"Pennar Engineered Building Systems Limited Q1 FY17 Earnings Conference Call"

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MODERATOR: **MR. KISHOR BAGRI – DOLAT CAPITAL MARKET PRIVATE LIMITED.**

Moderator: Good Morning, Ladies and Gentlemen, Welcome to the Pennar Engineered Building Systems Conference Call Q1 FY'17 Earnings hosted by Dolat Capital Market Private Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Kishor Bagri**.** Thank you and over to you, sir!

Kishor Bagri: Hello, everybody and very good morning. This is Kishor Bagri**.** and I welcome you all to the Quarterly Results for First Quarter FY'17 for Pennar Engineered Building Systems Limited. So, we have the management of the company Mr. P. V. Rao -- Managing Director; Mr. Aditya Rao -- Vice Chairman and Mr. Shrikant Bhakkad -- Chief Financial Officer on the call.

So, I would like to take the opportunity now to hand over the call to Mr. Aditya Rao and he will address the call from here on. Thank you.

Aditya Rao: Thank you to all the stakeholders of Pennar Engineered Building Systems. Welcome to our quarterly conference call for the first quarter of the financial year 2017. It gives me great pleasure to report to you that we have had sustainable strong growth in this quarter.

We had gross sales of Rs. 103 crores. Net sales of 94 crores, which is an increase of 14.20%. EBITDA was Rs. 11.27 crores, which is up 17% year-on-year and our EBITDA margin was at 12%. We recorded a PAT of Rs. 4.04 crores, which is up 14.90% year-on-year and our cash profit was about Rs. 6 crores.

The structure of the conference call today will be that Mr. P. V. Rao -- the Managing Director will be giving you the overview of the quarter in terms of our performance and also on any details on order book and new orders that have been booked during the quarter. Shrikant Bhakkad -- our CFO will then take you through the financial numbers in detail and we will have a short discussion or overview of our strategy plan which was initiated in the last quarter, a five-year strategy plan which defines out the various growth plans we have for each vertical. After that, we will be handing over to the moderator for any questions you may have.

With that, I would like to hand it over to Mr. P. V. Rao our Managing Director for his overview of the quarter's performance.

P. V. Rao: Good morning, everybody.

As explained by Aditya, we are on a sustainable growth path. In terms of highlights of Q1FY17, we received major orders from Shapoorji & Pallonji for a project in Pune; Musaddilal warehousing projects in Bhiwandi and Rajasthan; Hyderabad Industries Limited, AGI Glaspac, Tewari Warehouse, Vee Rubber and JBF Industries. We received repeat orders from RCC Infraventures, Phoenix, which is a Hyderabad company where we are constructing a multi-storey apartment complex, UltraTech Cement and Hetero Drugs. The current order book as of the end of the first quarter is about Rs. 410 crores and as of now it is about Rs. 465 crores. We have prospective orders, which we are the pipeline to the tune of about Rs. 650 crores.

Then, we have the Engineering Services business which is growing significantly. We have been able increase the number of man hours from 7,800 to almost 18,000, which is a significant increase in terms of sales as well as billing per hour also. Also, we received some major orders from NCI for Engineering Services. Additional man power has been recruited at the Vishakhapatnam office. The current revenue is around Rs. 70 lakhs per month and we are expecting to do around Rs. 10 crores in this financial year. We entered into a term sheet with an engineering company based out of Bangalore, which is providing engineering services to companies in the U.S. The general contracting companies and the fabricators are getting engineering services from this company. The financial due diligence, tax structure diligence and all legal due diligence are almost completed and the definitive agreements are being prepared. We will shortly take majority stake in that company. And we are expecting that also to deliver revenue of around Rs. 10 crores in this financial year.

As far as plant production and operations is concerned, we have taken an existing pre-engineered building client in Baroda on job-work basis and the production in this new facility have already started in the month of May. Currently the facility is operating in two shifts which we will be increasing it to three shifts very shortly. The monthly production is almost around **1100** tonnes as of now. So, we are also evaluating options for setting up permanent facility. We are on the verge of finalizing the land in the North, in Gujarat, which Aditya will cover and then the financial performance which I will request Shrikant to cover. Shrikant, can you please take over?

