Earnings Conference Call

Q2 FY2016

November 16, 2015

Management:

Mr. N R Ganti, Director

Mr. Vijay Kumar, Executive Director and Chief Financial Officer

Moderator: Ladies and gentlemen good day and welcome to the Pitti Laminations Q2 FY2016 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 after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing a '*' then '0' on your touchtone phone. Please note that this conference is being recorded. Joining us today on this call are Mr. N R Ganti – Director and Mr. Vijay Kumar – Executive Director 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 risk and uncertainties. For a list of such considerations please refer to the earnings presentation. I now hand the conference to Mr. N R Ganti, thank you and over to you sir.

N R Ganti Thank you. Good evening and welcome everyone to our Q2 FY2016 earnings conference call. I have with me on the call today Mr. Vijay Kumar – Executive Director and 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 macro-economic scenario followed by performance of the quarter including highlights of our key strategic and operational performance. We will then open the call for an interactive Q&A session.

India's Index of Industrial Production (IIP) grew by 4% in the first half of FY2015 compared to a growth of 2.9% in the same period last year. The growth in IIP was driven by robust 4.2% growth in manufacturing which has around 75% weight in the IIP Index. Mining output in H1 FY2016 remained soft with growth of 1.5%, while electricity generation increased 4.5% during the same period. Capital Goods index registered strong performance for the third consecutive month with a growth of 10.6%, 21.4% and 10.5% in July, August and September respectively. Year to date growth of capital goods sector was 7.9% which is an early indicator that government spending is beginning to fructify. Inventory built up ahead of the festive season in October-November provided a sequential boost to output of manufactured goods.

Supported by favourable industry trends we recorded a total volume growth of 3.9% to 4,737 metric tons compared to same period last year. Our domestic volumes continued its steady pace, while expert volumes experienced some softness. Domestic volume for the quarter was 3,440 metric tons, an increase of 13.1% year on year. This robust growth was a result of improvement in the overall economic activity in India. Our export volume declined by 14.4% to 1,298 metric tons compared to the same period last year. This decline was primarily due to reduction in sale of stator frames. However it is expected to recover in the second half of the fiscal year. Driven by the growth in volume, our revenue for the quarter increased by 8.9% year on year to Rs. 781 million. Of the total sales, domestic sales accounted for 55% of the total sales and remaining 45% was contributed by exports. Domestic sales for the quarter increased by 5.9% year on year to Rs. 428 million, while export sales for the quarter was Rs. 350 million an increase of 14.1% compared to the same period last year. The other operating income accounted for Rs. 4 million. Our EBITDA for the quarter was Rs. 32 million, a decline of 60.9% compared to Q2 FY2015. EBITDA is defined as profit from ordinary activities before finance cost, depreciation exceptional items and includes foreign exchange loss or gains. EBITDA margin for the quarter was 4.1% compared to 11.4% for the same period last year. The company has reported a net loss of Rs. 28 million for the quarter compared to PAT of Rs. 10 million the same period last year. Profitability during the quarter impacted to due to combination of higher raw material cost, significant decline in the prices of scrap, unfavourable foreign exchange variations and also due to the withdrawal of certain incentives for exports to the USA and Europe.

As per the export policy of 2015-16 one of the export incentives of MEIS was withdrawn for exports to USA and Europe. The same has been reintroduced with effect from 29th October, 2015, the benefits of which will be available for the remaining part of the fiscal year.

Moving to our leverage profile we are comfortable with our current capital structure. As of 30th September, 2015 our total debt was Rs. 1,657 million which included Rs. 361 million of long-term debt and Rs. 1,296 millions of short term debt. Cash and cash equivalents for the quarter was Rs. 165 million resulting in a net debt position of Rs. 1,492 million. The net worth of the company was Rs. 1,160 million at the end of the quarter. As of September 30th, 2015 we had a conservative leverage profile with total debt to equity ratio of 1.4x and net debt to LTM EBITDA of 3.8x.

