Earnings Conference Call

Q3 FY2016

February 15, 2015

Management:

Mr. Akshay S Pitti, Vice Chairman and Managing Director

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 Q3 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 at the end of today's presentation. 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, Mr. Vijay Kumar – Executive Director & CFO and Mr. N. K. Khandelwal – CFO Designate.

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 to Mr. N. R. Ganti, thank you and over to you, sir.

N R Ganti Thank you, good evening and welcome everyone to our Q3 FY 2016 earnings conference call. I have with me on the call today Mr. Akshay S Pitti – Vice Chairman and MD, Mr. Vijay Kumar – Executive Director and CFO and also Mr. N. K. Khandelwal – CFO Designate.

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.

Before discussing the financials for the quarter, I would briefly discuss the performance of key macroeconomic indicators. India's Index of Industrial Production contracted 3.2% in November after raising to a five-year high in the previous month mainly due to poor performance of the manufacturing sector and a sharp decline in the capital goods output. Fewer working days because of the festival season along with excess capacity in the electricity sector impacted industry activity in November. The Manufacturing sector, which constitutes over 75% of the Index, contracted by 4.4%, while capital goods sector contracted by 24.4% in November 2015. However, the electricity sector increased by 0.7% and the mining output grew by 2.3%.

Performance of the Company during the quarter remained subdued which is clearly a reflection of the prevailing macro uncertainties and challenges. During the quarter total volume declined by 17.4% to 4,921 metric tonnes compared to same period last year. Both domestic and export volumes experienced softness. Domestic volume for the quarter declined by 4.2% year-on-year to 3,657 metric tonnes due to the softness in the manufacturing and capital goods sectors. Export volume declined by 40.9% y-o-y to 1,263 metric tonnes due to postponement of orders from customers. We expect the situation to improve gradually in the coming quarters. Our volume especially for the domestic business is expected to experience an uptick in the last quarter of the current fiscal year.

Our revenue for the quarter declined by 24.2% year-on-year to Rs.708 million. Of the total sales, domestic sales accounted for 62% and remaining 38% was contributed by exports. Domestic sales for the quarter declined by 5.2% y-o-y to Rs.433 million, while exports sales for the quarter were Rs.268 million, a decline of 42.4% compared to the same period last year. The other operating income accounted for Rs.7 million.

Our EBITDA for the quarter was Rs.23 million compared to Rs.117 million in Q3 FY2015. EBITDA is defined as profit from ordinary activities before finance cost, depreciation, exceptional items and includes FOREX loss / (gain). EBITDA for the quarter was impacted due to significant decline in export volume. Lower realization from the sale of scrap also impacted the operating profit for the quarter.

The Company has reported a net loss of Rs.40 million for the quarter compared to net profit of Rs.29 million during the same period last year. Lower operating profit coupled with sale of obsolete and non-moving inventories impacted the profitability of the Company for the quarter.

Moving to our leverage profile, we are comfortable with our current capital structure. As of 31st December, 2015, our total debt was Rs.1,678 million which included Rs.363 million of long-term debt and is Rs.1,315 million of short-term debt. Cash and cash equivalent of the quarter was Rs.157 million resulting in a net debt position of 1,521 million. The net worth of the company was Rs. 1,119 million at the end of the quarter. As of December 31st, 2015, we had a conservative leverage profile with a total debt-to-equity of 1.5x.

Overall, the industry continues to face challenges due to weak demand situation and higher cost of funds for the business. However, going ahead, we anticipated that our volume demand, especially domestic, to start seeing improvement starting Q4 of the fiscal year. We expect to see meaningful expansion in the profitability by the first-half of the fiscal year and all our strategic initiatives undertaking during the current year start to fructify. Furthermore, despite muted economic growth in November, we expect improvement in the industrial activity in the coming quarter. The government's efforts to de-bottleneck investment coupled with early signs of pick-up in urban demand would also support our growth.

We have strong product portfolio, leading market position and long standing customer relationship. This gives us confidence of capitalizing on the rebound in the industrial and manufacturing activity.

We now like to open 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. Our first question is from Shashank Kanodia of ICICI Securities. Please go ahead.

Shashank Kanodia: My question is to Mr. Akshay S Pitti. Sir in the last three months what are all risk mitigation techniques have been undertaken in order to improve the profitability at Pitti Laminations, given the fact that scrap prices were down and you might be carrying some high cost inventory?

Akshay S Pitti: Shashank, we have liquidated close to 50% of our inventory position. If you see the quarter beginning we are about 12,000 tonnes of total inventory and as of this quarter, we have reduced it to about 6,000 tonnes. So the exposure on high cost inventory we have dealt with significantly in this quarter. Apart from this we had initiatives of strategic cost reduction plan to wind down certain operations in Plant-1 which is running at a very low capacity utilization and trim overall overheads of the Company to better benchmark to the existing operating levels.