Shrikant Bhakkad: Yes. Good morning, everyone. Just to take you through the numbers. The gross revenues were up from Rs. 92 crores in Q1 FY16 to Rs. 103 crores, an increase of 11.7%. Net revenues were up around 14.2%.

EBITDA was Rs. 11.27 crores, up from Rs. 9.64 cr. in Q1FY16, which is an increase of about 17%.

Profit before tax was Rs. 7.04 crores from Rs. 5.76 crores in Q1FY16, a 22% increase yoy. Profit after tax was Rs. 4.4 crores compared to Rs. 3.83 crores in Q1FY16. The contribution margins have been around 22% in the current quarter. We do not have any long-term debt and the working capital continues to be more or less the same in the Rs. 55 crores range and this quarter, we have a cash profit and then working capital has been positive during the quarter.

With this, I hand over to Aditya to take off the strategy and discussion.

Aditya Rao: Thank you, Shrikant. Thank you to Mr. P. V. Rao as well for his overview of the performance. I just want to spend a minute to tell you about some of the initiatives that are being undertaken here at PEBS.

We have historically been a company with four business divisions, the core pre-engineered buildings division, the new solar module mounting systems vertical, the engineering services division which we added about a year and half ago and the high rise structure fabrication and general fabrication division. Those have been the verticals of the company and any growth we derive has been derived by what the addressable market size for each of these. Our basic claim to growth has always been that the addressable markets in each of these verticals are vast. Much vaster then our current revenue share in them so there is plenty of room for us to grow. What we have initiated in the last quarter is a cohesive plant for us to rapidly scale up revenues margins and profitability and also consistently focus on positive operating cash flows. Over the next few quarters but more frankly over the next few years so, to make sure that in the five years now we are the market leaders in each segment that we are present in and more importantly we consistently scale up revenue and profitability.

So what we see happening over the medium-term which is the next few years is the investment which we have made in high rise buildings to pay off, our solar module mounting systems will evolve further where we will go from our existing seasonal tilt and fixed tilt structures to also incorporate tracking solutions. We have received our first solar tracking order from Hero Future Energies and we are very confident with the way the markets moving we will be one of few players present with strong capabilities in solar single access capacities, tracking systems.

We have devolved into a market leader and clear span building which are building which very large width with no supporting column in between and we do not believe that any other company in India has the positioning that we do. We believe this will be a clearly important vertical in the future. We have made investment in engineering services and we continue to make them by building up our team and expanding our man hours we have more than doubled our almost tripled our man hours available from the same period last year. And we have very good guidance from our customers in the U.S. that they expect to scale up this business consistently year-on-year and quarter-on-quarter and we are very bullish on engineering services as has also seen from quarter-on-quarter basis there is a lot of growth. But for the year in question also we are looking very high growth for the engineering services vertical which will consistently drive margin expansion.

So our five strategic plan is to involve into a complete building technology devolutions company. We will expand our engineering capabilities in steel and also in crude composite construction and facade systems, building integrated photovoltaic is also an important vertical for us. We received also in this quarter our first roof top solar orders.

We will speak to you more about this over the next few quarters, over the next few years but it gives me a lot of pleasure to tell you that I think we have positioned our company well to deep these benefits in the future of these investments that we have made. We have planted a lot of the seeds and our focus over the next few quarters and years will be to transform ourselves into a fast growing a high ROCE, high operating, positive operating cash flows generating company.

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

Moderator: Thank you. Ladies and gentlemen, we will now begin the Question-and-Answer Session. We will take the first question from the line of Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: Basically sir, just wanted to know still we have high interest cost so, can you just explain on that?

Aditya Rao: Yes, the interest cost for the quarter has been very high by almost Rs. 1 crore. I will give it over to Shrikant to explain why the interest costs are high.

Shrikant Bhakkad: Vikram, the interest cost has been high because we have started procuring a lot of raw materials because of the MIP pricing. On the hope that it is coming, we have opened a lot of LCs on this for which LC charges have been incurred.

Aditya Rao: Yes, I think the interest cost, as Shrikant has said, is primarily the output of our raw material. We had to consistently book the orders and our order book currently has increased from the beginning of the Q1. We are sitting at Rs. 465 crores and considering the markets, with MIP coming, with Anti-Dumping Duty being levied yesterday, we do have to go long on the raw material price. But if you are asking, interest cost is an output of what is the total debt in the company, our rupee debt has not increased. We have no long debt, absolutely zero, and our short-term debt is at Rs. 50 crores, the same as it has been for the last few quarters. Our short-term debt, the LCs that we use, has increased which is for raw material only. So that is the reason for the increase in interest cost.

