



Earnings Conference Call

Q2 FY2017

November 9, 2016

Management:

Mr. N R Ganti, Director

Mr. N. K. Khandelwal, Chief Financial Officer

Moderator: Ladies and Gentlemen, Good Day and Welcome to Pitti Laminations Q2 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 at the end of today's presentation. Please note that this conference is being recorded. Joining us today on this call are: Mr. N. R. Ganti -- Director and Mr. NK Khandelwal -- CFO.

Before we begin, I would like to mention that some of these 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. Ganti, thank you and over to you, sir.

N. R. Ganti: Thank you, Aman. Good evening and welcome everyone to our Q2 FY2017 earnings conference call. I have with me on the call today Mr. Nand Kishore 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 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 macro-economic indicators.

India's Index of Industrial Production contracted in August 2016 by 0.7% on year-on-year basis primarily due to de-growth in mining and manufacturing output. Compared to July 2016 IIP benefitted from a sequential improvement in the performance of basic goods, capital goods, and consumer non-durables. The core industries outperformed the overall IIP for the tenth month in a row. As the reservoirs replenished at the end of the monsoon season, hydroelectricity generation is likely to continue to record strong growth going forward.

IIP information by segment compared to the same period last year. Mining sectors and manufacturing sectors contracted by 5.6% and 0.3% respectively. Electricity output grew marginally by 0.1%. The IIP contracted by 0.3% in April - August period first five months of this financial year versus growth of 4.1% in the corresponding period last year.

Q2 FY2017 performance and operational overview

Overall demand scenario was encouraging during the quarter. Of our 3 major end markets, industrial segment experienced strong growth whereas performance of the power generation and transportation segments were relatively stable. We experienced improvement in the price realization for both exports as well as domestic business mainly due to better product mix. Our Q2 FY2017 performance clearly reflects the improving trends that we discussed about during the last quarter.

During the quarter, we received various long-term to medium-term contracts from some of our existing clients.

Major contracts during the quarter were from the GE India amounting to Rs. 500 crores over a period of upto 2030. Under the contract, Pitti Laminations will supply traction motor related products along with some other products to be used in locomotives for catering to the requirements of Indian railways.

Moving to the Machined casting business which is generating significant interest, the management is in the process to expand the capacity to cater to clients such as GE India and Siemens. The plant is expected to be operational by Q4 FY2017 with capacity of around 72,000 machine hours. In addition, we are also in the process of shifting Pune operations to another industrial hub of Maharashtra state, Aurangabad. The plan is running as per schedule and the new plant is expected to start operations by Q1 FY2018. This plant will also cater to the new order receipt from Crompton Greaves to supply 1,000 metric tonnes per year for small laminations which have application in ceiling fan.

Rationale for shifting to Aurangabad: In December 2014 the company on a trial basis had set up a facility in Pune on leased premises by shifting few old machines from Hyderabad and purchasing few new machines with a purpose of understanding the local environment and its handling capability of an outstation unit from its home state. The experience gained during this period has given the company confidence to set up the fully owned unit in Maharashtra. The choice of Aurangabad is based on the need of optimizing its cost of its logistics by being nearer to the source of raw material and also close to the customers. Furthermore, it will also enable the effective utilization of working capital coupled with cost efficient operation.

Q2 FY2017 operational performance: Sales volume in Q2 FY2017 was 4,572 MT, increased from 4,253 MT in Q1 FY2017, registering a growth of 7.5% which is mainly supported by improved domestic demand. Compared to same quarter last year total volume declined 3.5% to 4,737 MT. Domestic volume in the current quarter increased by 7.1% to 3,951 MT compared to Q1 FY2017 to 3,688 MT, supported by increase in demand from industrial segment and stable demand from transportation and generation segments. Compared to Q2 FY2016 domestic volume increased by 14.9% from 3,440 MT. Export volume in Q2 FY2017 stood at 621 tonnes compared 565 MT in Q1 FY2017 registering a 10.0% growth. This is due to improvement in global business outlook and higher stator frame sales. However, as compared to Q2 FY2016 export volume declined by 52.1% from 1,298 MT.

Moving to the revenue breakdown, revenue for Q2 FY2017 recorded at Rs. 667 million and in Q1 it was Rs. 581 million, registering a growth of 14.9%. Revenue benefited from higher volumes and better price realization in both domestic as well as export markets. However, in Q2FY2016 we had a Rs. 781 million turnover, so there is a negative growth of 14.6% compared to same period last year.

