Earnings Conference Call

Q3 FY2017

February 14, 2017

Management:

Mr. N R Ganti, Director

Mr. N. K. Khandelwal, Chief Financial Officer

Moderator: Ladies and gentlemen good day and welcome to Pitti Laminations Q3 FY2017 Earnings Conference call. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Please note that this conference is being recorded. Joining us today on this call are Mr. N R Ganti –Director and Mr. N. K. Khandelwal – CFO.

Before we begin, I would like to mention that some of the statements made in today's call may be forward looking in nature and may involve risk and uncertainties. For a list of such considerations, please refer to the earnings presentation. I would now like to handover the call to Mr. Ganti, over to you sir.

N R Ganti: Thank you. Good evening and welcome everyone to our Q3 FY2017 Earnings Conference Call. I have with me on call today Mr. N. K. Khandelwal – CFO. We hope that you have had a chance to review our results presentation, which is also available on our website. I would like to start by providing an overview of the prevailing macroeconomic scenario followed by performance of the quarter including highlights of key strategic and operation performance. We will then open the call for an interactive Q &A session.

During the quarter though the performance of capital goods sector experienced some improvement but the pace of improvement continues to remain slow; however, we remained confident of medium term growth prospects on the back of the various initiatives taken by the government. Continued government focus on revival through increased infrastructure allocation is widely expected to drive growth in the sector in the near to medium term.

Moving to our performance for the quarter, we recorded a volume growth of 1.7% to 5,005 metric tons (MT) compared to same period last year. This growth was driven by a strong growth in domestic market. Domestic volume for the quarter was 4,000 MT, an increase of 9.4% y-o-y. However, export volume declined by 20.4% to 1,005 MT compared to the same period last year. Demand for our stator frame also experienced robust with 91 units in Q3 FY2017.

As a result of the growth in volume coupled with better price realization, our revenue for the quarter increased by 8.6% y-o-y to Rs. 769 million. Of the total sales, domestic sales accounted for 60% of the total sales and remaining 40% was contributed by exports. Domestic sales for the quarter improved by 4.8% y-o-y to Rs. 454 million. Export sales for the quarter was Rs. 307 million, an increase of 14.5% compared to the same period last year. The other operating income accounted for Rs. 8 million. Our EBITDA for the quarter quadruple to Rs. 97 million compared to Rs. 23 million in Q3 FY2016. EBITDA margin for the quarter was 12.7% indicating an improvement of 935 basis points compared to same period last year. Improvement in profitability for the quarter was primarily driven by increased exports, improved operating efficiencies and optimization of costs. We like to highlight that EBITDA is defined as profit from ordinary activities before finance cost, depreciation and exceptional items and includes foreign exchange loss or gain. PAT for the quarter was Rs. 19 million compared to a loss of Rs. 40 million in the same period last year. PAT margin for the quarter was 2.5%.

Moving to our leverage profile, we are very comfortable with our current capital structure. As of December 31st, 2016, our total debt was Rs. 1,546 million which included Rs. 418 million of long-term debt and Rs. 1,128 million of short-term debt. Cash and cash equivalents for the quarter was Rs. 130 million resulting in a net debt position of Rs. 1,416 million. The net worth of the company was Rs. 1,116 million at the end of the quarter. As of December 31st, 2016, we have conservative leverage profile with a total debt to equity ratio of 1.4x and net debt to LTM and EBITDA of 4.5x.

Our business plans are moving as per schedule and expected to gain further momentum in the last quarter of this fiscal year. Our GE India order which we received last quarter has completed sampling stage and we expect the commercial deliveries to start from Q2 FY2018. In addition our plan of the setting up of a plant 4 at Hyderabad for machining of the castings for GE Locomotives, Gamesa and Siemens orders is going as per schedule and we are confident of commencement of production by April 2017. As mentioned during the last quarter, we are also in the process of shifting Pune operations to Aurangabad and it is running as per schedule to start by Q1 FY2018. Furthermore, we are also in the process of upgrading our plants and equipment, which will enhance our competitive edge by making our manufacturing platform leaner and overall operations more efficient.

Our business outlook for the last quarter and full year is positive and we are expecting to continue the growth momentum. Our order book continues to remain robust which gives us the visibility for a strong performance over the medium term. We would like to open now the call for question and answer session, thank you.

Moderator: Thank you very much sir. Ladies and gentleman, we will now begin the question and answer session. We have our first question from the line of Shashank Kanodia from ICICI Securities, please go ahead sir.

Shashank Kanodia: Yes sir, since last quarter, we have been guiding that full year basis our export is going to be 4,500 MT so is this something which is the cause of concern now, because in 9 months you have just done around 2,200 MT.

N K Khandelwal: Hi, good evening Shashank, Khandelwal here.

Shashank Kanodia: Yes sir, good evening.

