PITTI ENGINEERING SOLUTIONS

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Earnings Conference Call

Q1 FY2015

August 20, 2014

Management:

Mr. N R Ganti, Director

Mr. Vijay Kumar, Executive Director & CFO

Moderator: Ladies and gentlemen, good day and welcome to the Pitti Laminations Q1 FY2015 Earnings Conference Call. As a remainder, 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 the 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 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 Q1 FY2015 earnings conference call. I have with me on the call today, Mr. Vijay Kumar – Executive Director and CFO. The earnings call this time was delayed due to a long holiday period. 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 this quarter's financials followed by highlights of our key strategic and operational performance. We will then open the call for an interactive Q&A session.

The Indian economy experienced some positive signs of improvement driven by increased industrial activity. The index of industrial production grew by 3.4% and 4.7% respectively in April and May 2014. This was primarily driven by strong recovery in the manufacturing sector and was supported by improvement in the mining sector. Steady growth in the electricity sector also contributed to the overall growth. The performance of capital goods sector also remained strong during the period with growth rates of 14.3% and 4.5% in the month of April and May, respectively.

We continued our growth momentum built at end of last fiscal year and recorded a volume growth of 30.6% year-on-year to reach 4,884 metric tonnes during the quarter. The strong volume growth was primarily driven by recovery of the export business. Of the total volumes, domestic volumes accounted for 3,400 metric tonnes representing a growth of 38.6% year-on-year and remaining 1,484 metric tonnes was exports with 15.3% growth compared to the same period last year.

Our revenue for the quarter stood at Rs. 720 million indicating an increase of 12.8% y-o-y. This robust performance was driven by strong volume growth. Domestic sales for the quarter reached Rs. 433 million with an increase of 32.2% compared to Q1 FY2014. Exports sales increased by 7.5% year-on-year to Rs. 280 million. Exports sales for the quarter included the impact of significant decline in the sale of stator frames due to temporary postponement of orders by some of our clients. However based on our current order book, management is confident about the recovery in the sale of stator frames during the second half of the fiscal year.

EBITDA for the quarter included the impact of temporary postponement of orders for stator frames. As a result, it declined by 28.6% compared to same period last year to Rs. 70 million. The EBITDA margin for the quarter was 9.7%. We expect EBITDA to improve in the latter half of the fiscal year.

Financial expenses for the quarter declined by around 6% compared to same period last year to Rs. 25 million. The improvement was due to repayment of our debt coupled with better working capital management. Our Q1 FY2015 PAT increased by 20.9% compared to Q1 FY2014 to Rs. 8 million. The improvement in PAT was driven by favourable foreign exchange variations. The profitability for the quarter was offset to a certain extent due to higher depreciation charges on account of implementation of the new Companies Act.

We are very comfortable with our current capital structure. As of 30th June 2014, our total debt was Rs. 1,011 million and cash and cash equivalents of Rs. 117 million resulting in a net debt position of Rs. 894 million. Our net debt declined significantly due to repayment of debt and better cash conversion cycle. The net worth of the company was Rs. 1,120 million at the end of quarter. As of June 30th, 2014, we had a conservative leverage profile with Total Debt to equity ratio of 0.98x.

We are pleased that we started the new financial year with strong volume growth, primarily export volumes. With improvement in industrial activity in the economy and resulting demand scenario, management has decided to strategically shift some of its manufacturing capacity to Pune. We are also pleased to announce that our plant will formally be commissioned on 22nd August 2014 and we expect to commence full-fledged supplies to our customers in the coming 3-4 months. This shift will help us to reduce our cost significantly by being closer to the customers as well as supplier. Furthermore, it will enable us to enjoy preferred vendor status with our customers by servicing them in a more time efficient manner. Current order book provides us the confidence to continue this growth trajectory with better profitability. Our focus for the year would be to improve our margins along with strong revenue growth. We are also pleased to announce that three-year long term supply contract for Laminations has been finalized with GE providing us with more visibility of our exports. We would now like to open the call for Q&A session. Thank you.

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Amitabh Sonthalia from SKS Capital. Please go ahead.

