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Earnings Conference Call

Q4 and Full Year FY2017

May 19, 2017

Management:

Mr. Akshay S Pitti – Vice Chairman and Managing Director

Mr. N R Ganti, Director

Mr. N. K. Khandelwal, Chief Financial Officer

Moderator: Good day, ladies and gentlemen and welcome to Pitti Laminations Q4 and Full Year 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 after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. Joining us today on this call are, Mr. Akshay S Pitti – Vice Chairman and MD, Mr. N R Ganti –Director and Mr. Nand Kishore 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 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 Q4 and FY2017 Earnings Conference Call. I have with me on the call today, Mr. Akshay S Pitti – Vice Chairman and MD and 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 our key strategic and operational performance. We will then open the call for an interactive Q &A session.

During FY2017, index of industrial production rose by 5%, while the capital goods sector rose by 3% on Y-o-Y basis. Overall, we are expecting that industrial activity will experience expansion in FY2018 owing to improvement in demand across various segments. Increased government expenditure with improvement in private sector investment will give an impetus to the industrial sector.

Moving to our performance for the quarter, we recorded a volume growth of 1.2% to 4,946 metric tonnes (MT) compared to the same period last year. This growth was driven by robust performance of domestic business and start of commercial delivery to GE India for Indian Railway Project. Domestic volume for the quarter was 4,347 MT, an increase of 20.2% Y-o-Y. However, export volume declined by 52.9% to 599 MT compared to the same period last year. Demand for our stator frames also experienced robust growth with 290 units in Q4 FY2017.

As a result of the growth in domestic volume coupled with better price realization, our revenue for the quarter increased by 9.6% Y-o-Y to Rs. 842 million. Of the total sales, domestic sales accounted for 74% of the total sales and remaining 26% was contributed by exports. Domestic sales for the quarter improved by 50.8% Y-o-Y to Rs. 615 million. Export sales for the quarter was Rs. 220 million, a decline of 37.2% compared to the same period last year. The other operating income accounted to Rs. 7 million.

Our EBITDA for the quarter almost trebled to Rs. 105 million compared to Rs. 37 million in Q4 FY2016. EBITDA margin for the quarter was 12.4%, indicating an improvement of 755 basis points compared to same period last year. Improvement in profitability for the quarter was primarily driven by better product mix resulting in improved price realization of the domestic business, reduction in employee cost and significant improvement in operational efficiency. 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. 16 million compared to a loss of Rs. 43 million in same period last year. PAT margin for the quarter was 1.9%.

Moving to our leverage profile, we are very comfortable with our current capital structure. As of 31st March 2017, our total debt was Rs. 1,795 million which included Rs. 577 million of long-term debt and Rs. 1,218 million of short-term debt. Cash and cash equivalents for the quarter was Rs. 110 million resulting in a net debt position of Rs. 1,685 million. The net worth of the company was Rs. 1,133 million at the end of the quarter. As of March 31st, 2017 we had a conservative leverage profile with total debt to equity ratio of 1.6x and net debt to LTM EBITDA of 4.4x.

We would like to highlight that we have started commercial delivery to GE India for Indian Railway project during Q4 FY2017, which is one year ahead of the expected schedule. Moreover, we are expecting contributions from this business to increase further in next fiscal year. Our plan of the setting up of plant 4 at Hyderabad for machining of castings for GE Locomotives, Gamesa and Siemens orders is going as per schedule and we are looking forward for commencement of production by Q1 FY2018. As mentioned earlier, we are also in the process of shifting Pune operations to Aurangabad and expect to start operations from H1 FY2018. Furthermore, with the view to further enhance the operational efficiency the company is also undertaking modernization and technology up-gradation initiative across its facilities.

Our business outlook for the next fiscal year is positive and we are expecting to continue the growth momentum. Our order book continues 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 gentlemen, we will now begin the question and answer session. We have the first question from the line of Kaustav Bubna from SKS Capital. Please go ahead.

Kaustav Bubna: Margin profile for this quarter was a little lower than expectations, which is below 10%. What was the reason for that?

Akshay S. Pitti: The EBITDA margin for Q4 FY2017 was 12.4% and 13.2% for FY2017.

Kaustav Bubna: So, moving into next year, do we maintain our guidance for 13-15% EBITDA margin?

Akshay S. Pitti: Yes, around 13% for next year.

Kaustav Bubna: And also, you are saying that your GE orders have already started, so I do not know if I remember right but you were saying about any incremental Rs. 50 crores of revenue a year from GE India, so should we start expecting that in FY18 and itself?

Akshay S. Pitti: From the second half of FY18.

Kaustav Bubna: Second quarter?

