we really look at the last 3-4 years, our history and if you want to see the number, receivables have really gone bad. So, what could be that number sir, on a yearly basis? Rs.3 crores-4 crores every year go bad or permanently bad or no?

Shrikant Bhakkad: Close to around Rs.5 crores not more than that.

Rajat Sethia: So, they go permanently bad. They are net of reversals.

Shrikant Bhakkad: Yes, they are not permanently but this is because of the buckets in which they are transitioning. They do not come let us say we have design in terms of 180 days to 365 days to 732-1095. If they are a realizing in the last quarter it is a provision for the earlier quarters are introducing because similar policy needs to be applied for even the current debtors which are outstanding. So, really in terms of bad they are not but yes, there is an increase in terms of provision because of the ECL.

Rajat Sethia: And sir, just one last question. Again, another bad year overall, I would say in terms of revenues or the margins and I think steel is again hurting us pretty bad which is pretty much visible through the gross margins. So, what is the outlook from here onwards, I have heard about the order book and all but when it comes to the margins what is your outlook on that?

P. V. Rao: See, in PEB we are expecting, we already got orders from KIA Motors, Detel, Shapoorji, Reliance and then MRF and Bridgestone. These are sizeable orders, and which are to be executed in this current financial year and port activity also has increased recently in terms of warehousing. After the GST implementation the warehousing activity has increased a lot all over India. So, that we are expecting good orders from Amazon and other warehousing companies. So, we are quite bullish about structural steel as well. Because Reliance started in a big way Phase-II to and we are one of the prime suppliers for the towers for Reliance and then some other structural steel orders from Jindal, JSW Paints, Cements, so enquiries are very big now. So we are quite focus that is why we are expanding in Hyderabad also.

Rajat Sethia: On the margins front because steel is were we are getting hurt badly. So …

P. V. Rao: I think there, we are now having a contract with JSW and Tata Steel Basically around 65% to 70% of the contracts are having plates consumption and the balance is Purlins steel. So, to that extent, plates we are trying to cover up without having any impact of the price increase. But because of the steel price increase, Purlins still remain a point of concern for us. But as and when the orders are finalized, we are getting the material list from our engineering department at least trying, not full quantities but at least some of the quantities where we can book the orders like that we are trying our best, but you know very well that the steel prices are very volatile last year, this time the plates were about Rs. 33,000 and now it is Rs. 49,000 per tonnes.

Rajat Sethia: 33,000 to 49,000 is the price now?

P. V. Rao: Yes.

Moderator: Thank you. The next question is from the line of Vikram Suryavanshi from Phillip Capital (India) Private Limited. Please go ahead.

Vikram Suryavanshi: Sir, how was the erection revenue share in this quarter?

Shrikant Bhakkad: Erection revenue was Rs. 86.94 crores and quarter, Rs. 31.74 crores.

Vikram Suryavanshi: And second in the expansion what we are doing in structural steel which is Rs.25 crores. How is the revenue potential we are looking in that?

P. V. Rao: We are expecting around an increase of Rs.100 crores we can do from that new facility which we are building up in Hyderabad.

Vikram Suryavanshi: So, around one-fifth of turnover?

P. V. Rao: Yes.

Vikram Suryavanshi: And basically, we have already explained steel price and all that but what would be our strategy because we have increased earlier in last quarter the inventory level and all that. So, how do you see working capital and receivable cycle going ahead?

Shrikant Bhakkad: Predominantly because of the higher raw material prices and other things, we have to cover our order book. So, hence there is reason for us to procure this material and inventory . So, we have if you see in terms of number of days, we are more or less maintaining like almost like 120-127 days of in terms of inventory. In terms of receivables also we have just even with the increased turnover, we have not increased in terms of our revenues per se. So, it is almost like 55 to 58 days is what it is and on the plan is to ensure that we maintain this in terms of receivables and the overall, we are aware that the working capital is high but the raw material prices going on the upward trend. We cannot leave our order book uncovered which will be lot of deteriorating effect rather than this one. So, hence we continue to have the inventories on a higher range.

Vikram Suryavanshi: And last question sir, regarding since we have closed the Baroda facility, what would be our strategy to capture the market in North particularly?

P. V. Rao: North we have sales office there but the number of enquiries in North not as speedily increasing as in South and West. So, we are primarily concentrating on South and West where the major expansions are happening for the steel mills, cements companies and then pharmaceutical companies, warehousing and automobiles. These segments are expanding more in South and West compare to the North.

Moderator: Thank you. The next question is from the line of Rajat Sethia from Vriddi Capital. Please go ahead.

Rajat Sethia: So, sir one more question around your creditors. So, creditors have gone down in this quarter. So, any particular reason because our inventory levels are pretty much same.

Shrikant Bhakkad: Yes, creditors earlier we had period of almost like 120 days of LCs and that was giving us a little higher rate of interest. So, we have tied up with the banks even with little higher limits. So, we are able to open the LCs for a period of 90 days predominantly that is the reason there is a shift to close to around Rs.30 crores reduction in terms of overall trade payables.

Rajat Sethia: But sir, same is not reflecting in the lower finance cost. Finance was pretty much the same compared to the last quarter.

Shrikant Bhakkad: Finance cost has reduced from Rs.17 crores to Rs. 16 crores even though there is an increase of close to around Rs.40 crores in terms of revenue.

Rajat Sethia: On a yearly basis Rs.17 crores to Rs.16 crores.

Shrikant Bhakkad: Yes.

Rajat Sethia: You expect this to maintain at this level or you think this can go further down?

Shrikant Bhakkad: Yes, I think we will be able to maintain at this level. Overall 3.07% is the finance cost I think we should be in that range or we will try to reduce the thing with the benefit of the reduced interest rates compared to last year.

Rajat Sethia: And sir, you have guided so, volume growth. In terms of the product mix do you expect the product mix to remain same and hence the margin profile will also remain the same or not?

P. V. Rao: We are expecting increase in the margins as well because in linear way the fixed costs will not increase compared to the revenue.

Rajat Sethia: And in terms of product mix that would remain the same?

P. V. Rao: Product mix almost remains the same. But engineering services we are expecting a big increase this side. It is a star performer for us in terms of EBITDA with less investment. So, we are expecting to increase the man power also and then significant increase in the margins as well this year.

Rajat Sethia: And sir, in the merger in terms of the process, so now you will be applying to NCLT, so once you get the NCLT approval then you will go for shareholder approval?

P. V. Rao o: Yes, first NCLT approval after that shareholders' approval.

Rajat Sethia: And that would be the last step, right?

P. V. Rao: Yes.

Moderator: Thank you. As there are no further questions, I now the hand the conference over to Mr. Vikram Suryavanshi for his closing comments.

Vikram Suryavanshi: We thank you the Management for giving us the opportunity to host the call and taking time out for interacting with the stake holders. Thank you all for being on the call.

P. V. Rao: Thank you very much and we look forward to have much more interactive sessions in the time to come, thanks a lot.

Moderator: Thank you. Ladies and gentlemen, on behalf of PhillipCapital (India) Private Limited, that concludes today's conference. Thank you for joining us and you may now disconnect your lines.

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