Earnings Conference Call

Q3FY2018

February 16, 2018

Management:

Mr. N R Ganti, Director

Mr. N. K. Khandelwal, President (Corporate Resources) and CFO

Moderator: Ladies and gentlemen, good day and welcome to the Pitti Laminations Q3 FY18 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. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded.

Joining us today on this call are Mr. N. R. Ganti – Director and Mr. Nand Kishore Khandelwal – President Corporate Resources and 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 risks and uncertainties. For a list of such considerations, please refer to the earnings presentation.

I would now like to hand the conference over to Mr. Ganti. Thank you and over to you, sir.

N. R. Ganti: Thank you. Good evening and welcome everyone to our Q3 FY18 Earnings Conference call.

I hope you had a chance to review our results presentation. It is also available on our website. I would like to start by providing an overview of the prevailing macroeconomic conditions followed by financial and operational performance during the recently concluded quarter including key highlights of our strategic and operational initiatives.

Index of industrial production growth momentum continued as it grew 7.1% in December aided by robust manufacturing output.Manufacturing output increased 8.4% year-on-year, electricity generation was up 4.4% y-o-y while mining output increased 1.2% y-o-y. Capital goods output rose 16.4% y-o-yin December, compared with 9.8% y-o-y growth in November 2017. Cumulative IIP growth for the period April-December 2017 over the corresponding period of the previous year stands at 3.7%.

Moving to our performance for the quarter, total volume declined 20% y-o-y at 3,998 metric tons (MT), domestic volume for the quarter was 3,197 MT a decline of 20% y-o-y, while export volume declined by 20.3% to 801 MT compared to the same period last year, mainly driven by production loss for about 30 working days during the shifting of Pune and Hyderabad plant 1 facilities to Aurangabad in Q3 financial year 2018. Stator frame demand increased almost twice to 175 units in Q3 FY2018 compared to 91 units in Q3 FY2017. Despite the decline in total volume, our net revenue increased marginally by 0.5% y-o-ysupported by increased capacity of machine shop in plant 4 Hyderabad.

In terms of sales mix, domestic sales accounted for 75% of the total sales and remaining 25% was contributed by exports. Domestic sales for the quarter improved by 26.3% y-o-yto Rs. 57.3 crores. Export sales for the quarter was Rs. 19.5 crores a decline of 36.6% compared to the same period last year. Our EBITDA for the quarter increased to Rs. 11.2 crores up by 20.7% on y-o-y basis driven by better operating efficiencies. EBITDA margin increased by 242 basis points to 14.5% from 12.1% in Q3 FY2017.

During the quarter our employee cost and power and fuel cost declined 9% and 6% respectively compared to the same period last year. This decline was also due to capitalization of these cost pertaining and pre operating expenses related to Aurangabad plant. Profit after tax was Rs. 2.7 crores, an increase of 4% from the same period last year with a PAT margin of 3.5%.

Further taking into consideration the overall business dynamics, we remain comfortable with our current leverage profile.As of 31st December 2017, our total debt was Rs. 203.5 crores which included Rs. 72.7 crores of long term debt and Rs. 130.8 crores of short term debt. Cash and cash equivalents for the quarter was Rs. 14.5 crores resulting in a net debt position of Rs. 189.1 crores. The net worth of the company was Rs. 121.7 crores at the end of the quarter. As of December 31st 2017 we had a conservative leverage profile with total debt to equity ratio of 1.21x. Total debt to equity ratio adjusted for quasi equity that is loan from promoters considered to be quasi equity of Rs. 46.3 crores for Q3 FY 2018.

Based on projection our long term debt expected to decline in next 2-3 years and shall be around Rs. 30 crores to Rs. 35 crores. Moreover we have received an in principle approval from stock exchanges both NSE and BSE and allotted equity shares by conversion of unsecured loan of Rs. 25.6 crores and issued share warrants for cash to the promoter group with the balance of Rs. 20 crores. The securities were issued at Rs. 90 per share including a premium of Rs. 85.