Akshay S. Pitti: It has already started in last quarter for some quantities, it will ramp up to the full level by October.

Kaustav Bubna: And how come it was so quick because you were expecting it to start one year later, so what fundamentally change, that the orders started?

Akshay S. Pitti: I think you have to ask GE about that because they are in more control of that than we are.

Kaustav Bubna: And similar orders like you got from GE, I do not know what the company's name, was Alstom?

Akshay S. Pitti: Yes, Alstom was the target company but they are currently progressing slow on their bid process. So, it will take some more time for Alstom to come in, like you rightly observed GE has moved very fast and has preponed their orders, Alstom has still sticking to their original timeline. So, we should see some development on that next year.

Kaustav Bubna: Should we be expecting a similar type of deal as we got with GE?

Akshay S. Pitti: It will not as lucrative as the GE deal because the GE deal was for electric diesel locomotive, whereas the Alstom deal is for electric locomotives. So the total quantum of material that goes into the Alstom locomotive is less than GE.

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

Shashank Kanodia: Sir, just talking specifically over the quarter, so this quarter there was a compression in the gross margin for us, so just wanted to know was there any high cost inventory that was available or what are the reason for compression in gross margins?

Akshay S. Pitti: Basically, couple of factors like we have started recruiting people for our Aurangabad facility and the expanded facility in Hyderabad coupled with a higher skew of business towards the domestic sector. So, these factors together has caused that. We have not started producing at the higher level of the new facilities because they are still in commencement phase and we have to start recruiting for people in advance, so employee cost, travel, etc. Those incidental costs have already start incurring which would mostly be like pre-operative expenses in case of a new company.

Shashank Kanodia: So, sir now this year we ended by around 19,000 MT of laminations, right? So, what are you targeting for next year and what is your breakup in terms of domestics and exports?

Akshay S. Pitti: Next year we are targeting 22,000 MT of lamination sales. 18,000 MT for domestic and 4,000 MT for exports. The reason for lower exports target is predominantly because the GE India business would start and our supply to US would get diverted to their local facilities here.

Shashank Kanodia: But sir is it of that high value added products which we supplied to GE Locomotives US and something?

Akshay S. Pitti: It is the exact same product. Today we are exporting it, more of will be selling it in India. One of the reasons for lower exports this year because GE India facility has started in advance of their expectations and some of the products that was supposed to be direct export for us got shifted to the domestic facility.

Shashank Kanodia: Sir, at the start of the year and even in mid of the year we have revised downward exports volume and ended up at 2,800 MT. So what gives us confidence that this year will make clock 4,000 MT?

Akshay S. Pitti: This 4,000 MT are for pure exports. Earlier when we started this year we were talking of exports alone, mid-way through the year the supply got diverted to the Indian facility. So, when you take the export and domestic break-up at the end of the day material is going to GE. But it is GE India therefore coming under domestic head. That is the reason for us projecting a lower number for next year exports and a much higher number for domestic.

Shashank Kanodia: And sir, on the export front so GE has a clear contract with us like from CY15 to CY17, so this will particularly end this year. So now going forward how our things and how will exports shape up?

Akshay S. Pitti: I think like I just mention about 4,000 MT would be exports to GE and about 2,000 to 3,000 MT would be in the domestic segment for GE. So, more or less in line for contract that we have signed. Better idea in terms of revenue, we are projecting about Rs.380 crores of net revenues vis-à-vis this year's net revenue of Rs. 283 crores. If you annualize Q4 net revenue, which is roughly Rs.84 crores, it is already reached at Rs.330 -340 crores level. Going forward from October 2017 as the GEIndia contract kicks in the full swing, you will end up with the annual revenues of about Rs.380 crores at a net-net level, with a 13% EBITDA margin range.

Shashank Kanodia: In FY17, I think in the export front value added increased tremendously. I think terms of stator volumes, stator frames stuff like. So can this run rate been maintained, can we have the same state of blended realization for us?

Akshay S. Pitti: This will increase further, this is the reason for the increase in net revenue in the coming year and the reason for the higher net revenue in Q3 and Q4.

Shashank Kanodia: Because virtually our volumes have dropped drastically whereas the sales in value terms are not drop that drastically, I think largely because the share of value added service increase right?

Akshay S. Pitti: Yes, that is also one reason and the raw material prices like I mention in the couple of quarters ago is starting to go up, so the selling price also is increasing.

Shashank Kanodia: Coming on the cost front, so there has been a stark in reduction in the employee cost, so from Rs.41 odd crores you have dropped to Rs.32 odd crores like in FY17. So, in terms of absolute numbers how do we see in next 2 years shaping up?