Over the next few quarters we expect this to moderate as we start reducing our inventory levels. But in the area where there is so much volatility in raw material prices we cannot afford to take exposure on raw material hence, with an expanding order book, we have to have higher interest cost but we do have reserves as well there is other income which we have, which is because of our investments and our auditors have not allowed us to net that off. If you have to remove that then there is absolutely no growth in interest cost at all. But that is the reason for the increase in interest cost and we expect it to moderate, you do not need to expect it to be at Rs. 4.2 crores for the coming quarters. We will see a decrease as we eat out inventory.

Vikram Suryavanshi: Okay. And how much typically would be the advances on this, the order book we have like in pipeline or basically…

Aditya Rao: We have advances of around Rs. 30 crores with us as of now.

Vikram Suryavanshi: Okay. And any improvement in receivables position?

Aditya Rao: Yes, receivables have in fact reduced from where we were in the March to now and we have been continuously reducing. There are a lot of retentions and other things which are in the projects which were held up. I think the retentions are getting cleared up and during the course of the year we see the retention to further come down. So as of now it is close to around Rs. 140 Crores that we are sitting at the receivable and we expect this to further decrease. Our goal is to bring it to two months but in the short-term we will be at two and half months.

Vikram Suryavanshi: Got it. And sir, basically, can you just explain more about this new facility we are looking in Gujarat capacity and when it can start**?**

Aditya Rao: Yes, Gujarat we are looking for land. We are almost on the verge of completion, finalizing the land and that is a 30,000 tonnes capacity plant, which we are looking at and we are expecting that to get functional operational by end of this financial year.

Vikram Suryavanshi: So once we start this, will the existing arrangement in Baroda will continue or how…

P. V. Rao: No, that would not continue. The existing arrangement in Baroda will not continue once we will run our own plant.

Vikram Suryavanshi: Okay. So basically production will ship from the…

P. V. Rao: Yes, that is correct.

Vikram Suryavanshi: And I just wanted to know how big the opportunity for us in terms of high rise building and what its current revenues here?

Aditya Rao: The acceptability of high rise building is increasing in India as of now. Currently we are now doing high rise four covers for a company called Phoenix in Hyderabad in Jubilee Hills and the acceptability is slowly picking up and some more buildings are coming up in Bombay and Delhi and in Hyderabad itself another project some other builder also after seeing this also wants to go for commercial complex in Hyderabad so, we are expecting that this will increase because the non-availability or shortage of skilled workers like masons the other shuttering contractors now. So in the time to come it will definitely catch-up because of its advantage because you are not having enough skilled workers in India and the market size is very high and even if it catches up we went up to 5% also it is huge. So definitely we are very positive and bullish on that.

Vikram Suryavanshi: Okay. And in our five-year business plan, is there any revenue share target we have for this segment?

Aditya Rao: For this we do not have a target as of now but we are expecting at least year-on-year growth of about even 30% to 40% in this.

Moderator: Thank you. We will take the next question from the line of Dhimant Kothari from Invesco. Please go ahead.

Dhimant Kothari: Sir, can you just quantify some of the balance sheet numbers for us for this quarter?

Aditya Rao: Sure, what numbers would you want?

Dhimant Kothari: Could you tell us what are the payables?

Aditya Rao: Payables have decreased from Rs. 150 crores to Rs. 130 crores.

Dhimant Kothari: 130?

Aditya Rao: Yes. This is mostly the raw material against it is counted as LCs that is very good seeing.

Dhimant Kothari: And receivables you told it is close to Rs. 140 crores?

Aditya Rao: Rs. 140 crores, yes.

Dhimant Kothari: And how much is the inventories?

Aditya Rao: Inventories has increased, from Rs. 90 crores it has gone up to Rs. 120 crores.

Dhimant Kothari: And how much are the loans and advances both short-term and long-term?

Aditya Rao: We will get back to you on that number. They are not very material but we will get back to you. We do not make too many advances and we do not take too many loans but we will get back to you on the exact number.

Moderator: Thank you. We will take the next question from the line of Vinit Samre from DSP Black Rock. Please go ahead.

