"Pennar Engineered Building Systems Limited Q2 FY19 Earnings Conference Call"

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MODERATOR: **MR. DEEPAK AGARWAL – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Pennar Engineered Building Systems Limited Q2 FY19 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 telephone. I would now like to hand the conference over to Mr. Deepak Agarwal from PhillipCapital (India) Private Limited. Thank you and over to you, sir.

Deepak Agarwal:

Good morning and very warm welcome to everyone. Thank you for being on the call of Pennar Engineered Building Systems Limited. We are happy to have with us Mr. Aditya Rao – Vice Chairman, Mr. P.V. Rao – Managing Director, Mr. Shrikant Bhakkad - Chief Financial Officer. Without taking much of time now I will hand over the call to the management for their opening remarks post which we will open the floor for Q&A. Over to you, sir.

Aditya Rao:

Thank you. This is Aditya for the Q2 FY19 the PEBS Pennar Results. Thankful for all the stakeholders for joining us and as an overview for our performance this quarter we have recorded gross revenues of Rs. 153 crores, net revenues of Rs 134 crores, EBITDA Rs 6.57 crores and PAT at Rs 1.14 crores. The gross revenue for the division was at as I had mentioned for PEB business Rs 138.7 crores which was up substantially by about Rs 18.26 crores, but the solar division was much lower solar in Pennar Engineered Building Systems continuous to struggle to even achieve the revenues that it had last year owing to dramatic change in the market and number of executable projects that are out there right now in the solar photovoltaic power plant business.

Our engineering division of course did quite well at Rs 6.42 crores which is up almost 46% on a comparative period last year. Overall the systemic changes we wanted to put in place including focusing far more on profitability on revenue growth and cash flow generation have yielded results. So, I think for the past four to six quarters it would be fair to say we have been struggling to increase revenue that ends as of this quarter. While we are again not providing guidance for Q3 we can definitely commit and I can definitely commit on behalf of management that we are now quite bullish on revenue and profitability growth for PEBS in the coming quarters and Q3 onwards I think the changes that we have put in place and the structural initiatives that we have taken have yielded a lot of results.

Consequently, our order book is now at a record, we are now at Rs 422 crores in terms of order book which is amongst the highest that we have had the order book contribution are also up. We put several controls in place which ensure that we will get cash flow and the profitability that we intend to reach. On the back of that performance, on the back of those numbers we are quite confident of projecting growth from now on and for the sustainable future. So, just as we have for the parent entity we are quite comfortable from now onwards committing the PEBS is on the way for growth and we can definitely look at high double digit growth on the third quarter onwards for PEBS.

The last point I would like to take to you about before I hand it over for questions is regarding the merger. The stakeholders have given their approval including the equity shareholders to go ahead and have the AGMs and NCLT has approved that or our unsecured creditors have approved that, bankers have approved that. So, we will be going ahead and having AGM on December 14. The voting however starts 14 of November which is today. So, we obviously look forward to getting a very quick decision on the merger very soon.

With that I would like to hand it over to the moderator for any questions that they have.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Ashwini Agarwal from Ashmore Investment. Please go ahead.

Ashwini Agarwal:

Quick couple of questions if I look at the EBITDA profile for the quarter at 4.7% and for the first half how do you want us to think about it I mean cost of goods sold has gone up a lot so obviously there is some steel price embedded there, how much of this impairment is permanent, what should be the long term profile of gross margins and EBITDA margins in this kind of business?

Aditya Rao:

The question relates directly to what are EBITDA margin expectation is and to basically breakup the EBITDA margin for this quarter and for the past few quarters. So, when we take order we typically try to reach an operating margin as we call it a contribution if you will which is prior to fixed cost of about 20%. Often times we end at 15%, 16% at Q2 revenue base fixed cost comes to about 10% of our revenue. So, when you have a 14%, 15% contribution then your EBITDA consequently become 4% to 5%. So, our EBITDA is directly a consequence of what our contribution margin is minus our fixed cost. Now going forward, we do not expect massive changes in the 14%, 15% profile I think we may have certain positive buffers in terms of our engineering services revenue which could potentially impact that by about 2%