Traditionally first half of the fiscal year is relatively slower for us compared to the second half due to the prevailing seasonality in our industry. We expect the same trend to continue during this year as well. Our order book continues to remain robust, which gives us the visibility for a strong performance for a medium term. Furthermore, the recent economic data experienced some early signs of recovery during last few months and we expect to benefit from this trend. We also believe that the various initiatives undertaken by the government to boost Indian economy coupled with a focus on infrastructure development will drive the performance of our company in the long run. Now we would like to open the call for question and answer sessions. Thank you.

Moderator Thank you. Ladies & gentlemen, we will now begin with the question and answer session. The first question is from the line of Ritesh Mistry from Moneybee Advisors. Please go ahead.

Ritesh Mistry Sir I have a question regarding inventory. Could you provide me that bifurcation of inventory like raw material, work in progress and finished goods?

N R Ganti Yes, we will do that. I will request my colleague Mr. Vijay to give you specific details. Broadly it is about 2 months of raw material and 15 days of semi-finished goods and 15 days of finished goods. That is the usual rule of thumb inventory.

Vijay Kumar Our raw material inventory is around Rs. 39 crores, work in progress around Rs. 27 crores, finished goods Rs. 46 crores and other stores, scrap and all put together Rs. 17 crores.

Ritesh Mistry Regarding finished goods, any order postponement or delays because you have Rs. 46 crores inventory in the finished goods?

Vijay Kumar Little bit delay is there. Those finished goods will be dispatched in November & December.

Ritesh Mistry Can you provide details regarding the Stator frames order breakup.

Vijay Kumar We are discussing with customers. Clarity will emerge in a month's time. As on date we are discussing with customers.

Ritesh Mistry Sir regarding export order, can we match last year's export quantity?

Vijay Kumar We are expecting, hope so.

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

Shashank Kanodia Just a couple of questions. First on the EBITDA margin front, can you please explain us the reasons for such a steep fall in EBITDA margins for this quarter?

Vijay Kumar Raw material costs & scrap prices have been fallen down you know that.

Shashank Kanodia But sir raw material is supposed to be entire pass through for us, right.

Vijay Kumar Correct. There is a pass through but whereas we are carrying 90 days of raw material. We ought to keep at least 2 to 3 months raw materials with us. So naturally we have to pass through, whereas there were old raw materials, those raw material we need to consume.

Shashank Kanodia Sir that is true but you mentioned that your contracts are such a pace that the entire raw material either the benefits or increase or the drop in raw material price is entirely passed through.

N R Ganti Exactly! our sale price was tagged to current raw material prices where as our purchase price was far higher**.** You need to carry certain amount of inventory and you have to manufacture so there will be some semi-finished goods and there will be some finished goods. So as per the accounting standards you have to value all this entire inventory at either the current market price or the invoice price, whichever is lower So that is one issue that has definitely impacted us. The raw material prices fell steeply. We expect the prices to stabilise and normalcy gets restored.

Shashank Kanodia Is there any risk mutation that we are undertaking to arrest this fall in raw material cost, so that is passed through the customers?

Vijay Kumar As Ganti sir explained, we are carrying 90 days inventory in raw material form and WIP form, whereas this quarter suddenly the raw material prices have fall down, we have to pass it through. But we consumed the high cost material, which we purchased 2 to 3 months back.

Shashank Kanodia So you are saying that there was some inventory write down, right, in this quarter as on the balance sheet date 30th September?

Vijay Kumar There is no write down of an inventory. Inventory prices have fallen down more than 25-30% continuously for last 4 months.

Shashank Kanodia And sir what is the situation on the scrap prices?

Vijay Kumar Scrap prices have also fallen down very steeply.

Shashank Kanodia So on quarter on quarter basis what was the fall?

Vijay Kumar Quarter on quarter basis if you see last three quarters it was overall 35-40% fall-down is there. Each quarter minimum 10-12% price fall is there in scrap.

Shashank Kanodia Last quarter was 12% and last three quarters 35% to 40%.