Domestic sales in Q2 FY2017 increased by 15.2% to Rs. 439 million from Rs. 381 million in Q1 FY2017 driven by strong growth in domestic volume and increase in base raw material prices. Compared to Q2 FY2016 revenue increased by 2.7% from Rs. 428 million. Domestic sales as a percentage of total sales for the current quarter was at 67%, whereas in Q1 FY2017 it was 66% and in Q2 last year it was 55%. So, there is uptick in domestic contribution.

Coming to export sales, in Q2 FY2017 we have recorded Rs. 220 million export sales as compared to Rs 193 million in Q1 FY2017, registering a growth of 14% supported by improvement in volume primarily stator frames. However, as compared to Q2 FY2016 it was declined by 37.1% from Rs. 350 million. The export sales as a percentage of overall sales was 33% in Q2 FY2017, 34% in Q1 FY2017 and 45% in Q2 FY2016.

Continuing the financial performance. Q2 FY2017 total revenue was at Rs. 667 million as explained, registering QoQ a growth of 14.9%. Revenue benefited from higher volumes and better price realization both domestic as well as export market primarily on account of better product mix. However, as compared to Q2 FY2016 there is a negative growth of 14.6%.

EBITDA for Q2 FY2017 declined to Rs. 87 million as compared to Rs. 89 million in Q1 FY2017, slight fall of 2.1%. EBITDA for the quarter decline mainly due to higher cost of raw material consumed due to change in product mix. As compared to Rs. 32 million in Q2 FY2016, EBITDA increased significantly, registering a YoY growth of 171.9%. EBITDA is defined as profit from ordinary activities before finance, cost, depreciation, exceptional items and includes foreign exchange gain or loss.

Net profit in Q2 FY2017 is Rs. 15 million compared to Q1 FY2017 of Rs. 12 million, there is a growth of 21.8%. Increase in PAT is primarily due to lower finance charges on account of better working capital management. In Q2 FY2016, we had a net loss of Rs. 28 million, hence it is not comparable. Net profit margins in Q2 FY2017 improved to 2.3% compared to 2.1% in Q1 FY2017.

Coming to leverage profile, we are comfortable with current capital structure. As of 30th September, 2016 total debt is Rs. 1,369 million, which includes Rs. 343 million of long-term debt and Rs. 1,026 million of short-term debt. Our total debt included unsecured loans of Rs. 170 million from promoters. During the quarter, we also repaid around Rs. 420 million of our debt compared to quarter ended June 30th, 2016. We had a cash and cash equivalents Rs. 101 million; resulting in a net debt position of Rs. 1,268 million. Net worth is at Rs. 1,097 million. As of September 30th, 2016, total debt to equity ratio of 1.2x which represents conservative leverage profile.

Now touching upon strategy and outlook, as mentioned earlier, we are focused on expanding our presence in the domestic market to reap the benefit of growing the domestic economy. This initiative has started yielding preliminary results and we expect to further benefit from this in the coming quarters. We will continue to build on initial momentum generated and expect further

improvement during the second-half of the current fiscal year. The factors driving growth in near-term include better product mix and efficiency enhancements across all the plants. We are anticipating improvement in the industrial activity in the coming quarter.

Now, we would 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. We have the first question from the line of Ritesh Mistry from Moneybee. Please go ahead.

Ritesh Mistry: Sir, I have a couple of questions, one is regarding the CAPEX. So, how much capex will we are going to do like in machine casting? And the new order which we have received from Crompton Greaves so, this order we have received recently?

N. K. Khandelwal: I will answer your first question regarding CAPEX first. We are planning CAPEX of about Rs. 28.75 crores for the machine shop in Hyderabad and about Rs. 49.25 crores in Aurangabad for laminations that will be by way of shifting the Pune facility and certain equipments from Hyderabad Plant I and Plant II. So, the idea is that Aurangabad will serve as a manufacturing hub for lamination for domestic market and Hyderabad. Plant II will serve for the export market. This is financed by Rs. 26 crores from the promoters as a part of long-term interest free unsecured loans and Rs. 52 crores of long-term debt from the institutions.