Amitabh Sonthalia: Just wanted few numbers like what is the current order book position and you can bifurcate between domestic and exports on volume side?

Vijay Kumar: For the year?

Amitabh Sonthalia: Yes.

Vijay Kumar: For the year, it is 65% domestic volume and 35% export volumes.

Amitabh Sonthalia: And can you quantify that like what is the volume order book currently it is booked as of now?

Vijay Kumar: As on date, we are expecting 20,000 tonnes per annum.

Amitabh Sonthalia: And what would be the CAPEX number FY2015 and FY2016?

Vijay Kumar: Rs. 8-9 Crores.

Amitabh Sonthalia: And sir as you have mentioned that you are shifting your base to Pune and it will take 3-4 months' time to basically get back to the current standing. Is my understanding correct?

N.R. Ganti: Yes, that gets commissioned on 22nd August. It will have some trial runs and it will take a while for it to commence full-fledged supplies. We will start parallel production in Pune from year end.

Amitabh Sonthalia: And any impact because of this on the production and sales for the quarter may be like 15 days production might be hampered?

N.R. Ganti: Not really. Plan is such a way that there is no discontinuity of supplies to our customers.

Amitabh Sonthalia: And sir, on margin front on a Y-o-Y basis we have seen a sharp decline in EBITDA margin from 15 to almost 10%, 500 bps decline, what is the outlook going forward and for full year guidance if you can on margin front?

Vijay Kumar: As mentioned in the opening remarks, some of the high contribution products of the stator frames sale declined this quarter substantially and were deferred to the second half of the financial year. Because of that, the EBITDA margins declined and PBT slipped because of high depreciation rate as per the new Companies Act.

Amitabh Sonthalia: Okay, so what is the margin profile in that particular segment like you mentioned that it got deferred and second half you will see the ramp up in the sales from that particular product. So what will be the margin profile of this particular product stator frames?

Vijay Kumar: We do not provide such information, but compared to other products it is a high contribution product.

Amitabh Sonthalia: And what is the contribution of stator frames in FY2014 as a percentage of sales?

Vijay Kumar: Around Rs. 20 Crores for the year.

Amitabh Sonthalia: In FY2014?

Vijay Kumar: Yes. Particularly in the Q1 FY2014, the stator frames sales were very high. The first quarter of FY2014 stator frames sales was 193 units whereas in current year first quarter it was only 5 units.

Amitabh Sonthalia: And can you just explain the long term tie-up. You at the end of the commentary mentioned about the tie-up with the GE. Can you just explain more about it?

N.R. Ganti: They have indicated their requirement for the next three calendar years beginning January 2015. So that has been finalized. That provides us some definite visibility for export volumes. The arrangement is expected to be formalised shortly.

Amitabh Sonthalia: Any volume guidance we have like any contractual binding for the volume offtake?

N.R. Ganti: Yes it is likely to be 5,000-7,000 tonnes.

Amitabh Sonthalia: Okay sir and one last thing about like any guidance for FY2015 and FY2016 on what is the sales growth and margin?

N.R. Ganti: Not in rupee numbers, but as my colleague, Vijay, was telling, it would be around 20,000 to 22,000 tonnes for the entire year.

Amitabh Sonthalia: And margins will be somewhat improve?

N.R. Ganti: Yes. we expect margins to be better.

Vijay Kumar: Normally the second quarter is little bit dull because of the monsoon season. Third quarter onwards, our volumes will increase substantially and margins also will improve.

Moderator: Thank you. The next question is from the line of Ritesh Mistry from MoneyBee Advisors. Please go ahead.

Ritesh Mistry: Sir, I would like to know more about the facility that we are shifting to Pune. What would be the cost we want to incur on this particular, shifting the plant from currently to Pune because that we have to build up facility, right?

Vijay Kumar: No, we have not built-up any facility. We have taken a premise on lease basis and after testing the water for couple of years, we thought we can go for the construction of own plant. We are shifting some of the existing facilities from Hyderabad to there. We thought we can be close to the customers. Majority of the domestic customers are coming from Maharashtra only and raw material supply also comes from Maharashtra. So the facility would be in 100 KM radius, enabling us to reduce time lag in raw material procurement as well as supplying to customers. The proximity is expected to result in increase in the volumes and better customer service.