Apart from this like Mr. Ganti in his statement said that we expect a robust growth in domestic sector and I think that should help us get back to the profitability that we use to see before.

Shashank Kanodia: So sir, given the fact that your quarterly run rate is actually around 6,000 tonnes and you maintain some 90 days of inventory so what was the need for us to maintain something like 12,000 tonnes of inventory at the start of quarter two?

Akshay S Pitti: If you see for our product of 1 tonne of finished goods we consume about 1.8 tonnes of raw materials. If you say that we operate at 6,000 tonnes per quarter you require close to 12,000 tonnes of inventory for the 90-day period approximately so, that was the issue. And to the lower operating level the 12,000 tonnes you know even much higher than 90 days which was the risk areas for us.

Shashank Kanodia: Okay. And have we renegotiated our contracts with any of our customers given the fact that scrap prices have subdued to such a large extent?

Akshay S Pitti: Yes, we are doing that right now with all of our customers. If you see what happened in the past was with the increase in scrap prices and realization, we compensated for the increase in the operating cost of that company so when we use to negotiate with our customer they would say that the scrap prices have increased so there is no need for increasing the conversion cost. Now, we are seeing a same rationale with them that okay, when the cost has increased and now the realizations are coming down you need to compensate us. It is slightly long negotiation with these customers since most of these relations are long, we cannot force them to do it immediately but we are seeing some positive results in certain customers.

Shashank Kanodia: Okay. But, if view the case let us say the contracts that are being negotiated what is the profitability rate we can expect at the EBITDA level?

Akshay S Pitti: Let me just walk you through our analysis on the loss, Shashank. If you see, our loss is about Rs.5.1 crores before tax and about Rs.2.3 crores is the impact of the obsolete inventory clean-up. We have taken a loss of about Rs.50 lakhs this quarter on AS-2 closing stock valuation. So we can say that operational loss is about Rs.2.3 crores and the cost savings measures that I have mentioned to you should yield about Rs.3 crores per quarter effective Q1 FY2017. In this a situation without any increases from customer on our selling price and without any increase in operating leverage, I forecast us to return to profitability in Q1 itself. And if you see the impact of scrap realizations this quarter vis-à-vis the same quarter of the last quarter is about Rs.2.25 crores. The scrap prices were approximately Rs.23 per Kg last year in December and this year they were approximately about Rs.12 per Kg net realization to us, around 5,000 tonnes of scrap sale, industry transmission about Rs.2.25 crores loss.

Shashank Kanodia: So, sir roughly Rs.2.3 crores is the obsolete inventory loss that we incurred, Rs.2.2 crores is a scrap prices decline that we have incurred so roughly Rs.4.5 crores is the incremental loss on Y-o-Y basis for us.

Akshay S Pitti: Yes.

Shashank Kanodia: So scrap prices cannot be reversed but in terms of inventory and in terms of operation efficiencies we are targeting close to Rs.3 crores of savings by Q1 FY2017?

Akshay S Pitti: Yes.

Shashank Kanodia: Okay. So sir, next quarter what is the volume rate that you are guiding, can you maintain this 5,000 tonnes run rate?

Akshay S Pitti: For Q4?

Shashank Kanodia: For next quarter, Q4.

Akshay S Pitti: Yes, I think the same run rate will maintain for Q4 but the cost savings measure of about Rs.3 crores which I mentioned will come at a cost. Because a lot of this is reduction in man power and partial shutdown of one of our facilities which will result in certain costs so for Q4 also I predict a little bleak picture only and , that is why I am saying that Q1 will return to profitability.

Shashank Kanodia: Okay. So sir, for next year what are the volumes that you are targeting?

Akshay S Pitti: Next year we are targeting about 21,000 tonnes of sales on a conservative basis as of now. But we will have more clarity in March. It is too early to give a firm number.

Shashank Kanodia: Okay. Because that will the 33% kind of growth rate top-line given that this year we might close to something about Rs.300 odd crores of top-line.

Akshay S Pitti: Yes, next year I think we should close about Rs. 340 crores.

Shashank Kanodia: Okay. And given that the exports have declined so what is the sense you are getting on GE order, have something's talked upon?

Akshay S Pitti: Yes, if you see November and December were good months on standalone basis and we see that slowly it will rebound the GE orders. Basically what happened is that their product requirements also have reduced and they had to defer some orders because the earlier supply is at a much higher rate for their consumption so last three - four months, we have seen a decrease in exports because of them trying to equalize the inventory. Now that the inventory pile-up should be over at their end, the regular supply should increase from our side.