But you are quite confident of the order books now reaching Rs 420 crores plus is that the fixed cost as a percentage of revenue would moderate. So, over the next few quarters what you should look at is when you have strong double digit growth in revenue you are retaining your contribution and your fixed cost does not scale up . What you end up seeing is that the 10% fixed cost on revenues moderates to 7%, 8% which all drops down to EBITDA. So, that means that we are quite optimistic that we will be able to see 100 basis point of improvement definitely in the EBITDA margin going forward in the next few quarters and this change will be immediate because the revenue growth is coming immediately, we have already seen it in Q3 as well. We are quite bullish so you should expect that with the margin profile staying the same with the order book margin being what is, engineering services continuing to perform adequately well. EBITDA margin I think we are now comfortable projecting an EBITDA margin increase of at least 200 basis points as effective as of this quarter Q3.

Ashwini Agarwal: So, the Rs 430 odd crores of order book that you have what would be the execution cycle for this?

P. V. Rao: Execution cycle is roughly around 6 to 8 months time.

Ashwini Agarwal: So, we should expect the revenue numbers to get close to Rs 200 crores for the next two quarters, would that be a fair assessment?

P. V. Rao: Approximately.

Aditya Rao: Very close sir you are not off by more than 5% but again this is not guidance this is what you see coming. So, you should not take Rs 200 crores as guidance for Q3, but that is where we are headed.

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

Rajat Sethia: Just couple of questions on the balance sheet there is a loan line item of around 48 crores under the current assets what does that pertain to?

Aditya Rao: In terms of current assets.

Rajat Sethia: Yes, current assets.

Aditya Rao: Most of them are in the nature of EMDs that we have given. These are for certain projects where we have given the EMD and the amount will get back to us in a period of three months or so once the EMD period gets over and there were certain corporate deposits that we have.

Rajat Sethia: You mean EMD period is like once you complete the project?

P.V. Rao: No, not the projects these are basically EMDs that are given for the tender once we participate at the beginning of the tender. So, once the tender is awarded if we are successful in the tender the amount gets adjusted in the contract, if we are not successful than the amount comes back to us in three to four months of time.

Rajat Sethia: So, I think as the order book increases this number will increase in line with the order books like more queries, more order books…..

P.V. Rao: This is more of a reflection of the order quotes that we are giving and not in terms of order book.
Order booking is which we have already received and to a certain extent it forms part of order book predominantly it is based on quotes that we are getting. We have to give announcement before this and we are quoting for the jobs.

Rajat Sethia: Other question is on the capital work in progress this quarter we see around Rs 49 crores of capital work in progress amount, so this pertains to the new plant and if you can elaborate what all are we doing here?

Aditya Rao: This is for the internal expansion that we are doing at Sadashiv Peth and we also we are setting up some equipment for us to give the higher results in order to cater to the higher order book in terms of structural steel and PEB a

Rajat Sethia: In terms of capacity what will be the capacity addition once this get expansion matters?

Aditya Rao: We will be roughly about 50% above capacity once it is done and we are expecting the expansion works to complete may be in the three to four months' time.

Rajat Sethia: So, right now we are at 90,000 PEBS capacity so that can go up to 135,000 right?

Aditya Rao: Yeah exactly.

Rajat Sethia: If we look at the gross margin in this quarter I mean there has been a lot of volatility in the gross margin while the steel prices have not really been that much volatile so if you can explain that?

P.V. Rao: Steel prices has been volatile, every month there has an increase in steel prices. What we are doing is that to counter that we are actually having some quarterly arrangement with the steel suppliers like Tata Steel and JSW. To some extent we are able to came up with that, but steel prices are increasing every month.

Rajat Sethia: Yeah, I understand that they are increasing every month. So, point is that last quarter so if you look at Quarter 4 gross margin they were at 33% last quarter 48% now again 31%?