Akshay S. Pitti: Next year we should see about Rs. 32-35 crores of employee cost. In the last year's Q4 concall, we had mention that we have cut down labor cost and other manpower cost dramatically and have incurred certain severance cost which are booked in Q1 and Q2. This Rs.32 crores is including those severance cost, so whatever increments and new recruitments that we will be doing this year and have already done also for our new projects including that you should see an employee cost in the region of Rs.32 -35 crores.

Shashank Kanodia: And what is employee cost you are expecting in FY19?

Akshay S. Pitti: It will again have to be relook next year looking at FY19 firm numbers but if you ask base on today's projection, I think it should be about Rs.38 crores.

Moderator: Thank you. Next question is from the line of Ayush Gupta from Quadeye Securities. Please go ahead.

Ayush Gupta: My question pertains to inventory management. So the amount of inventories has been increasing for quite some time now and in the last conference call you mentioned that we could be utilizing inventories going forward and so those numbers should come down but we did not see that happen, so what was the reason for that?

Akshay S. Pitti: See in quantitative terms inventory value has come down significantly, in value terms it has gone up because we are producing more high value added components which have a longer manufacturing and delivery lead time. So, our WIP and FG is increasing. If you see total quantity terms our inventory is down significantly and total inventory for the year is down by Rs.6 crores.

Ayush Gupta: So, how long do we see the inventory levels normalizing to previous stable levels?

Akshay S. Pitti: It is normal for this operating level. If you see our total inventory, I do not have that figure in front of me but should be in the region of aboutRs.130 odd crores, which is normal for our kind of business, trade payables and inventories combined. Typically, we have about 2 working capital cycles in a year. So if you are doing Rs. 300 crores of turnover we should have net about Rs. 150 crores of receivables and inventory.

Ayush Gupta: Another question pertains to the movement that we should be having from the Pune plant to the Aurangabad plant? This Pune plant was started just 2 years ago if I am correct, right? So what is the reason for shifting to Aurangabad?

Akshay S. Pitti: See Pune is a rented facility, I had covered this in the last conference call as well. It's the rented facility and we had gone there as an exploratory facility for Maharashtra sales and having a good experience in Maharashtra operations in Pune, we have decide to setup a fully own facility. The cost of setting up a facility in Pune was significantly higher than Aurangabad. So, it is strategic decision, we have decide to move the facility to Aurangabad, which is going to be owned by the company and not on the lease.

Ayush Gupta: And sir how do we see our debt levels going from this time onwards? So debt levels have been increasing for quite some time now and I believe they have reach to levels of around Rs. 180 crores. Rs. 180-170 crores this time, so what is our plan to reduce that?

Akshay S. Pitti: See, this is increase because of the promoters unsecured loans which is to be converted to equity, once it converts to equity you should see a reduction in this but then there will be a corresponding increase in the term loan that we will be having for the Aurangabad and Hyderabad facility expansions. So, at a maximum level we had about Rs.180-190 crores. Any increase in working capital as a result of increase operations will be an added or a reduced factor in that.

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

Shashank Kanodia: Sir, what kind of CAPEX we spent in FY18 and FY19?

Akshay S. Pitti: See let me put it this way, the CWIP of FY17 including that we will have about Rs. 100 crores of CAPEX.

Shashank Kanodia: And what was the CWIP at the end of FY17?

Akshay S. Pitti: I do not have the number in front of me that is why just said. Mr. Khandelwal can get back with firm number to you on that.

Shashank Kanodia: Because as far as we remember you are supposed to spend something close to Rs.70 odd crores this fiscal year but I think the actual CAPEX …

Akshay S. Pitti: We are supposed to spend Rs. 78 crores this year we could not spent all of it, major chunk of it is still in CWIP.

Shashank Kanodia: And as per our calculation just ~Rs.30-35 crores that you have spent in FY17, so then largely in that CAPEX is back ended in FY18.

Akshay S. Pitti: Yes that will get spent in FY18.

Shashank Kanodia: So, roughly ~Rs.70 crores incremental CAPEX should be there right for us?

Akshay S. Pitti: It should be there.

Shashank Kanodia: So sir, our debt levels we peak in FY18 right, then something to tune of.

Akshay S. Pitti: By FY2018.

Shashank Kanodia: ~Rs.250 crores is something that would targeting at the debt levels?

Akshay S. Pitti: No, see out of the Rs.180 crores the debt level is including unsecured loans from promoters which is yet to be converted to equity which is around Rs.25-26 crores. It will be reduced from the debt levels and CAPEX will get added. And the total CAPEX, I think the debt portion is about Rs.52 crores.