N.R. Ganti: There is no capital cost as of now. Not much really except for moving the machines and erecting them there. Other than that, there is no other cost.

Moderator: Thank you. The next question is from the line of Bhavya Gandhi from CIMB. Please go ahead.

Bhavya Gandhi: Basically as you have stated that our guidance for 20,000-22,000 tonnes for this year. I think earlier we have stated somewhere at 24,000 tonnes for this year.

N.R. Ganti: In view of the prevailing domestic and international markets, the guidance was revised.

Bhavya Gandhi: And what is it pertaining to exports?

Vijay Kumar: 5,000 to 7,000 MTs.

Bhavya Gandhi: And to just understanding more on the transfer of a plant to Pune. Does it give a bit of better operating margins?

N.R. Ganti: Yes, it does. It reduces lot of transport cost and some taxation.

Bhavya Gandhi: So in terms of EBITDA, what is the betterment or how much capacity we are building it over there?

Vijay Kumar: We are planning a capacity of around 12,000 tonnes per annum there and the commercial sales will start in next three months. The benefits from this shifting would be visible in the Q4 FY2015 results. .

Bhavya Gandhi: So Q4 will see the impact of that that is what you are saying.

N.R. Ganti: That is correct. The impact will more visible in Q4 FY2015.

Bhavya Gandhi: And how about our large export customers, how the demand from their end is?

Vijay Kumar: As mentioned by Ganti Sir, we are in the process of signing three years long term agreement starting from 2015 January. That gives a minimum volume guarantee of 5,000-7,000 metric tonnes. So that will give some comfort to our topline.

Bhavya Gandhi: For three years?

Vijay Kumar: Initially they have signed for three calendar years. So, after two years again they will start the discussion and will sign for another three calendar years.

Bhavya Gandhi: The contribution is fixed in absolute terms right?

N.R. Ganti: Yes, that is right. Basically it is also price and volume agreement including factors such as forex volatility, raw material costs, etc. It is a very complex arrangement wherein we protect our margins.

Bhavya Gandhi: And one more thing the sequential increase in depreciation is predominantly because of the new Companies Act.

N.R. Ganti: New Companies Act has now reduced the life of most of the machineries with effect from 1st April 2014.

Moderator: The next question is from the line of Sabyasachi Paul from Kredent Research. Please go ahead.

Sabyasachi Paul: Sir just one thing. This Pune plant that you are coming up with, it is on lease basis right?

N.R. Ganti: Yes.

Sabyasachi Paul: So what is the kind of money that you are paying, will it affect your margins to that extent?

N.R. Ganti: Not really. **The additional costs are more than offset by savings in transport and other costs.**

Sabyasachi Paul: Correct, that is what I am saying. So it would affect the operating margins to that extent.

N.R. Ganti: We do not expect it to impact profit margins because of the additional lease cost, as explained earlier. We expect that the shift actually provides us with more cost efficiency brought about by lower transport and other savings.

Sabyasachi Paul: Once your Hyderabad capacity is idle, obviously there would be some fixed costs at your Hyderabad plant also.

N.R. Ganti: No, capacity would not be idle because part of the capacity is getting shifted to Pune.

Sabyasachi Paul: No, in terms of the manpower?

N.R. Ganti: Same with manpower.

Sabyasachi Paul: Manpower, everything shifted to Pune.

N.R. Ganti: We have taken a dry lease of the premises there. We are moving our equipments and people.

Moderator: Thank you. We have the follow on from the line of Bhavya Gandhi. Please go ahead.

Bhavya Gandhi: Sir what is our CAPEX plan for the year?

Vijay Kumar: Around 8 to 9 Crores. This year it is not much.

Bhavya Gandhi: And post our Pune, our capacity will be like in Hyderabad it would be around 20,000 tonnes.

N.R. Ganti: Yes, 20,000-22,000 MT Hyderabad.

Bhavya Gandhi: And Pune would be 12,000 MT?

N.R. Ganti: Around 12,000 MT.

Moderator: Ladies and gentlemen 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