Vijay Kumar Yes, if you see last three quarters there is more than 35% fall-down in scrap prices.

Shashank Kanodia What is your guidance for long-term margins for the company given that we already are in a declining cycle of commodity prices, let say scrap prices fall further. So what is your outlook for the second half?

N R Ganti I think we need to go back to our drawing board and relook at it because we are assuming that this will stabilize sooner than later. Scrap prices are basically a function of two things. One is of course the raw material prices. If it stops falling further then scrap prices also will not start deteriorating. Prices will not fall down. Second thing is of course the availability of iron ore. Now iron ore prices were coming down significantly. Iron ore can be used as substitute in the place of scrap. Then may be a little reduction in usage of scrap on account of this and therefore prices may fall down. We are not very clear as to how that is going to pan out. But if they continue to be significantly lower, then we may need to go back to our customers and renegotiate the selling price. As of now we are seeing it as a temporary aberration and hopefully it would settle soon.

Shashank Kanodia Because last quarter there was a drop in 100-200 basis points of margin but this quarter is roughly at 600 basis points. So even if we do the similar profile in the second half we do not see your PAT level exceeding the 15 numbers.

N R Ganti Q1 to Q2 has a significant fall mainly on account significant drop in export sales. GE is taking stock and reworking on their inventory levels and they have pushed some of these orders to the next quarter. So we expect that once they fix that and exports pick up as we expect the margins to be better.

Shashank Kanodia How things are shaping on the export front for this quarter since we are already around 1.5 months down the line?

Vijay Kumar We are expecting that exports will pick up by December onwards.

Shashank Kanodia But sir H2 FY16 can we make for the loss in exports and the profitability?

N R Ganti That will be the aim, but how far we succeed depends on how quickly raw materials get back to normalcy because even this quarter we may have little bit of overhang.

Shashank Kanodia And sir you have talked about that export incentives have been reinstated as of 29th of October, right. So 2% of the exports value will be begin, right.

N R Ganti Unfortunately it is not retrospective. It is effective only from October 29th. So all the exports subsequent to that date only will be eligible for that.

Shashank Kanodia And sir recently there was a news item wherein GE is supposedly setting up a locomotive factory in India in Bihar. So in that front are we aggressively pushing ourselves for some major components to be manufactured at this facility or is there any progress or talks that has been initiated with GE?

Vijay Kumar Yes, we are going to supply to them but they have just got the tender, even GE and Alstom also. They needed at least 1.5-2 years to establish their manufacturing facility in India. Post that we will supply to them, we are already their approved vendor.

Shashank Kanodia And sir how was the situation of working capital front? Did it deteriorate in the first half?

Vijay Kumar As agreed working capital is under control.

Shashank Kanodia And sir what is the net working capital for us as of date?

Vijay Kumar Rs. 129 crores.

Shashank Kanodia And sir what is the progress on the Rs. 1,000 crores of top-line mark for 2018 to have a long term vision?

Vijay Kumar We will rework and come back on it.

Moderator The next question is from the line of Anand Jhawar from JM Financial. Please go ahead.

AnandJhawar Most of the questions have been asked by our previous participants, however one thing, I just want some more clarity. So you are suggesting that the raw material prices which have obviously collapsed has negatively impacted the previous quarter and till the time it does not stabilize we cannot expect the EBITDA margins to pick up because obviously it has taken a huge knock which has taken everybody by surprise I would say. So couple of just quick points I would like to make and then probably you can give your view on that. So obviously we are overly dependent on GE from the export side and the moment GE decides to defer their inventory or take stock of their inventory our exports get a hit. So how is management trying to diversify the export bit from GE because the expectation was that once we have GE as a long term customer it would be rather easier to get some of the other big boys into the customer portfolio which has not kind of happened in the past two years and from the domestic point of view obviously the sales have gone up and just wanted to get your sense that there are only few green shoots in the economy up till now, may be defence and road, construction and renewable energy, very few of them. So anything in particular that Pitti is focusing to capture because investment cycle has clearly not picked as of now, so any change of strategy on that front if you could highlight?