Shashank Kanodia: Sir, when can I expect the conversion of debt to equity for the promotor level?

Akshay S. Pitti: The postal ballet has already done and it is pending NSE approval for listing. So as soon as that comes in I think it should be converted to equity.

Shashank Kanodia: Any time frame that you can suggest?

Akshay S. Pitti: I think it's in NSE hands, so I would not like to comment on a time frame. It can be any day.

Shashank Kanodia: But this is largely on the same terms like 50 lakh shares at the price of 50 or how this pricing will determine for this?

Akshay S. Pitti: Price is not yet decided.

N K Khadelwal: Number of shares.

Shashank Kanodia: So price is going to be then again a right, the 2 week high- low that is 6 weeks that is used right?

Akshay S. Pitti: Yes that is the minimum price we might be going a small premium on top of that.

Shashank Kanodia: On the loans and advances parts, they have been tremendous increase on loans and advances in your balance sheet. So this is also relative to the CAPEX front or something else?

Akshay S. Pitti: Primarily on CAPEX front.

Shashank Kanodia: Both short term and long term?

Akshay S. Pitti: And the unsecured loans.

Shashank Kanodia: But have we extended any further loans to Pitti castings …

Akshay S. Pitti: No, that is an advance to supply of capital equipments.

Shashank Kanodia: And sir on the GST front so recently, I think recently some rates having finalized and released what is the current rate structure for us and how is one of the new GST affect us? Any colour that you can throw on it

Akshay S. Pitti: It is too early to comment on that, I think it requires a deeper scrutiny and study to comment on that. But for us the impact is going to be minimal if not zero because all the taxes and duties are pass through, we are not at the top of the supply chain so whatever we incur will pass on to our customers, any increase or decrease in cost.

Shashank Kanodia: Any guidance for the tax rate for FY18 and FY19?

Akshay S. Pitti: It will be a full tax rate.

Shashank Kanodia: So ~33% right?

Akshay S. Pitti: Yes.

Shashank Kanodia: So given that if you are targeting ~Rs. 380 crores of top line and roughly 13% margin so, we are expecting something close to Rs. 10 to 12 crores at the PAT level.

Akshay S. Pitti: It is a factor of what kind of depreciation we will have so, out of the Rs. 100 crores what get capitalized in FY18, by September will dictate the PBT level. So that is why we are trying to restrict our statements to EBITDA level of 13%.

Shashank Kanodia: And sir the Aurangabad expansion is as per plan?

Akshay S. Pitti: As per plan. We said by end of Q1, so we will be holding on to that.

Shashank Kanodia: And sir on the GE India front, so you said that we are starting supply them well ahead of schedule right? So is the pie of the market that we cater to increase or are they catering to some new products that we not intended to supply them earlier or something of that sort.

Akshay S. Pitti: See, basically it is a composite facility of GE in India, one word they have couple of facilities in the country and all of them will together cater to the Indian railways market. So, some of the facilities is common for the US operations as well. So to treat this business of the India facility they decide to pull certain volume from the Mexico and US facility to India and we have catered to that requirement here, that is number one. Number two, the samples are any way supposed to be despatched this calendar year. Two piece locomotive samples are supposed to be supplied in this year by GE to Indian railways, not even from us to GE. So that supply had gone in December, after that is approved they are starting to build up inventory for their 2018 calendar year. If they are to build a locomotive in 2018 they ideally start buying part by September end or may be mid-October they have pulled a timeline by about 6 months.

Shashank Kanodia: And sir just lastly, if you can break up the CAPEX of Rs.100 crores between the Aurangabad facility and the new machining facility at Hyderabad?

Akshay S. Pitti: It will be Rs.60 crores and Rs.40 crores respectively.

Shashank Kanodia: And what is the intended revenue that we can relays from the machining facility from Hyderabad?

Akshay S. Pitti: Machining facility this is including the existing value-add stuff that we do, it will be about Rs.90 to 100 crores for full year operations of fiscal year 2018-2019.

Moderator: Thank you. Next question is from the line of Ayush Gupta from Quadeye Securities. Please go ahead.

Ayush Gupta: So, I wanted to know about the growth strategies of the company? So what targets are we looking at for growth for 5 year compounded annual growth?

Akshay S. Pitti: I think 5 years is too longer horizon in any business to comment or refer to keep our commitments and as stated in past in the past in 2 to 3 years we are targeting Rs.1,000 crores of turnover with some inorganic growth.

Ayush Gupta: Inorganic growth, so this inorganic growth is being looked at in terms of competitors from India or are we also willing to move outside?