P.V. Rao: Some selling prices we are removing raw material cost is that what you are looking at it. There are two or three products that we are doing. One is in terms of structural steel , second is in terms of the solar module mounting structures and third is in the terms of PEB that we do. So, if we have more in terms of primary sections the gross margins are higher. If we do more of sheeting sections which are like relatively the roof sheeting as a wall sheeting the gross profile margin is little lower so that is where the difference comes in.

Rajat Sethia: So, you would attribute this volatility largely to steel price increase and the product mix?

Aditya Rao: Predominantly due to price increase and small amount due to change in a mix.

Moderator: The next question is from the line of Rohit Koti from Marshmallow Capital. Please go ahead.

Rohit Koti:

I just had a question on the contribution margins I believe a couple of years back we have contribution margins around 20%. In this call you have mentioned that it is said 15%, 16% right now, is this the new normal for the contribution margin or do you see it inching back up in the future?

P.V. Rao: When we got 20% margin and all there ware certain jobs where margin levels are very high, but normally in this industry the contribution levels are 15%, 16% we cannot get more than that. So, with the increase in revenue and profitability in engineering services we will be able to compensate to some extent. As told by Aditya we have an order backlog of around Rs 420 crores and the fixed cost are not legally increasing compared to the revenues. So, we should be able to be in a better position in a coming quarter.

Rohit Koti:

So, the needs of the contract that determines how highway contribution margin can go and the average contribution margin can max at around 16% is what you are saying right?

Aditya Rao: Yes in case of PEB structural steel but in engineering services it is much higher.

Rohit Koti:

So, again, on this particular PEB and structural steel business again so would I be right in thinking that with economies of scale coming in addition to contribution margin the max average normalized margins where this business can generate is around 8%.

Aditya Rao: From an EBITDA point of view?

Rohit Koti: Yes from an EBITDA point of view.

Aditya Rao:

We will hesitate to give you a direct projection on that a lot of that depends on the revenue mix. We are specifically for the PEB business say for twice or thrice right now then our EBITDA margin would be 10%. So, I think a lot depends on how much scale we can deliver and our endeavor is to increase scale, but I think for the next few quarters we can definitely say that margin improvement would be consistent and gradual, but at this point I think it is difficult for us cap them or to tell you that we are committing 8% either way, but you can expect growth several hundred basis points over the next one year that we can commit.

Rohit Koti:

Could you comment on how the steel prices have been acting over the last few quarters including this month as well is it as volatile as it is before or is it stabilizing?

P.V. Rao:

Steel prices were Rs. 30,000 per ton if you take two years back but now it is Rs. 52,000 now. So, every month there is an increase of Rs. 1,500 to Rs. 2,000 .

Rohit Koti: So, the increase continuous even now is it?

Management:

Even now it is increasing.

Rohit Koti: You have opened few times in your opening comments that there are few measures that the company has been taking to rationalize cost could you detail that a little more?

Rohit Koti:

Aditya Rao: No I did not say rationalize cost I am actually not a fan of fixed cost cutting at all. For a company like us even if we cut fixed cost by 10%, 20% which is a massive cut I do not think it will help us that much. What we have done is set a structure and format in place so that we prioritize cash flows and contribution margins above all else which includes fundamental changes in the way we take contracts and the way we look at raw material procurements and even in the working capital exposure where we are willing to take. Consequently, you would have seen dramatic improvements in our working capital over the last few quarters in place. On behalf of the senior management team Mr. P.V. Rao and his team I think we are now very confident of revenue growth, revenue growth with operating margin substance will bring in EBITDA growth and overall I can promise positive cash flow from operations. Mr. P.V. Rao mentioned that we are dramatically increasing capacity that is because we are completely full now. So, the picture I gave you was not about cost rationalization at all I do not believe that is in any way possible to fundamentally order business. I think the challenge we are at now is scalability we have now achieve that so with our order book keeping a record and we have figured out a way to make sure our margins are consistent and stable so consistent margins plus scale is what is giving us the growth that is what I am talking about no cost rationalization we are not promising anything there.

Rohit Koti: Because of the order backlog what we have understand?

P.V. Rao:

We like to share with you that we are almost booked up to end of February we cannot take any additional orders which could be produced immediately because every job has a cycle time because of that we are already booked up to February.