Key strategic and project updates. We have successfully started commercial production in Aurangabad plant in January 2018. The new facility is expected to contribute meaningfully the top line from Q4 FY2018 onwards. The plant is currently operating at 1,000 MT per month and is expected to reach 1,250 MT per month by end of Q4 FY2018. Furthermore our commercial production for GE India a part of Indian Railway project is running as per schedule and is expected to contribute meaningfully.

As for the business strategy, we are more focused on machining and value added business. With increased focus on domestic market and continuing to cater export market, we have very strong order book. Long standing association with customers coupled with strategically located new facility gives us the confidence that Pitti Laminations is well poised to capitalize on the upturn in the market. We would like to open the floor now for an interactive question and answer session. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session.

The first question is from the line of KaustavBubna from SKS Capital & Research. Please go ahead.

KaustavBubna: Recently wind energy player basically stated that for the coming year wind energy will be at 10 gigawatts. So I mean since we catered as an industry how does that change your outlook for lamination.

NK Khandelwal: See wind is definitely one of the important factor to which the lamination is basically going other than power generation and transportation. So we are very well-positioned in terms of supplying to wind customers whether it is Suzlon, Enercon, or Gamesa. **KaustavBubna:** You had mentioned that the bidding for the coming year would be 10 gigawatts?

NK Khandelwal: Right, so it is an addition for the wind that is a positive point for us because we had been already supplying to various customers on wind side which was actually down over the last two to three quarters.

KaustavBubna: So when do we see the demand picking up is my question?

NK Khandelwal: On the wind side, from our point of view it is still a quarter or two away. The major demand is coming from the other sector industry transportation, mining right now. So we see a gap of about two quarters for the wind to pick up.

KaustavBubna: Okay great. And so just wanted an update on the Alstom order which we were expecting, how is that going?

NK Khandelwal: Alstom order is still at the same stage as earlier told by MD that initially first two years Alstom is planning to supply from their France facilities, so they are still very slow on that. It is in the initial discussion stage and it will take still some time to come to any kind of firm order level.

KaustavBubna: And since now our Aurangabad plant is operational, could we meet our FY18 estimate set, I think we had set it Rs. 360-380 crores revenue our top line guidance right? So will we be able to meet that, I guess we would have to do about Rs. 100 crores of revenue next quarter for that?

NK Khandelwal: We will be able to meet it.

KaustavBubna: Okay and could you reiterate the guidance for the coming two years?

NK Khandelwal: Two years is actually a long time but I think still we will be able to achieve around Rs. 450-500 crores turnover in 2018-19. And 2019-20, it would be growth of about 20% further.

KaustavBubna: And how is the on ground interactions going in the consumer side like with Crompton Greaves and Havells, I understand this is a lower margin business for us but seems to be tremendous volume scope so I mean what is our plan on this consumer side the white goods providing these laminations?

NK Khandelwal: Crompton already we have started commercial supplies and it is about 3,000 MT a year at present with a potential to move up to 5,000 MT in the next year. On Havells, still we have not initiated the discussion because first we want to stabilize with one of the customers and then we move to different customers. So the potential in terms of volume is very high, but since we do not want to actually move with high volume growth in that segment as you rightly said it is a low margin product. We want to use it more as a strategic product mix for the better use of raw material.

KaustavBubna: Okay. And in terms of margins I mean how do we see this shift in plants now that everything is done positively impacting our EBITDA margins I mean any range in EBITDA margin guidance?

NK Khandelwal: We are into the same EBITDA range what we have given guidance for around 14.5% and we have been able to achieve. Earlier it used to be around 12-12.5%.

KaustavBubna: Okay sir now would not you have added benefits from this new plant or?

NK Khandelwal: Yes it will come because one of our plant has already started in August itself. So machining is a high value added products. So that is starting to generate revenue and going forward as a percentage of value added product increases in the total sales,we will see a growth in EBITDA margin and as for the guidance we are moving towards that it is already 14.5% maybe another 0.5-1% increase that will come in the coming quarters.

Moderator: Thank you. The next question is from the line of Shashank Kanodia from ICICI Securities. Please go ahead.

Shashank Kanodia: I just wanted to know what was the total CAPEX spend in this financial year and what is the outlook for next two years?