Vinit Samre: So, just wanted to know what has been the revenue run rate for our engineering services this quarter?

P. V. Rao: Rs. 70 lakh per month.

Vinit Samre: So, for the quarter it is Rs. 2 crores, is it?

P. V. Rao: Rs. 2.2 crores.

Vinit Samre: Okay. And what kind of visibility you have for this current year because your numbers of manners seem to have gone up quite a bit.

P. V. Rao: Budget is around Rs. 10 crores but we are expecting to do a little more than that because the asking rate is becoming high from NCI. So, they came here 15 days back and they are impressed with our facility and the arrangements and the software we are using and the quality of work we are doing. So, we are bullish on that. We are very positive. Even the acquisition of the engineering agency is going to increase our chances. So definitely we are very positive on that.

Vinit Samre: So this revenue is largely from one account or we have now a couple of accounts?

P. V. Rao: In U.S. apart from NCI we have four accounts.

Vinit Samre: Okay. And is NCI still the largest account for us?

P. V. Rao: Yes, NCI is still largest account, around 75%.

Vinit Samre: Okay. The other thing which I wanted to understand was this accounting entry in terms of your raw material consumption to sales and then there is inventory work in progress which is also very high amount I mean can you take me through that and explain what exactly does that mean when we mentioned that there is Rs. 34.9 crores of inventory adjustment what is that amount?

Shrikant Bhakkad: This is the increase and decrease in the stock level that you have. So, if you see the March comparison with the June quarter that is the increase and decrease in the stock that you have so, that is one of the Rs. 34 crores and if these needs to be netted-off with the raw material consumption. You need to net off Rs. 73 crores from Rs. 34.9 crores of change in inventory and compare with Rs. 45 crores which is at the corresponding quarter.

Vinit Samre: So within this inventory amount. The break-up of work in progress sill continues to remain the same or there is a growth there as well.

Shrikant Bhakkad: Yes, there is growth in work in progress as well as well as in terms of finished goods.

Vinit Samre: Okay. So does this also signify the kind of traction we are having in terms of our business prospect?

Shrikant Bhakkad: Yes, this is prospective sales because of certain delays in the clearance etc, which will increase inventory and that is the reason WIP and finished goods are appearing to be higher. These will get executed over this quarter and the next.

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

Vikram Suryavanshi: Sir, what you mentioned the term sheet that we have signed for the acquisition of one company that revenue will also be Rs. 10 crores in this year or it is like annual revenue what we are looking at?

Aditya Rao: We would not be giving guidance on that but it is obviously going to add substantially to this year's engineering services revenue but the number that Mr. P. V. Rao had given, is not inclusive of the acquisition revenue.

Vikram Suryavanshi: Okay, got it. And would you like to share what was the volume number in this quarter?

Aditya Rao: For engineering services standalone PBES standalone?

Vikram Suryavanshi: PBES standalone.

Aditya Rao: It is Rs. 2.2 crores.

Vikram Suryavanshi: No, I am talking about the metric tonne volume.

Shrikant Bhakkad: It is gone up by 15%, it is approximately 10,000 that we had earlier. Now it is 15% up.

Aditya Rao: About 12,000. Between 11,000 and 12,000.

Vikram Suryavanshi: Okay. And we can see incremental volume in Baroda facility?

Shrikant Bhakkad: Yes, I think in the last quarter, we were only operational for one and half months there. So, we will be operational for the full quarter this time.

Moderator: Thank you. We will take the next question from the line of Saurabh Patwa from HDFC Mutual Fund. Please go ahead.

Saurabh Patwa: I just wanted to understand in last two quarters our gross margins have improved drastically compared to what it used to be regular run rate so, should we believe this is the run rate which we can expect going forward? And is it because of the traction which we are getting in the engineering business?

Aditya Rao: Saurabh, thanks for that but if you were to break up the gross margin business vertical wise, our core PEB business gets about 20%; engineering services is at a much higher number as it goes straight to EBITDA and you can assume a steady state of 60%-65%; solar is lower at 12%-13%. Some of the orders we had this quarter are higher. But the gross margin improvement overall which you speak about, is not drastic. If you look at our history in the last three to four years, it has always been in the range of 20% to 22%. But what is happening now is that with engineering services playing a larger role, on a quarter-on-quarter basis, our operating margins are trending upwards.