Rohit Koti:

My last question pertains to the engineering services business I mean if you could detail what is happening there I believe you are setting up an office in US to get more clients etcetera on structure steel and other lines, if you could detail what is happening there and how do you see this growing over the long term let say next three to five years that will be helpful?

Aditya Rao: Actually, we have our presence in the US as well. We are now trying to meet the other companies. See currently we are working for a big company but there are some other companies also we have been able to impress upon them and we have got orders also from them. I would say that definitely there will be very good growth I cannot tell the numbers now, but we are looking for even to improve to set up a big office or so have some people there and then here also encouraging the manpower in India. We also opened an office in Vishakhapatnam having 100 people already. So, the numbers will definitely dramatically increase that much I can say, but I cannot say the actual numbers, but I am very bullish on that. And it will continue to maintain the EBITDA margin profile of around 50% am I right there?

Aditya Rao: I cannot say the numbers, but definitely it will be in that range.

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

Rohit Koti:

Ashwini Agarwal:

Mr. Rao just spoke about going to Delhi and getting that order and so on and so forth, so could you also help me understand what is happening in the industry are you seeing a revival in order flow or is it that PEBS is becoming better at picking up those orders what are you seeing in terms of comparative activity. We hear that KEC International has also got into the space and there are couple of other people trying to get in as well if you could help me understand what is going on?

P.V. Rap:

They do not have any manpower facilities. They started taking UPC jobs involving steel buildings also and of course we are executing two building for KEC as of now. As an overall scenario in the last six months the quotation activity has increased significantly increased, earlier there were only major inquiries from automobile like tyre for example we are doing MRF Bridgestone as of now. We were thinking only automobile field is doing well and other manufacturing is not doing well, but for the last six months we are seeing in the market lot of inquiry is coming up and other manufacturing activities also like textile ,cement ,steel and automobile ancillaries. So, other manufacturing industries have also started expanding and then after the GST introduction many people entered into the warehousing segment, people who were never into warehousing segment like Musaddilal Jewellers those type of companies also started building PBS warehousing . These warehousing segments are definitely picking up a lot and for the last six month the quotation activities has been doubled . I would say that is the reason why if you look at the players in the market earlier there were 10 players and now their active players are about 5 now. So, we have a positive situation because people are less and quotation activities increased so I am very bullish and is the reason why we are expanding our capacities also in Sadashiv Peth and we have taken one plant on lease near Pune and we are adding some equipment also there.

Ashwini Agarwal:

You mentioned that number of players has down from 10 to 5, so what has happened it kind of shut shop or is it possible that they will come back into the business at some point?

P.V. Rao:

Some people for example Tata Steel the kind of investment they have done they should not have done in my opinion that much of investment. If you look at the ROC it definitely matters how much investing you can have so that is why some companies have remained very strong in terms of engineering, in terms of production capability, in terms of direction and all. So, definitely there is a positive indication as of now because many manufacturing industries are expanding and setting up new facilities and I am very bullish on that.

Ashwini Agarwal: And solar outlook continuous to remain fairly muted would that be a fair assessment?

Aditya Rao: Definitely yes. I think this is the first year probably since the solar industry in India started where they are now implementation will be lower than the previous year. Last year I think about 8 gigawatts or little higher than that. We are definitely going to be lower than that, but at this point we definitely would want you to take away the solar business may be able to achieve the operating profit achieved last year, but we are not expecting heavy growth in that business.

Moderator: The next question is from the line of Dikshit Mittal from Subhkam Ventures. Please go ahead.

Dikshit Mittal: So, just wanted to understand this close of margin compression is it because you took the orders at lower steel pricing is the main reason?

Aditya Rao: Actually the order backlog at the beginning of Quarter 2 is lower than that we have as of now. Second reason is raw material price increases every month . So, we have certain fixed cost already profiled. Once the order backlog increases then naturally the revenue increases but linearly the fixed cost will not increase. So, we are expecting a margin improvement in Q3 and Q4 as well because we have order backlog of around Rs 420 crores and we have almost plant is already booked up to end of February as of now with the order and we are expanding also. So, our volumes are going to increase in the times to come and hence the margins will increase too.