Akshay S. Pitti: Not competitors at all we would not like to have any inorganic growth in our own sector because we are a leader there and we do not need to spend money to acquire business. We have been looking at allied sectors where we can provide a better value added product to our customers like in the case of machining where we started the machining activity along with lamination, so something like that may be forging. The product is yet to be decided but there is definite intend for inorganic growth in the next 2 years. Organically we are targeting about Rs. 600-800 crores of turnover in the next 3 years, which will be gross revenue.

Ayush Gupta: So, is this through the industry growth or are we looking to increase our market share?

Akshay S. Pitti: Combination of industry growth, new orders like the GE order itself is going to add Rs. 50 to 60 crores of turnover, there will be Alstom order which we start may be 2 to 3 years from now. Additional machinery is a new business line for us. So combination of new business lines specific project base opportunities which are long term in nature and industry growth.

Ayush Gupta: And what are the, if you could brief down the contributions of each of these factors would it be possible?

Akshay S. Pitti: I do not think I would like to go into that much of detail right now.

Ayush Gupta: Could you also please throw some color on the order book, orders that we correctly have or are expecting in the near future?

Akshay S. Pitti: Like I said we are targeting about Rs.380 crores of turnover this year, most of it is tied up in terms of orders.

Ayush Gupta: So, we have large orders from GE locomotive any other players that we have fix large orders from?

Akshay S. Pitti: Most of our customers we have long term orders but the schedules are different. So it is very difficult to tell you what is the order and what is the schedule. It is typically a capacity commitment and based on that we are projectingRs.380 crores turnover quarter-on-quarter month-on-month the schedules will change but the overall composite we are targeting Rs.380 crores of net revenue.

Ayush Gupta: And sir could you also throw some colour on this Hyderabad plant that we have starting for wind business, I believe.

Akshay S. Pitti: We have a machining facility which is started in Hyderabad in addition to our other facilities in Hyderabad. It is a multipurpose facilities and do pretty much any kind of machining in that. It is not the wind power or windmill specific. The large clients are intended to be railways, wind, cement, oil & gas, mining. It is very diverse facility.

Moderator: Thank you. Next question is from the line of Shashank Kanodia from ICICI securities. Please go ahead.

Shashank Kanodia: Sir, on the demand front if you can just guide which segment are you witnessing strong demand in the domestic business?

Akshay S. Pitti: I think in lamination we are witnessing a very strong growth in power generation, renewable and conventional. So that is going in high-double digit may be like 20-25% Y-o-Y for the last two years we are seeing that kind of growth and going forward it is in transportation and industrial. As you know GE transport orders already there in Transportation sector. Industrial motors are sluggish but they are growing. Our market share is growing more than our industry segment so we have a higher penetration in the market in the industrial segment.

Shashank Kanodia: But sir on the power generation front so they are hardly any new thermal power plants which are coming up right? So conventional front what exactly is driving the growth for us?

Akshay S. Pitti: There are couple of power projects in thermal and wind both. In Telangana state itself I think NTPC has set up 4,000 megawatt power plant. So what you would typically see in your industry reports is once it is commissioned. What demand we see is when it is in installation phase they can be a year or year and half kind of lag between two. Alstom T&D which is a listed company they have won lot of orders for their steam power generators in India, which are recently being bought over by GE incidentally. So there we have significant orders from them for conventional power, especially steam based power.

Shashank Kanodia: And sir recently I think the Power Ministry also sanctioned plans for some 10 nuclear plants and stuff like that so do we see a good amount of opportunities panning for us?

Akshay S. Pitti: Typically, this nuclear power plants are mostly import base, so I do not see much opportunity for us there unless we are able to break into the Russian power segment, which is highly unlikely. If there is a domestic content going to come in then yes definitely we can look at that.

Shashank Kanodia: Because his comment talks upon building them indigenously, from that perspective because largely it is just generation of heat and steam in.

Akshay S. Pitti: For us it is not even on that front. For us the business is on the rotating elements like the stator and rotor which actually generate the powers. So it is from the generator piece.

Shashank Kanodia: Which is largely common to all pieces right? Whether it be thermal or nuclear or gas?

Akshay S. Pitti: Yes, it is different but the lamination content is still the same. So, they are 'n' number of people who are capable of making the generator whether it is BHEL, Alstom Power India, a lot of them. So, if it comes to India definitely, yes there is an opportunity for us to grab that. Wherein as in today I do not think there is any scope for us to get that business.

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

N R Ganti: Thank you, ladies and gentlemen for your participation, in case you have any further doubts please do get in touch with Churchgate Partners and we will come back to you. Thank you.

Moderator: Thank you very much members of the management. 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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Note: This transcript has been edited to improve readability