About the Crompton Greaves, we have entered into an agreement with Crompton Greaves for supply of small lamination basically used in manufacturing of the ceiling fan. This is a new segment for us and we are trying to enter this market. This agreement is for supply of 1,000 MT of small laminations over a period of one year, however it has a potential to grow up to 3,000 MT a year subsequently.

Ritesh Mistry: Okay. So, as of now we have order for one year?

N. K. Khandelwal: Yes.

Ritesh Mistry: Okay. And sir, couple of just book keeping questions like inventory, can you give up the break-up on inventory, sir?

N. K. Khandelwal: I do not have this information readily available. The inventory has gone up for the finished goods for exports mainly for the reason that we are utilizing two shifts, we have rationalized our man power to reduce our overhead cost, therefore we are keeping the product ready for shipment. Otherwise, when we get a sudden order we will have to put in three shifts and produce that quantity, so basically it is leveraging of the production capacity over a period. Therefore we are holding a little higher export inventory which will liquidate in Q3 and Q4.

- Moderator:** Thank you. We have the next question from the line of Shashank Kanodia from ICICI Securities. Please go ahead.
- Shashank Kanodia:** Sir, just taking it forward from the last participant, so, you mentioned Rs. 28.75 crores for the machine shop at Hyderabad and Rs. 49.25 crores for the lamination business in Aurangabad, right?
- N. K. Khandelwal:** Yes.
- Shashank Kanodia:** Right. So, its totality is Rs. 78 crores. So, we would be shifting even the Pune facility to Aurangabad as well?
- N. K. Khandelwal:** Yes.
- Shashank Kanodia:** Okay. So all laminations domestic will be then considered in Aurangabad?
- N. K. Khandelwal:** Yes, for domestic market.
- Shashank Kanodia:** Right. So, sir, then what will be the capacity for this Aurangabad facility?
- N. K. Khandelwal:** Aurangabad facility will have a capacity of 26,000 MT .
- Shashank Kanodia:** Okay. And remaining capacity Hyderabad Plant II would be how much?
- N. K. Khandelwal:** Hyderabad Plant II will be 8,000 MT.
- Shashank Kanodia:** 8,000 tonnes?
- N. K. Khandelwal:** 8,000 MT and in Plant I the capacity will be zero, because we have already closed down Plant I, equipments will be moved out to Pune and some equipment which is very old will be scrapped. So, finally our capacity for lamination after Aurangabad is completed will be 34,000 MT.
- Shashank Kanodia:** Right, which is against our existing capacity of Rs. 36,000 tonnes, right?
- N. K. Khandelwal:** Presently our capacity is 32,000 MT
- Shashank Kanodia:** 32,000 tonnes. So, as such there is no good amount of capacity which is coming on stream because of this Aurangabad facility, right so, Rs. 50 odd crores we intend to spend, what are the benefits that we tend to realize in terms of economic benefits that we foresee?
- N. K. Khandelwal:** The entire project is conceived mainly because of the logistics cost because as you know that our product has an input output ratio of about 1:1.8 like if we have to supply 1 MT of finished products, we have to use about 2 MT of raw material. This raw material is coming from Maharashtra and Gujarat, which is carried all the way to Hyderabad, produced in Hyderabad and

supplied to the customers in Maharashtra or north of India. So, it is a bulky product involving unnecessary material movement which could be saved. The logistic cost is the main contributor other than that we will be present at the doorstep of the customer. Our customers are concentrated mostly in Maharashtra so, it will help us in increasing the volume also. The pay back of this entire project would be about five to six years.

Shashank Kanodia: Five years to six year so, what is your absolute logistics cost that we intend to save per year because of this? Or as a percentage of sales if you can share right now what is the logistics....

N. K. Khandelwal: Right now I do not have the numbers on logistics readily available but as I said say overall payback will be five to six years.

Shashank Kanodia: Okay. And out of this Rs. 50 odd crores for Aurangabad, how much is the land cost and how much will be spent on the plant and machinery.

N. K. Khandelwal: In Aurangabad, the land cost is about Rs. 4.5 to Rs. 5 crores and plant & machinery is about Rs. 24 crores, shed and building about 13.5 crores and the balance is for tools, dies and pre-operative expenses.

Shashank Kanodia: Right. And sir, how is your progress going on in this direction and how much amount that we have already spent as we stand today in H2 FY2017?

N. K. Khandelwal: As we have said in our earlier presentation also that total completion of the project for commercial production will be by Q1 FY2018. And right now we are in the process of registration of the land.