Dikshit Mittal: Sir on the existing order book of 420 crores are the margins at the current steel prices we can assume the normalized margins at the contribution level?

Aditya Rao: Yes around 15%, 16% roughly contribution level.

Dikshit Mittal: Secondly this quarter you have seen sharp jump in other income so is there any one off in that?

Shrikant Bhakkad : Other income predominantly consists of basically the interest that we get on mutual funds and other things and also the interest that you are seeing on the balance sheet are loans that we have given to certain companies we also have certain foreign exchange gain which gets deflected here because of the foreign income that we have for engineering services. The revenues were recognized at date, but when revenues were realised, they have come at a higher rate so there is a foreign exchange gain that has come and also there was some straight lining of lease provision which was there earlier has got removed. They are the combination of all these things in other income.

Moderator: The next question is from the line of Manan Patel from Equirus. Please go ahead.

Manan Patel: Sir one thing I wanted to understand I understand that PEB is much better way of constructing rather than conventional construction, but looking at the size of the market around 3,000, 4,000 crore it is way smaller than the entire construction industry, so what is inhabiting the growth of PEB and do you see that change going forward?

P.V. Rao: See in the last two years if you see because of the problems in credit availability and all the banking issues the market consumption levels has not seen much growth in terms of manufacturing in the last two years, but last six months if you see there is a significant growth in terms of quotation activities in all the segments like structure steel and PEB also. Most of the PEB companies are booked already. Now the order backlog has increase around 420 crores we are also taking steps to increase our capacity in Hyderabad as well as in Pune we are taking a lease facility in Pune. So, definitely we are expecting good growth in the time to come because of the positive indications from the market.

Manan Patel: Sir I just wanted to understand like what is the share of PEB versus conventional construction at least the new construction that are happening?

P.V. Rao: See construction in the sense there are many areas were people still prefer conventional for example you take steel plants they do not use PEB section because there are about 300, 400 metric ton crane in there. Similarly, in infrastructure projects also except the buildings there are so much of usage of steel where they use steel support structures and all. So, I would say if you construct percentage wise, I cannot say exactly how much percentage is PEB, but I would say around 20%, 25% can be PEB and not more than that.

Manan Patel: Going forward do you see that change to 30%, 40%?

Aditya Rao: If you look at the building parts industrial buildings, warehouses, high rise building people have started thinking of high rise building in steel . In Hyderabad itself we are building about 5 high rise building. I am expecting a good growth in the time to come and once these banking issues get resolved . I am expecting a positive change.

Manan Patel: My next question is again on contribution margin so you said 15%, 16% is a normalized due to probably the industry structures. So, there are probably two factors one you said competition is decreasing so does not that give you a better pricing power keeping steel prices aside for this?

P.V. Rao: Competition is not decreasing. The only thing is that the number of people have come down but the existing players have increased their capacities that is also there. So, we are also increasing our capacity. Definitely in the time to come I would expect that margins also may also increase even from 15, 16 it may go up to 17, 18 also, but the time we have to see for a period of time how it matters.

Manan Patel: Sir we were talking about the margins and competitive dynamics?

P.V. Rao: Currently the margin levels are on 15%, 16% for PEB and structural steel and in the time to come it may increase. Now lot of inquiries are coming up the quotation activities has been doubled compared to the six month back situation. We are increasing the capacity so that revenue will increase linearly but the fixed cost will not increase so that it will definitely have an increase in the EBITDA. We already initiated actions on that placed the order for equipment for financial period as well as Pune plant definitely things should be positive in the coming quarter.

Manan Patel: And sir do you see any of your clients or any of your prospective clients faced any credit squeeze due to all NBFC and all those issues?

Aditya Rao: I do not think.

Manan Patel: Steel prices I understand are very high so if the steel price start going down does the contribution margin again come back to 20% or 18%, 19% level or will you have to pass on those prices to the customers again?

Aditya Rao: In some cases we have to pass on and in some cases we will gain.