Saurabh Patwa: Okay. And sir, I think last quarter the volume numbers which was shared was I think there was some confusion about that. Can you just give us the last quarter volume numbers as well?

Shrikant Bhakkad: It was 18,000 and that was only PEB. The solar part of it did not get added at that particular point in time. So totally 58,000 tonnes was the last annual turnover and out of that, if you add all, it was 18,000 tonnes PEB, solar and structural put together.

Moderator: Thank you. We will take the next question from the line of Soumil Zaveri from DMZ Partners. Please go ahead.

Soumil Zaveri: I appreciate the long range plan from Aditya, the specific question I had was on the other expenses line in the release, just wanted to get a sense on what the big moving parts in that the big components in that are out of that Rs. 35 crores.

Aditya Rao: What the other expenses increase is, as I said, there are a lot of investments in expanding our engineering services manpower. Now for us to acquire them and to build that up over a period of one to one and half quarter, string them and then they will start generating revenue it takes some time and also we have made massive investments in terms of people, in terms our high rise building capacities, our solar tracking, and also a solar rooftop business which we believe are going to be scaling aggressively over the next few quarters. So a lot of this is people cost related which we had and our auditor does not allow us to capitalize anything. In fact, no expenses have been capitalized at all in the first quarter. Everything is at the P&L and in spite of that we have good EBITDA growth. All of that is sitting in other expenses where all the new software platforms that we have invested in, all the new people that have come in and our investments in high rise. We hired people from IIT, ISB, from existing engineering companies, from L&T. All of that has come in entirely. That is the reason for other expenses going up. It is actually a part of fixed cost, what you will see happening is over the next couple of quarters, our general admin costs and other costs will come down but this will probably sustain. We are going to have a significant fixed cost increase this year. But in spite of that, because they will become revenue generating quite soon, we do expect margins to expand further as well from this level. But the other expenses is you can take it as pre-operating expenses for our business scaling that we are doing now and it will become positive revenue generating over the next few months.

Moderator: Thank you. The next question is from the line of Dhimant Kothari from Invesco. Please go ahead.

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Dhimant Kothari: Aditya, can you just give us the investment plan, what will be the investments for the next couple of years like Gujarat you have, North India, and you have some acquisitions as well so, what could be the total investment what we can look at?

Aditya Rao: The investment plan will go around, will be in phases, we have four phases defined for the next five years in terms of which are the investments we will be making. On a cumulative basis, the investments will be substantial. We will be adding two more manufacturing plants at a cost of about Rs. 40 crores each. We will be investing into software platforms and engineering services which means we need to have engineering office and sales office in the U.S. The third point where we will be looking at is the acquisition portfolio. We do not perceive further acquisitions in the engineering services space. So, the one we are making right now which would be above $2 million, it is not extremely heavy. At this point we are not seeing further investments. But I would like to state that all of these investments, all of this capital expenditure over the next four years will be done completely through internal accruals. We will not need to raise debt. We have not raised debt in a very long time and we do not intend to raise any debt. The investment plan essentially for this financial year would be the Gujarat plant plus engineering service acquisition and of course any technology platforms that we invest into will all be met through on accruals.

Dhimant Kothari: Okay. And how soon do you expect the North India to come up?

Aditya Rao: This financial year. We already have Baroda. What we call the North India plant essentially is kind of West and South. We are in the South so, everything in North was North, but it will come out in Gujarat. And in this financial year, you can expect closure. We have already started operations, so it will be an easy for us to set that up quickly.

Moderator: Thank you. As there are no further questions, I would now like to hand the conference over to the management for their closing comments.

Aditya Rao: Thank you to all of our stakeholders, to all the people who are investors, we thank you for your trust and faith in us we are very confident of having a high growth company on our hands and the investments we are making and the efforts that we have made are all geared towards insuring that we position this company well for strong growth quarter-on-quarter and we are very confident of achieving the targets we have set for ourselves this financial year. And if you had looked at our positive cash flow generation, our margin expansion and profit growth, those are all key metrics for us and we are committed to ensuring we deliver on our books for this financial year and for the next few financial years. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, on behalf of Dolat Capital Market, that concludes this conference. Thank you for joining us and you may now disconnect your lines.

(This document has been edited to improve readability)