Shashank Kanodia: Okay. So this entire amount will be spent in the second-half of this financial year, right?

N. K. Khandelwal: Yes.

Shashank Kanodia: Okay, all Rs. 50 odd crores?

N. K. Khandelwal: Yes.

Shashank Kanodia: Okay. But in six months' time we will have this Aurangabad facility up and running, you are confident about this fact?

N. K. Khandelwal: **BY** Q1 FY-18, we have nine months, actually we are expecting internally six to seven months.

Shashank Kanodia: Okay. And will it lead to any loss of volumes for FY2017 or it will be...

N. K. Khandelwal: No, it would not. In our industry, we have standalone equipments, it is not a continuous process plant, so we can plan that way so, it will not have effect on the production.

- Shashank Kanodia:** Okay. And sir secondly on the machine shop Rs. 29 odd crores of CAPEX, when do you intend to spend this amount?
- N. K. Khandelwal:** This also will get spend in second-half of FY-17; in fact we have planned to go for commercial production by end of the financial year.
- Shashank Kanodia:** Okay. But sir, given the leverage on the balance sheet how has been the financing for all these projects? Are banks and institutions willing to lend you money?
- N. K. Khandelwal:** Yes, we have already tied up. 1:2debt-equity is not an issue, Promoters are contributing interest free unsecured loan of Rs. 26 crores and Rs. 52 crores is the institutional funding.
- N.R.Ganti:** There are no long-term debt from Promoters
- Shashank Kanodia:** Okay. And sir, what will be the cost of debt for this the institutional funding?
- N. K. Khandelwal:** 12.5% to 13%
- Shashank Kanodia:** Okay. And sir, in this machine shop what is the revenue potential for this?
- N. K. Khandelwal:** Machine shop revenue potential once it is up and running for full year it should generate about Rs. 60-70 crores turnover per year.
- Shashank Kanodia:** Okay. So, this should be realizing in FY2018, right?
- N. K. Khandelwal:** Yes.
- Shashank Kanodia:** Okay. So, this will have an additional Rs. 60 crores - Rs. 70 crores of revenue in FY 2018, okay. Now, sir, coming to the GE order like Rs. 500 crores of three-year contract that you are executing right now so, what is the run rate of shipment which you have been witnessing in October or November. I think in Q3 because first-half was weak as it was guided by you, right. You have been guiding that will be make good in second-half, right? So, how has been the shipment now as we stand today in October, November or times?
- N. K. Khandelwal:** For H2 projections are definitely better than H1 and shipments will start in about a week's time and we have continuous shipments till the end of the year. So, whatever we were expecting our turnover from export that was about 6,000 tonnes so, we would be able to reach somewhere near that.
- Shashank Kanodia:** So, 6,000 tonnes for FY2017?
- N. K. Khandelwal:** Laminations.
- Shashank Kanodia:** Yes, you kind of revise that downwards, right around. 4,500 tonnes or is it 6,000 tonnes?

- N. K. Khandelwal:** I think Yes, 4,500 tonnes, we have downsized that so, we will be able to achieve that.
- Shashank Kanodia:** Okay. So, in the first-half you have just done if I am correct around 1,200 odd tonnes so, rest 3,300 will be doing in the second-half?
- N. K. Khandelwal:** Yes, around that.
- Shashank Kanodia:** Right. And the shipments are in tandem with that?
- N. K. Khandelwal:** Yes, it look so.
- Shashank Kanodia:** Okay. And sir, secondly on the GE India order like Rs. 500 odd crores of order so, this time we have been guiding that from Q4 of FY 2018 we will start that supplying to that locomotive division, right.
- N. K. Khandelwal:** Yes.
- Shashank Kanodia:** So, have we seen a timelines from GE India because we have not building anything any progress on the ground for this project at least right now.
- N. K. Khandelwal:** No, see the agreement is already signed and we are in the process of development of samples, the samples will be supplied in some time, shortly within a month or two months for certain items. GE takes a long time for validation of the samples. So, then after that there will be a pilot lot going so, commercially when we will be able to supply by Q4 FY2018 only.
- Shashank Kanodia:** You have the visibility by Q4 we will start doing that, right latest....
- N. K. Khandelwal:** 100%, Yes, of course.
- Shashank Kanodia:** Okay. And that will be roughly around Rs. 50 crores per year.
- N. K. Khandelwal:** That will be Rs. 50 crores per year for 10 years, actually around Rs. 55 crores because actual supply period would be nine to nine and half years only.
- Shashank Kanodia:** Right. And what is the EBITDA margins that we will realize on that contract?
- N. K. Khandelwal:** That is similar to the regular business GE which we are doing right now also.
- Shashank Kanodia:** Okay, 13%-14%, right?
- N. K. Khandelwal:** We will come to know.
- Shashank Kanodia:** Okay. And sir this machine shop, what kind of margins will you realize in these machine shop on which we intend to spend Rs. 30 crores?