Aditya Rao: I think the spread is what is important so spread that we are getting per ton is the same now or is the same when we are 20% three years ago because steel prices have risen by 25%, 30% in the last one and half and two years. Consequently the spread we have retained but the percentage has come down. Steel prices go down and then it will move up but Mr. P.V. Rao said some may have to be passed through. These are hypothetical and the market dictates our margin. We can assure you will get very close to the margins in all the major players in this industry are getting.

Manan Patel: Sir, my next question is on order book, so can you give a breakup of your order book in terms of solar versus PEB and structure?

Shrikant Bhakkad: Solar roughly we have around Rs 30 crores and PEB we have about Rs 350 crores, we have erection contracts that are about Rs 40 crores, engineering services running business there is an order book of maybe Rs 3 to Rs 4 crores.

Manan Patel: So, if I remove the other income from P&L or one of gain due to FOREX and all our EBITDA looks to be negative, so how do you think about it?

Aditya Rao: It is accurate as of now the profitability is very poor it is entirely because the low revenue base as the revenue base goes up the issues gets addressed. What you should pay attention to determine the health of the business is to look at where we are headed from a revenue point of view .If the revenue goes up and our operating margins gets and consequently our EBITDA increases and PAT also increases ,but you are right but if you remove all of those extraordinary items the numbers do not look good.

Manan Patel: Sir the new capacity in Sadashiv Peth in Pune when do they come online?

Management: By end of February they should be on.

Manan Patel: Sir one more item on the balance sheet so a long-term trade receivables have gone up almost by 10 crore so what is that related to?

P.V. Rao: Predominantly we contract where the period has yet to get completed and the retention amount is lying there. So, as and when the contracts get handed over we will get back this.

Moderator: The next question is from the line of Badri Vishal Bajaj from Bajaj shares and securities. Please go ahead.

Badri Vishal Bajaj: I just recall Mr. Aditya has mentioned about merger with PIL sir I have a fundamental question that your red herring prospectus which was submitted in January 15 and IPO came in August 15 again within two years your board has approved the amalgamation in November 17 anyway now you are proceeding further to various steps and taking approvals, but my fundamental question is you have come out in RHP giving solid point that private equity fund has involved and our target will be around Rs 1000 crore in three years revenue and CAGR will be better than 12%, but going by that 2013 to IPO of 2015 and now 2018 second half you are stagnated at around Rs 500 crores revenues and your margins are falling from Rs 30 crores to Rs 24 crores to now around Rs 16 crore in the last year. Now the rationale for going to IPO and again going back to amalgamation was same thing which I have gone through that is simplification of management structure, synergy, greater potential improved capital structure, benefit to shareholders, but do you feel that the process short lived and the aim was clear, but within two years it has been short lived and closed and the real benefit has come to whom not to the company, not to the shareholders, not to the minority shareholders. Please explain this complicated situation Aditya.

Aditya Rao: If I understand your question you are asking that we had gone for an IPO and in the red herring prospectus we had indicated that we do not give guidance, but we may have indicated market potential and our desire to grow. I think these are aspiration statement obviously when the IPO we determine a certain growth path for ourselves and we try our best to achieve that, but obviously we are all slaves to market forces especially when we make long term statements long term goals are set they have to be adjusted taking into account how market conditions changed. That being said the decision whether we are merging or not merging is a decision for the non promoter shareholders or both entities to decide. So, if you are as I assume you are a shareholder of PEBS or PIL it is a decision that has to be taken by shareholders which is yourself. We will follow whatever you say as regards performance obviously absolutely you are right that the performance of the company has been muted, but on behalf of Mr. P.V. Rao and management team and on behalf of myself also. We definitely commit to improvement that we can bring it, but this decision is yours we have a plan if merger is approved we have a plan if merger is not approved.