N K Khandelwal: Yes, definitely there is quantity wise shortfall in projection in lamination exports. We will not be able to achieve 4,500 MT and will be ending somewhere between 3,000-3,500 MT but exports as such has increased because there is an increase in stator frame. So, in revenue terms there is no deduction but in quantitative terms there has been shortfall against projection for laminations.

Shashank Kanodia: Okay, so is there like GE is stalling the shipment or GE is ramped down altogether as in what is the scenario on the GE front, GE exports.

N K Khandelwal: The scenario on the GE front it is more of the deferment rather than any shortfall in demand. The projections which were supposed to materialise during this quarter has shifted to the next quarter.

Shashank Kanodia: Okay, so right now since January it has already done, so what was the shipment levels in January in terms of tonnage.

N K Khandelwal: No, that is what as a year we will be ending around 3,000 to 3,500 MT.

Shashank Kanodia: Okay, so we did export around 400 to 450 odd tons in January right.

N K Khandelwal: Yes, Jan-Feb we are expecting that.

Shashank Kanodia: Okay and sir, what is the outlook going forward in FY2018 and FY2019 from the exports from GE in terms of tonnage.

N K Khandelwal: It will be in the similar range of around 4,000 to 5,000 MT. Next year it will be better than this year.

Shashank Kanodia: But sir have you heard anything from GE on this regard because we have been bullish on GE front for quite some time but some of the volumes have not picked up.

N K Khandelwal: No but see as an overall company strategy we are increasing the share with the other customers, so we are not so much GE centric as a whole.

Shashank Kanodia: Okay and sir then domestically, we have been maintaining this 4,000 MT kinds of run rate, so 16,000 MT is easily doable for us right this year.

N K Khandelwal: Yes.

Shashank Kanodia: Or is it like you are seeing some pent-up demand in this quarter, how is it shaping up.

N K Khandelwal: During the quarter demand is good, on the domestic front and that is our focus also. We will be definitely able to do better.

Shashank Kanodia: Okay so this year we will end with around 16,000 MT domestic.

N K Khandelwal: This year we will end about 15,500-16,000 MT on the domestic side.

Shashank Kanodia: Right and sir what will be your guidance for FY2018 and FY2019.

N K Khandelwal: I think that we will talk later on the guidance for next year.

Shashank Kanodia: Okay, but roughly 18,000 MT is doable or.

N K Khandelwal: 18,000 MT is doable.

Shashank Kanodia: Okay, and on the demand front, which all segments are looking promising towards as in domestically.

N K Khandelwal: All three sector; transportation, generation and industrial are doing well right now. Particularly during the last quarter there was improvement in the transportation.

Shashank Kanodia: Okay, and were there any new client or acquisitions in the last quarter.

N K Khandelwal: We have been discussing with Gamesa for lamination business also. So casting business we have received for machining from Gamesa, that is the first phase about 3.5 ton casting, now we are discussing for the lamination business with Gamesa so that would come as a new development for lamination in next year. Other than that most of the major client is with us in lamination so there is not much scope in large lamination, small laminations as we are told earlier with Crompton that would be the major clientele that will start for commercial production in next year.

Shashank Kanodia: Right and sir what is the right now the trend of realizations for scrap.

N K Khandelwal: It is stable. It has been stable during last quarter and this quarter as well.

Shashank Kanodia: Sir around Rs. 20 -22 a kg.

N K Khandelwal: No, it is between Rs. 18 -19.

Shashank Kanodia: So sir on a realistic basis, we might just clock Rs.300 crore of sales right this year in FY2017.

N K Khandelwal: Yes, this will be around Rs. 300 crore, plus or minus Rs. 5 or 10 crore.

Shashank Kanodia: Okay, and any scope for margin improvement in the last quarter because I think by then you will be roughly touching Rs. 100 crore of sales last quarter. So, is there any scope of margin improvement?

N K Khandelwal: Margin wise we will able to meet our projections, it is only on the topline that there is some reduction.

N R Ganti: Shashank you would have noticed operational efficiency is much better than what it was last year such as employee cost, raw material utilization and operational efficiency. As we go forward, the entire emphasis of the company is on making the entire cycle more efficient.

Shashank Kanodia: Okay but can we return back to a 13.5-14% kind of EBITDA margin trajectory that you used to enjoy to your sense.

N R Ganti: Yes I would assume so. We are definitely gunning for it.

Shashank Kanodia: Thank you sir. I will get back into the queue if I have some more questions.

Moderator: Thank you sir. We have our next question from the line of Anand Jhawar from JM Financial. Please go ahead.

Anand Jhawar: Yes, last quarter the promoter infused around Rs. 25 crore as an interest free loan to the company. I just wanted to understand like how soon would you reverse this or what is the rationale behind it. Because there are other alternatives of infusing equity into the company, but it is a rather unusual move to give an interest free loan. I just wanted to understand the thought process behind this.