NK Khandelwal: During this financial year total CAPEX is about Rs. 128 crores and in coming two years there is no major CAPEX plan. So it will be minor debottlenecking or some of the balancing equipment which will be turning out of the regular cash generation of the company.

Shashank Kanodia: So we have already spent this Rs. 128 odd crores or we are still yet to spend some portion of it?

NK Khandelwal: Some portion is still to be done, otherwise it is completely spent.

Shashank Kanodia: Okay, where do we see a peak level of debt as of end of FY18 and is it something?

NK Khandelwal: Yes that is about Rs. 72 crores long term debt we see at the peak level.

Shashank Kanodia: Okay so in total basis do we see something in excess of Rs. 220 crores at the debt level for us?

NK Khandelwal: No.

Shashank Kanodia: But sir given the fact that we generate something like Rs. 40 crores of cash flows and Rs. 20 crores of interest payment so I think only Rs. 20 crores is what is left to us and if we consider Rs. 120 crores of incremental CAPEX then Rs. 100 crores of money you need let us say even Rs. 30 crores, Rs. 40 crores is put in by the promoters. So again mathematically you will cross Rs. 230 odd crores?

NK Khandelwal: No, you are talking about including working capital. Even if we include working capital, about Rs. 130 crores is short term and Rs. 70 crores is long term debt. That makes to Rs. 200 crores only. So even if I take some leverage of another 20 crores which is our working capital borrowing up to Rs. 150 crores then also we fit into Rs. 220 crores.

Shashank Kanodia: Okay Rs. 220 crores. Then going forward in FY2019-20 what kind of debt repayment can we see for the company?

NK Khandelwal: Debt repayment?

Shashank Kanodia: Yes given that you have already measured through all the CAPEX programs and now we will be consolidating our operations, so what kind of debt repayment do we foresee for us?

NK Khandelwal: We have about Rs. 19 crores to Rs. 20 crores annual debt repayment.

Shashank Kanodia: Okay so that will be during 2019 and 2020 right each year.

NK Khandelwal: Yes that will continue for next 2 years.We are estimating around Rs. 35 crores of debt in the year 2019-20.

Shashank Kanodia: Okay. Now sir on the volume front so what kind of volumes we will be doing in Q4 and what is the outlook for next year?

NK Khandelwal: For Q4 we are estimating about Rs. 105 crores to Rs. 110 crores turnover. And next year as I said earlier Rs. 450 crores revenue.

Shashank Kanodia: Okay and sir can you guide us for a tax rate because this quarter again we had a tax rate impact so what was these on account of and what is the tax rate guidance for us?

NK Khandelwal: Tax rate is because of the CAPEX the deferred taxation will play its role but still we are into the regular tax rate only.

Shashank Kanodia: So we will be in the 22% bracket?

NK Khandelwal: We will be in the 22% bracket.

Shashank Kanodia: Okay, because of CAPEX benefits you are saying?

NK Khandelwal: Yes.

Shashank Kanodia: Okay sir lastly what will be the depreciation in interest run rate going forward for FY19 like now we will be commissioning all the facilities incremental depreciation interest will be charged to the P & L account. So what is the run rate that we foresee for us?

NK Khandelwal: I think Shashank we will talk about EBITDA right now because that is an important number the interest and depreciation will definitely keep on changing year to year based on the CAPEX cycle and debt level.

Shashank Kanodia: That is true but given the fact since we were enjoying interest free for promoter group and now they are committing in equity right so effectively our net rate of interest will increase?

NK Khandelwal: Promoter funding anyway is without interest. So as far as absolute number is concerned that would not change.

Shashank Kanodia: Okay. What was the average cost of borrowing for us right now if you can share that number?

NK Khandelwal: Average cost of borrowing for us is about 8%.

Moderator: Thank you. The next question is from the line of Avinash Gaurav Shankar from Joindre Capital. Please go ahead.

Avinash G.: I have two questions. One is I have seen the revenue growth has been extremely strong despite the fact that you know volume growth in the fourth quarter due to production loss. So I mean going forward, is the company confident that we could see growth rates of at least 20% to 25% on annual basis? This kind of topline value growth seems to be quite strong, so basically is it going to be a combination of volume and value or are you going to concentrate more on the value added mix which is going to drive top line?