If you would ask me for my opinion as a promoter my job is to ensure that we service our stakeholders to the best of our ability and the promoter per se if the merger does happen the promoter do tend to have reduce shareholding in Pennar. So, that is a decision that we have taken that if the shareholders of non promoter shareholders of both companies want to take this forward and both of them have to approve. If PIL shareholders says yes and PEB says no or PEBS say no and PIL yes also then it will not go through. So, the decision to do this or not it is up to you and on the performance point of view absolutely I would like to commit you that you are working hard to better and I believe PEBS are ahead of me. There is a process driven by independent directors, we have completely rescued us from the process. We will take our leanings from you, we will take our guidance from you that is possibly the answer I can give right now.

Badri Vishal Bajaj: Aditya you have fully avoided the basis issue that what made you within two years PEBS is getting amalgamation with PIL and two years back situation also other way so is it the two years period is short enough or sufficient enough to decide that market your efficiencies are there, but you are not getting rewarded by the market our market conditions are poor not favoring to us. So, all those situations because you being the promoter in PEBS as well in PIL and what is the process of merger, demerger that approvals and all anyway you will get it because you are holding the majority 60% in this PEBS also.

Aditya Rao: Mr. Bajaj I hate to interrupt you but what you have said is not accurate at all. The promoters are completely refusing ourselves from the relation so our 60% shareholding or shareholding in Pennar industries are not relevant to this discussion. You will be taking this decision as far as the merger is concerned it is not promoter driven. I think the narrative way of trying to communicate is that we are somehow deciding any of this we are not. It is a suggestion that has come the independent director feel there is a merit we are putting to the shareholders to decide that entire 60% you spoke off will be not on the board we will support whatever decision non promoters shareholders decide to do that includes major funds, it includes individual shareholders like yourself it was independent shareholders you please decide and tell us what to do.

As far the rationale two years what happened all of those these are things which decisions which the board think are possible to decide, discuss we are rescued ourselves completely we are not involved in the process at all either a valuation determination or a voting on the merger or of deciding the dates we have followed the process through as directed by our board and our shareholders. So, please I request that you please not misguide by saying that we are going at 60% so we want to vote. We have gone on record and I am committing to you right now we will not be voting on the merger decision that is for shareholders such as yourself to take. I can comment on performance, I can comment on how we intend to grow the company, but it is not my place to comment on whether the merger is appropriate why we are doing it not me doing it with respect. So, please let us move on from that question.

Moderator: The next question is from the line of Vignesh Krishnamurthy from Harmony Wealth Advisors. Please go ahead.

Vignesh Krishnamurthy: My question is more on the balance sheet side for the past two years the cash flow from operations is negative and I could see that the interest cost and payables and all those are increasing so any thoughts on reducing it and how are we going to improve the balance sheet?

Aditya Rao: The cash flow from operation has always been positive what would be different is cash flow from operations post working capital changes and post CAPEX that would be different, but your question was sustainability of business if you do not have cash flow positive. You are right in that I think what we can comment to is continued cash flow from operations. It is a function of how fast we are growing so if we are growing quickly I will ask you to take our working capital cycle into account we are looking at whether it is viable for a cash flow post working capital or not, but one thing I can assure you is that from operations and the way what we are looking we will make sure that we are generating positive cash flow, but we are in a two month, three month operating cycle. So, if my revenue increase at a strong double-digit rate it will be negative, but you have a good point that is important for us to have positive cash flow from operations post working capital and CAPEX also, but in this industry it is not possible.

Moderator: We would take the next question from Ashwini Agarwal from Ashmore. Please go ahead.

Ashwin Agarwal: So, I was just trying to rear into this erection expenses falling off I assume this is all on account of solar would it be right for me. See there is a mix of PEB and structure steel both there are some jobs where we are not doing erection also and there are some jobs where we do erection also. So, sometimes it varies in month billing is on the milestone we have to do the billing on the milestone and we reach certain milestone only we can raise the invoice. So, some months it will be more, some months it will be less.

Ashwini Agarwal: I am just trying to understand the margin movement and I was wondering if the profit margins are very different in different parts of your business such as PEB structure steel and solar and I am just wondering that is one of the reasons for margins to be so poor is that you are selling a lot more of structural steel because PEB and solar revenues are lower is that a reason?