N. K. Khandelwal: Okay, Anand actually this is unsecured loans from the promoters particularly for the CAPEX and working capital requirements of the company. As you know we are going for expansion in Aurangabad and Hyderabad, we have approached State Bank of India, who has sanctioned our term loan. So there is a stipulation to bring in the promoter's contribution, so initially to start the work, we wanted to immediately infuse the funds so we brought it as unsecured loan into the company from the promoters. As mentioned in this time's board meeting outcome, we are going to convert that into equity by way of preferential allotment to the promoters.

Anand Jhawar: Perfect, so that is what I want to clarify. This is the capital which gets converted into your preferential share allotment

N. K. Khandelwal: Yes.

Moderator: Thank you Mr. Jhawar. We have a follow-on question from the line of Mr. Shashank Kanodia from ICICI Securities, please go ahead sir.

Shashank Kanodia: Sir, this fresh issue of share as well as convertible warrant so in total amount 251 lakh shares right.

N. K. Khandelwal: Yes.

Shashank Kanodia: Yes, so that implies that we are converting about Rs. 50 a share for the promoters, right.

N R Ganti: Shashank, basically we need to go through a postal ballot to get the shareholders' approval for preferential allotment. It is just an enabling resolution approval from the shareholders. The issue price will be based on SEBI pricing formula. .

Shashank Kanodia: Okay but then that formula will apply from this board meeting date or it would be.

N. K. Khandelwal: From the date of allotment, when the allotment is considered by the board. That is after the postal ballot and all the statutory approvals.

N R Ganti: That is the reason why it is silent on pricing, it is very difficult to determine now what it is going to be.

Shashank Kanodia: Right, but sir we were under restrictions right, so there was an ongoing case with SEBI, so what is the matter on that because I think that restricted for us from raising funds for the equity, so has that been resolved.

N R Ganti: No, not yet. The open offer is pending with the SEBI for their approval of DLOF. We have filed again fresh with SEBI requesting them to clear the document based on SAT orders. In the interim, our legal counsel has said that additional equity being brought in by the promoters is not restricted by pending open offer so this is a separate activity.

Shashank Kanodia: Okay and this division between fresh issuance of warrants is just to avoid an open offer because I think creeping acquisitions allows you to have.

N R Ganti: Yes

Shashank Kanodia: Right and sir if you can throw some light on the GE India places and how is the developments being focusing on that front.

N. K. Khandelwal: Yes, GE India, as we have mentioned in our opening speech, already the materials are under the sampling stage, some of the samples have been already approved and some documentation is going on. So basically we will be able to start the commercial supplies by Q2 FY2018.

Shashank Kanodia: Okay, so this is going to be Rs. 50 crore of worth of order for every year right for the next 10 years.

N. K. Khandelwal: At the moment if it picks up then it will be Rs. 50 crore. For FY2018, it may be half or no, we don't know. FY2018 cannot be certain right now but in subsequent year FY2019, it will be about Rs.50 crore.

Shashank Kanodia: Okay and sir what will be margins to be realized from that quarter, EBITDA margins.

N. K. Khandelwal: That is as usual, it is the same product what we had been supplying till now.

Shashank Kanodia: Okay sir so 14% to 15% right.

N. K. Khandelwal: Depends, what is the product mix.

Shashank Kanodia: Okay and sir have we pitching for some kind of products with the GE because given that we have a long-standing relationship with them apart from lamination, some other processes of tool work that we can do for them.

N. K. Khandelwal: Other than lamination, machining is one of the major business that we are growing with GE. So machining of the castings is the reason for this expansion of plant 4 in Hyderabad is planned.

Shashank Kanodia: Okay and sir how is the movement of raw material prices, has that also stabilized and your input at realizations.

N. K. Khandelwal: Yes, raw material prices has stabilized. In fact, it has started increasing so there has been increases of about Rs. 2.70 during the quarter.

Shashank Kanodia: Okay, so have we pass on to our customers.

N. K. Khandelwal: It is in the PVC clause, so it will definitely come into the price variation clause.

Shashank Kanodia: Right, so initially you were targeting something around Rs. 400 crore of sales for FY2018 and 15% kind of EBITDA margin, so do you stick to that guidance or where do we stand today.

N. K. Khandelwal: FY2018.

Shashank Kanodia: Yes.

N. K. Khandelwal: Yes Rs. 400 crore, it would be around Rs. 400 crore no doubt about it.

Shashank Kanodia: Okay and 15% kind of EBITDA margin we could be able to clock right.

N. K. Khandelwal: EBITDA that will always be our target but all depends on what kind of product mix we are able to deliver.