Vijay Kumar In Renewable energy sector– wind power sector companies we are already supplying. In Wind power we are supplying to Regen Power.

AnandJhawar There was a Suzlon if I recollect -

Vijay Kumar We are supplying to Suzlon also.

AnandJhawar So any alignment because government is obviously pushing towards these few sectors more than others if I could put it like that, so are we realigning our strategy because the economy is obviously sluggish and it is only one quarter, two quarters away from real pickup but that seems to have not being played out.

N R Ganti As you know we do not directly supply to any of these huge infrastructure companies. We only supply to all the motor manufacturing companies and these are all well-structured and quite adept at reading the market. Actually we go by their reading and then we try and meet their expectation. So all of them are completely geared up to meet as economy opens up to whatever opportunities that emerge. Wherever the electrical motors are required, whether it is for fixed projects or whether it is for industrial motors, so all these large motor manufacturing companies are very much present and are quite aligned to all the opportunities. Because we are already supplying to all of these companies we expect that we get our share of the business and in fact we are trying to get little more of the pie compared to our competitors by offering various kinds of value-added services to them as we have been repeatedly mentioning to you. So coming to your overly dependence on GE and once they decide to go slow on their purchases then how are we going to mitigate that kind of eventuality that was the question, right? So basically we do see GE as a multiple entities and not just one individual company. GE has several subsidiary companies which cater to different segments. So while of course it is one big umbrella called GE but internally we think there are several smaller companies. So we are not unduly worried about some orders getting slightly postponed or deferred. They are all expected to come back.

AnandJhawar One final question, I remember some of couple of quarters back, the management indicated that we are shifting towards a bit towards the retail side. Has that come across?

N R Ganti No, not yet, that has been deferred for a while It is there on the cards but it is not imminent.

AnandJhawar And the Pune advantage has played out in the numbers. There is not nothing upside from the cost benefit point of view like the plants were shifted to Pune there was some benefits that one were to expect from the supplier-vendor side. All that has played out and nothing more can be expected from that front?

N R Ganti No, it might because the Pune plant for instance is only operating at around 400 to 450 a tons a month at this point in time, whereas it is expected to grow up to 900 to 1,000 tons. What we expect is rationalization of transport cost, taxation and being closer to our customers, that stickiness factor and all of that which would add some additional volumes to us. So that was the whole plan. Basically that is getting played out. Some of the customers are yet to give their approval for the new manufacturing facility so hopefully and in the next quarter or two we should reach optimum production there and then we will see some benefits coming in.

AnandJhawar So right now what would be the operating capacity percentage wise?

N R Ganti Around 50%.

AnandJhawar And Hyderabad also?

N R Ganti Yes

AnandJhawar Just the second half obviously as you rightly mentioned, second half should be better.

N R Ganti It has been like that for several years as we recall.

Moderator The next question is from the line of Rahul Koli from India Nivesh. Please go ahead.

Rahul Koli Sir my question was regarding the inventory, you have mentioned in your presentation that because you have used the past inventory that is why the operating margins have fallen. But if I see the inventory levels, it has actually increased in the balance sheet. So can you explain that?

Vijay Kumar We are continuously buying the raw material. Inventory consists of RM, WIP and finished goods. We carry normally 2 to 3 months inventory. We cannot make it zero.

Rahul Koli So currently whatever inventory level which we are having is at lower prices.

Vijay Kumar These are of two types. One is 2-3 months back inventory is costlier than existing one because of steep fall in prices suddenly in last 2-3 months. The valuation of the existing inventory at latest market price – both are impacting the valuation.

Rahul Koli And sir about this order book that you have mentioned earlier that you have about Rs. 600 crores of order book out of which about Rs. 200 crores is already executed. So what is the current order book from the GE we have right now which is still to get executed?

Vijay Kumar GE has signed for a 3-year contract. And overall order book we have mentioned is Rs. 600 crores. A little bit deferment is there. So we will get a clarity soon.