Aditya Rao: PEB and structure steel have more margins than solar, but solar is fast cycle the margin level if you see PEB, structure steel, solar and engineering services they differ I agree with you definitely, but we have different verticals and they will have different market and different margin levels definitely. So, overall we are trying to improve the revenue point of view in terms of PEB and structure steel so that fixed cost will not increase so that our EBITDA will increase that is what our planning as of now that is why we are increasing our capacity also in Sadashiv Peth as well as Pune.

Ashwini Agarwal: I am having trouble reconciling what you said earlier with what the numbers are saying. So, initial comment said that our contribution margin which used to be 20% have come down to 15% and it is largely the fixed expenses which have brought down the EBITDA margins so drastically or rather the fact that revenues are not adequate that is the reason why EBITDA margin have been so poor, but when I look at the number revenues are flat year-on-year whether it is first half or whether it is the quarter, but cost of goods sold and if I add erection expense to it as a variable expense that has significantly increase. So, there seems to be a significant contraction in the contribution margin itself which is much more than 500 basis points that you suggest what am I missing in this whole picture?

Management: First thing is the contribution margin that we are immune to fixed cost because that is something that comes before that you understand that. What I had said was that the 20% fell to 15% as a response to market changes and obviously because we are passing on spread we are not passing on percentages. So, if the raw material prices shoot up dramatically then we tend to have a bad impact on our operating margin. Now fixed cost is a percentage of sales has also increased from what it was 7%, 8%, 9% to 10% that has also resulted in a decrease a combination of both of this has decreased EBITDA specific to erection expenses or erection revenues for that matter is a quarterly number it is a number that constantly in flux if you were to add up all our revenue historically all of those you will get erection revenue 10%. So, effectively total 10% of total PEB revenue will be erection and that is reasonably very accurate. So, the detail here is that we should be focusing on revenue breakup , PEB ,erection ,solar, engineering services and whether the operating margin that we are getting is as per what we have gotten historically that there has been a decline in PEBS yes and that has resulted in modernization in EBITDA.

What is going to happen from now we are not saying that 15%, 16% will go back to 20%.We are saying as Mr. P.V. Rao said certain modest improvements modest being defined a 100, 200 basis points are definitely possible, but even if there is no change what we are committing is the scale impact which is revenue increasing in this quarter Q3 itself will result in substantial margin improvement over the next few quarters starting in this Q3 itself. So, that is what we would like to tell you. Sustainable EBITDA margins in this business will be completely dictated by what are operating margin is minus our fixed cost. So, erection revenue is typically at a vastly lower margin it is quite low. So, erection revenue becomes a stronger or large proportion of a revenue in any quarter then it tends to bring those quarters margins down but this is not something you can read on a quarterly basis. I would definitely suggest you look at historically see if revenue from erection has been 10% or not which we commit has been and the remaining part of it should be at the margin the we say which is 15, 16% so that is the entire story we will unpack it for you in more detail.

Ashwini Agarwal: No I got what you are saying and therefore what you are basically also saying is that tonnage has come down significantly because if the revenues are flat and spread is what you pass on and but you do not pass on prices intuitively that means the tonnage has come down significantly which probably explains the negative operating leverage that you suffered.

Aditya Rao: Yes and also there is slight difference in this also it is possible for tonnage not to have gone down, but because the revenue mix in PEB itself changes to reflect that we are maintaining spread, we used to do lot more rolled form from components now we are doing fabrication components. So, selling price for fabrication components and raw material cost for that matter is less than for rolled form components which is sheeting and others. So, the option of our production shipment which is rolled forming has declined which typically tends to be at a higher revenue number not spread, spread is equalized but revenue numbers have several impacts. In fact, it may have the opposite impact of actually improving a contribution a little bit not by little bit, but effectively the spread maintenance raw material base price increase is what the problem has been.

Moderator: Thank you. Well ladies and gentlemen that seems to be last question for today. I would now like to hand the conference over to the managing for their closing comments.

Management: Thanks to all of you for participating and we look forward to better quarters.

Moderator: Ladies and gentlemen on behalf of PhillipCapital (India) Private Limited we conclude today conference. Thank you all for joining us you may disconnect your lines now.