NK Khandelwal: Definitely we are focusing on the value added front, but it will be a growth on the volume and value both sides and as you said we are estimating 20% growth rate annually.

Avinash G.: Okay. And can we know what is the actual order book because I believe you all operate in the industrial products so do you have normal order book which you have a kind of plans where you can execute so typically what could be the order book as of date be like?

NK Khandelwal: See as of now we have a very strong order book at least good clarity for the next two quarters and we have explained earlier also we mostly work on the projections basis because there is no orders that are given by the customer. Once the product is developed then it is based on their projections. So for next two quarters we have a very good order visibility and for the next quarter it is about Rs. 110 crores order book.

Avinash G.: Okay. One more thing I wanted to know is that who would be the competitor for you in the domestic market like typically in your product category who could be the competitor?

NK Khandelwal: Frankly speaking under one roof there is no company who have all the four facilities of tool room, casting, lamination and machine shop. So we do not have a straight competition but there are companies who are into single segment. Machine Shop to craftsmen is there, Precision Machine is there, Precision Stamping and Kapson in lamination, in casting we have Sanmar and Ashok Iron, so it is segmental.

Avinash G.: And just one small one more question is that I saw from the presentation that some loans are going to be converted into equity so once this equity conversion takes place, what could be the post equity after the conversion be?

NK Khandelwal: Presently, our shareholder fund is about Rs. 121 crores. And Rs. 25.6 crores have got converted right now into equity shares.

Avinash G.: But what will be the equity capital that is what I want to know post conversion?

NK Khandelwal: About Rs. 38-39 crores including current conversion with share premium

Avinash G.: Okay so Rs. 39 crores will be the post equity.

NK Khandelwal: Yes. Subsequently when the share warrants get converted it will be additional Rs. 20 crores including share premium.

Avinash G.: Okay fine and correspondingly what will be the debt I mean currently total long term and short term I heard it was about Rs. 200 odd crores. So you know that debt to that extent about Rs. 25 crores gets reduced from the debt?

NK Khandelwal: No, that is Rs. 70 crores what we have told is the institutional long term debt. The promoter's debt we have been treating as a quasi equity till now.

Avinash G.: Okay fine so Rs. 70 crores will be there and the balance amount that is Rs. 130 crores will be the short term working capital debt. And just to reconfirm the equity capital after conversion is Rs. 39 crores, right.

NK Khandelwal: Yes, right.

Moderator: Thank you. The next question is from the line of Shashank Kanodia from ICICI Securities. Please go ahead.

Shashank Kanodia: On the GE front any pickup in the global scenes that we are witnessing, any renewed talks with the GE Global guys locomotives?

NK Khandelwal: Yes GE global sales has picked up quite a lot and the next two quarters visibility that I just expressed is good.

Shashank Kanodia: Because our exposure dropped to around Rs. 20 crores quarter basis so where do we see the run rate going forward?

NK Khandelwal: So GE we see around Rs. 40 crores sales per quarter going forward.

Shashank Kanodia: Okay so this is on a global basis you are saying Rs. 40 crores per quarter?

NK Khandelwal: This is on a global basis, it includes India and international.

Shashank Kanodia: Okay and in India we will be supplying Rs. 50 crores per year as per annual contract?

NK Khandelwal: Yes.

Shashank Kanodia: Okay so this is over and above the Rs. 40 odd crores, Rs. 50 crores per year in GE India locomotives?

NK Khandelwal: That is GE India locomotive if you do quarterly it comes about Rs. 13 crores, right. I am saying Rs. 40 crores so that includes the global GE also. Global plus India is Rs. 40 crores.

Shashank Kanodia: Secondly were there any new customer acquisitions in this quarter, any new segments or any new customers in the present segments that you operate?

NK Khandelwal: No, there is no new addition but as you know this traction motor we have been supplying so there is a pickup in the traction motor front which goes into locomotive and heavy vehicles so that is one. We are seeing a pickup on that side and other than that in some kind of fabrications we have started working on fabricated body machining and core drop, that is an extension of our existing activities only, but that is something new which we have started.

Shashank Kanodia: Okay and so on the present capacity of 35,000 odd MT of laminations so what is the peak utilization level that we can clock?