Rahul Koli But how much is still to be executed from that? Like from Rs. 600 crores I think you have executed Rs. 200 crores or more of orders by end of 2015 itself. What is remaining right now?

Vijay Kumar Remaining are next two financial years also. As such this is included for three calendar years.

Rahul Koli So Rs. 400 crores would be a safe number to assume or less than that? But it is out of firm order book, right?

Vijay Kumar Yes. Next 2.5 years it is there actually.

Rahul Koli And will it be safe to say that because of the export volume has fallen so that is the reason your overall realizations are not as high as what was in the earlier quarters so that is the reason the total fall in the operating margins, will it be safe to say?

N R Ganti That is only one component of it. It is on account of other causes as well. The sudden fall in raw material prices which we could not adjust to the sale price and fall of scrap price, unfavourable foreign exchange fluctuation and removal of the export incentives.

Vijay Kumar If you compare Q2 of last year, actually exports eventually increased, while compared to Q1 reduction of around 20%. Actual reason was what Ganti Sir has just said one is steep fall in raw material prices fall, scrap prices fall, and withdrawal of export incentive and FOREX loss.

Rahul Koli So this export sales increase will be mainly because of the foreign exchange gain, even though the export volume has fallen you said that your sales have increased. So this will be mainly on account of foreign exchange?

N R Ganti No. Increase in export sales is a function of higher volumes and also dollar rupee parity.

Rahul Koli I am comparing on YoY basis. YoY basis your volume has fallen but the sales has increased, right, compared to Q2 FY15.

Vijay Kumar In that FOREX price increase impact also there.

Rahul Koli Any word from the GE side when you will again start getting orders from them?

Vijay Kumar We are getting orders now. We are supplying from November onwards. Slowly the volume will increase. Once their inventory correction is over they will increase the volume.

Rahul Koli So like in this Q3 quarters whether they have started taking orders from you?

Vijay Kumar Yes.

Rahul Koli Q3 itself I am saying.

Vijay Kumar Yes, Q3 itself end November we will start reasonable amount of exports.

Rahul Koli So you are expecting in Q3 export volume to rise in Q3 FY15 may I say that?

Vijay Kumar That we have to work out and come back.

Moderator We have a follow-up question from the line of Shashank Kanodia from ICICI Securities. Please go ahead.

Shashank Kanodia On the order book front, on the same pattern like the firm order book that we have with GE, on the domestic front do we have any firm orders?

Vijay Kumar Domestic front we are always producing based on the trend only. Every month in advance they will give us orders.

Shashank Kanodia Okay, and have we added any new customers domestically?

Vijay Kumar Recently we have not added any. With this wind power, Suzlon we started again, Regen we are supplying already since 2 years. And the TDPS is already included. Existing customers we are supplying value-added products to them.

Shashank Kanodia And sir lastly there was an increase in employee cost in this quarter given that the subdued sales. So any specific reason? Was it something specific to the Pune plant or something?

Vijay Kumar Employee cost, most of it is contact labour, housekeeping and we have to increase minimum wages due to government is increasing the minimum wage every year twice. So those impacts also there compared to last year. Every

February and September Govt will increase minimum wages and we need to follow the norms.

Moderator As there are no further questions, I would like to hand the floor over to Mr. N R Ganti for closing comments.

N R Ganti Thank you ladies and gentlemen for participating in today's call. We hope we have answered all your questions. Any further clarification you need, please do not hesitate to get back to us through email or through Churchgate Partners.

Moderator On behalf of Pitti Laminations that concludes this conference. Thank you for joining us and you may now disconnect your lines.

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For further information, please contact:

GVSN Kumar, Executive Director &CFO *Pitti Laminations*	vijay.kumar@pittilam.com *+91 40 2331 2774*
Bijay Sharma *Churchgate Partners*	pittilam@churchgatepartnersindia.com *+91 22 6169 5988*

Note: This transcript has been edited to improve readability