Shashank Kanodia: Right, do we have any benefit sort of tax rate given that we have some accumulated losses for 4 to 5 quarters.

N. K. Khandelwal: That definitely will be there, there will be accumulated losses for the current year which you have brought forward from the previous year.

Shashank Kanodia: So what can we assume as a blended tax rate for us, for let say FY2018.

N. K. Khandelwal: FY2018, difficult to answer right now because we have to first close the FY2017.

Moderator: Thank you sir. We have our next question from the line of Sumadip Mitra from JM Financial. Please go ahead.

Sumadip Mitra: Good afternoon gentleman. I actually had a slightly microlevel question to ask. I understand that your segments are distributed across transportation, industrial and generation. To my understanding on the industrial as well as on the generation side, you know coal, thermal or wind, we are not seeing really that kind of traction in terms of you know incremental CAPEX that is happening, so is it that we would probably we are seeing higher traction mainly from the transportation side probably on the railway side or you know is there any gap in my understanding.

N. K. Khandelwal: Railways definitely is going to be the main area but other than that even in the wind. Also as I have just mentioned Gamesa is a potential customer for which already we have started working on the machine casting side, lamination also will be consumed, so there is a good scope in wind also. We have been seeing some good spike during the previous two quarters in wind also.

Sumadip Mitra: Right sir but as you must be aware that we are looking at the tax benefits, etc., expiring in this year itself and I believe even the power minister is talking about you know in wind installations probably falling from next fiscal, so I just wanted to get your take on that.

N. K. Khandelwal: I think for us it may not come as a much high growth but still it will be stable and I do expect 5-8% kind of growth, definitely will come in wind.

Sumadip Mitra: I understand, so sir what would you actually categorize as the key growth segment for yourself, would it be largely the railways area or some other industry as well.

N. K. Khandelwal: Presently it is major railways because that is the Indian Railways contract with GE which we will start supplying. Other than that even across the globe also traction motors again coming to railways until the oil prices move further then in that segment oil exploration business can be picked up but that does not seem to be the present case. Even for coal and freight until that picks up freight movement will increase, so that segment can start doing well. So all these things are at the brink right now, which the segment will pick-up it is anybody's guess as of now but any of these segments picks up it is good for us.

Moderator: Thank you Mr. Mitra. We have our next question from the line of Gautam Behl from Mauryan Capital. Please go ahead.

Gautam Behl: I just wanted to ask you what will be the trend for debt in FY2018.

N. K. Khandelwal: Debts are within a very well leverage profile right now, so as such we do not have much concern on debt side but as we have expressed we have already been gone for the term-loan with the State Bank of India for these projects, so I do not see much movement on the long-term debt side.

Gautam Behl: So it will remain stable?

N. K. Khandelwal: More or less similar level.

Gautam Behl: Okay and what would be your maintenance CAPEX for FY2018.

N. K. Khandelwal: Maintenance CAPEX is, it is more like a routine CAPEX, we do not have very high numbers on maintenance side.

Gautam Behl: Okay, not a very high number on maintenance.

N. K. Khandelwal: Yes.

Gautam Behl: And basically for the FY2018 and FY2019, what would be the normalized margin basically a range that you could give me.

N. K. Khandelwal: Range already our friends on the call has mentioned now, about 15% EBITDA margin everybody is expecting, so we also expect the same.

Gautam Behl: So 15%, no I am wanting a very realistic a normalized number may be.

N. K. Khandelwal: I think it would be 13-15% range.

Moderator: Thank you sir. We have our next question from the line of Kaustav Bubna from SKS Cap and Research. Please go ahead.

Kaustav Bubna: I just wanted to know you know what is the potential of getting orders such as deal such as the GE India deal in the future, do we see any progress of that or is that happen through name sake you know 2 to 3 years down the deal with GE, how this had worked.

N. K. Khandelwal: I think GE kind of deal could come from Alstom.

Kaustav Bubna: Yes exactly, I am talking about that.

N. K. Khandelwal: Yes, so still the movement is very slow but we are already progressing on that.

Kaustav Bubna: So you are on talks with Alstom right and I think.

N. K. Khandelwal: Yes definitely we are in talks and there has been regular exchange of information whatever is needed but this process is slow.

Kaustav Bubna: But we should expect that in the coming years.

N. K. Khandelwal: But we definitely expect that.

Moderator: As there are no further questions, I would now like to hand the floor back to the management for closing comments over to you sir.

N R Ganti: Thank you very much for your participation. In case you may have any more queries do get in touch with us through Churchgate Partners. We will be happy to provide whatever information is needed. Thank you.

Moderator: Thank you very much sir. Ladies and gentleman on behalf of Pitti Laminations Limited that concludes this conference, thank you for joining us, you may now disconnect your lines. Thank you.

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Note: This transcript has been edited to improve readability