NK Khandelwal: We can clock at 80% efficiency. So we talk about 36,000 MT we can run at around 29,000 MT.

Shashank Kanodia: Okay, Rs. 28 – 29 Thousand MT is easily doable on that front. Okay and sir lastly if you can throw some color on the scrap prices, so what was the trend in this quarter and the corresponding YoY basis?

NK Khandelwal: The scrap prices have gone up because the raw material prices itself has gone up. So presently scrap prices are around Rs. 26- 27 which was earlier around Rs. 23-24.

Shashank Kanodia: So you expect them to sustain at this level or even go further?

NK Khandelwal: No, I think it will not go further, it is a very high level at present.

Shashank Kanodia: So this should stabilize at Rs. 26-27 a kg?

NK Khandelwal: Yes, that is a factor of the raw material price, right? If the steel price does not fall, it is correlated with that.

Shashank Kanodia: And sir, just lastly if you can just reconfirm the tax rate for us because that will substantially change the PAT numbers that we can obtain for next two years?

NK Khandelwal: Then I think I will get some more details but I really need to reconfirm.

Moderator: Thank you. The next question is from the line of KaustavBubna from SKS Capital and Research. Please go ahead.

KaustavBubna: Could you just repeat for this quarter specifically what was your domestic GE sales and then moving into FY19 every quarter how much sales do we expect from this domestic GE front? And also are there any talks of an increase in the quantum of this deal, I mean is that true?

NK Khandelwal: Actually the deal was signed with Rs. 500 crores value but during the development of the product we have already reached to around Rs. 600 crores level over ten years. So about Rs. 10 crores additional turnover per annum has already increased .

KaustavBubna: When did this increase?

NK Khandelwal| This will keep happening over the period of the contract. Suppose some additional product is required so that gets added to it.

KaustavBubna: So it is Rs. 600 crores for 10 years?

NK Khandelwal: Yes it is a 10 year project.

KaustavBubna: So that is Rs. 60 crores a year?

NK Khandelwal: Rs. 60 crores a year.

KaustavBubna: At this quarter how much sales did we do specific?

NK Khandelwal: See that supply against that agreement officially will start from April 1, 2018. But since there was some preponement so we had started similar product supplying two to three quarters earlier. So during that quarter that we have supplied to GE India is around Rs. 10 crores.

KaustavBubna: And no sir, just want to understand you are guiding for Rs. 450 crores to Rs. 500 crores revenue next year. And this year you are saying you will be able to reach Rs. 360 crores or Rs. 380 crores, right? So at Rs. 60 crores is anyways coming from this GE deal when you start so what is the size of the wind opportunity because if this wind eventually wind capacity will pick up. It is not like that market is dying.

Even if the wind players do not gain because of low rates, we will still gain because we are supplying them components. So just wanted to know out of the Rs. 450 crores how much would be through lamination sales in the wind market? I remember last time you had given a figure.

NK Khandelwal: For predicting and projecting for the wind sector is very dicey. We have been seeing over the years it is very erratic. Sometimes suddenly there is a pickup in the wind demand, sometimes suddenly the customer is out of the market. So very difficult but yes it is a segment, if it picks it will definitely add additional turnover to our projections. But presently in Rs. 450 crores we have considered about Rs. 30-35 crores.

KaustavBubna: Okay so you projected about Rs. 35 crores out of the Rs. 450 crores? But that is keeping in mind how many gigawatts implementation any idea?

NK Khandelwal: Well that is quite technical for me to answer. I will have to check with the marketing team and come back.

KaustavBubna: And how much percent of total sales is scrap?

NK Khandelwal: Normally as a thumb rule scrap is about 10% of the lamination turnover.

KaustavBubna: Okay so it is about 10%?

NK Khandelwal: Yes.

Moderator: Thank you. As there are no further questions from the participants, I now handover the floor to Mr. Ganti for his closing comments. Over to you, sir.

N. R. Ganti: Thank you everyone for their participation. For any further queries or clarifications, please do get in touch with Churchgate Partners, they will help you out. Thank you.

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

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For further information, please contact:

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Note: This transcript has been edited to improve readability