Shashank Kanodia: Okay. Can we expect some Rs.200 crores of run rate for this calendar year from GE CY2016?

Akshay S Pitti: For FY2017?

Shashank Kanodia: Yes, for FY2017.

Akshay S Pitti: Yes, definitely Rs.200 crores.

Shashank Kanodia: Each year from GE, okay. So this will have incremental effect on our profitablility as well right because it is going to be a bit higher margin.

Akshay S Pitti: Definitely.

Shashank Kanodia: At the EBITDA level 10%-odd kind of operating margin is possible for to clock?

Akshay S Pitti: Definitely. In fact I would say more like 13%-14%, once we are return to profitability it should give us about 13%-14% EBITDA.

Shashank Kanodia: Okay. And on the leverage part you know your absolute debt has remained almost flat but your exports have come down drastically and majority of your loans are working capital loans, so had that working capital cycle elongated by any chance?

Akshay S Pitti: Because of the inventory pile-up the working capital was deployed in inventories rather than sales, so slowly the debt leverage will come down in Q1 it should be lower than what it was.

Moderator: Thank you. Our next question comes from Ritesh Mistry of Moneybee Advisors. Please go ahead.

Ritesh Mistry: I have a couple of questions, one is regarding raw material prices. During the quarter, our raw material prices as compare to sales has gone up around 68%, if we compare to last quarter it was around 65%, so can you just throw some light on that? And second is regarding employee cost, if you see compared to sales it is increasing from last three quarters. In June it was around 11%, then 12.69%, and then this quarter is around 14.5%.

Akshay S Pitti: The employee cost as a percentage will increase because our revenues have come down.

Ritesh Mistry: Yes, your revenue is almost like same.

Akshay S Pitti: Other than that there is no addition employees hire in any of these quarters to increase the cost.

Ritesh Mistry: And then regarding the raw material prices?

Akshay S Pitti: See raw material prices also is the same because we are consuming a high cost inventory which was there in our inventory earlier and our sales price had to be adjusted to the current quarter's pricing with our clients. As you know that we have 100% pass through of pricing with the clients. So first of every quarter whatever happens to the raw material prices, either increases or decreases, it is passed on to the customer. But we are always sitting on inventory based on our inventory norms, so we are consuming a higher cost raw material.

Ritesh Mistry: So right now still we have a higher cost inventory in our books

Akshay S Pitti: Every quarter if the raw material is falling quarter-on-quarter so your closing stock will always be of a higher value and your sale has to be adjusted to the current quarter's pricing which is lower. So if the price starts going up tomorrow quarter-on-quarter we will have a lower cost inventory being consumed, it is part of operations.

Ritesh Mistry: Okay. And the total what you have mentioned the sale of obsolete and the non-moving is around Rs.2.3 crores.

Akshay S Pitti: Net impact.

Ritesh Mistry: Net impact, okay. So in this quarter also are we expecting anything or is it just a one-off quarter?

Akshay S Pitti: It is a one-off.

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

Shashank Kanodia: What will be your operational CAPEX that we will spend in FY2017 and FY2018?

Akshay S Pitti: FY2017 - FY2018, as of now we are not envisaging any CAPEX, we are being conservative. If we see a huge uptick in volume then we shall consider something but that will be mostly putting up a fully owned facility in Pune and not for any machinery.

Shashank Kanodia: Okay. And has that Pune been operational and how is that running?

Akshay S Pitti: Pune plant is doing very well as of now. It is at 70% utilization of capacity and as the capacity also increases like I mentioned we are partly shutting down one of our facilities in Hyderabad to offset the cost.

Shashank Kanodia: Okay. And for the next year FY2017, just stand correct, you get it for 21,000 tonnes of volumes, right?

Akshay S Pitti: We are estimating as of now but our projects should be available closer to March when we get our indication from our client.

Shashank Kanodia: Because in that case it would be very much closer to what FY2016 we will be closing right, so minimal growth.

Akshay S Pitti: See we are being conservative right now because it is too much in advance. Closer to March we will have a better idea then everything is firmed up.

Shashank Kanodia: Okay. Anything like to show on the vision 2018 of rupees thousand crores of top-line have anything been progressed on that front?

Akshay S Pitti: With that current economic scenario I think, that would not be possible.

Shashank Kanodia: Okay. So you are shelving off that plant as of date?

Akshay S Pitti: We will reconsider that in Q1 FY2017 because we have to see how the economic scenario goes in India as well as the global situation. In current market I think that would be far-fetched.

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

N. R. Ganti: Yes, thank you gentlemen for participating today. In case you have any further queries you can reach out through Churchgate Partners. Thank you.

Moderator: Thank you. Ladies and gentlemen, 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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Note: This transcript has been edited to improve readability