- N. K. Khandelwal:** This will be definitely better than the lamination business.
- Shashank Kanodia:** Okay. Something to the tune of 20%-odd, is that possible?
- N. K. Khandelwal:** Actually as a combined entity, we expect EBTIDA margin to be between 13%-15%.
- Shashank Kanodia:** Okay. As a combine entity, okay. And this year we will do some 20,000 tonnes of laminations split between 16,000 domestic and around 4,500 exports?
- N. K. Khandelwal:** Yes.
- Shashank Kanodia:** Okay. And sir, how the realization moving on the ground as in is there any jack up in the material prices that we will be witnessing or anything on the ground?
- N. K. Khandelwal:** Material prices are more or less stable, actually this particular quarter, it has moved up about Rs. 2.5 per kg so, we see steady movement up only.
- Shashank Kanodia:** Okay. And something about this order from Crompton Greaves you can throw some more colour on it?
- N. K. Khandelwal:** Yes, till now Pitti was not focusing on the small laminations. Crompton Greaves is well known brand on the home appliances side particularly electrical items. We have signed an agreement with them for supply of about 1,000 MT of lamination for ceiling fan for which they have a huge demand, and earlier they use to get it from the captive unit but now that division is hived off. So, there is a lot of potential we can go up to 3,000 MT over a period of 2-2.5 years.
- Shashank Kanodia:** Okay. And what are the margins on this small laminations part, is it the same what we realize?
- N. K. Khandelwal:** Yes, it will be similar. So, less than the export but in comparison to our domestic margins.
- Shashank Kanodia:** Okay, because previously we do not intent to do that because it is not very good margin accretive to us, right?
- N. K. Khandelwal:** If you have to increase the volume, you have to be in all the markets and once we come up with Aurangabad facility, it will help us in utilization of our scrap which we are generating from certain models. So, it makes sense for optimizing the use of material.
- Shashank Kanodia:** Okay. And what about Siemens, you have been mentioning that you also received any firm order from Siemens this time?
- N. K. Khandelwal:** Yes Siemens, it is for the machined castings.
- Shashank Kanodia:** Okay. But that will eventually happen in FY2018 only, right?

- N. K. Khandelwal:** No, that will start from the end of the current financial year in the new machine shop.
- Shashank Kanodia:** Okay. And is it a firm order like two years - three years contract period or something like...
- N. K. Khandelwal:** No, it is not. It is about 40-50 numbers per month that needs to be machined.
- Moderator:** Thank you. We have the next question from the line of Rita Tahilramani from Edelweiss. Please go ahead.
- Rita Tahilramani:** Sir, most of my questions have already been answered. Only on this GE order, so what are further opportunities do we see in further opportunities from these kind of orders because we are seeing new locomotive factories by Alstom also so, are expecting more orders on these ends?
- N. K. Khandelwal:** Yes, for GE, already we have bagged the order for the diesel locomotives for various parts. Some quantities might go up as the period progresses. Other than that it also opens the opportunity for supply of similar parts to GE International. Few of such parts we are already supplying to GE USA, some other parts we will be making for the first time for supply against contract. So, this part once we start doing for Indian market, it will open the market for the international supplies also. The other opportunity is for the similar parts for Alstom because Alstom has also bagged the order for the supply of electric locomotives so, though Alstom is moving very slow right now but we are sure that this order will also come to us. We are supplying laminations to Alstom, it is our existing customer and this is a similar part which we have been regularly making for other customers.
- Rita Tahilramani:** Okay. So, are these orders already put on bid or has the bidding started for these orders?
- N. K. Khandelwal:** No, these discussions have started the process is going slow but it is going on.
- Rita Tahilramani:** Okay. And like are we seeing a lot of activities on the Indian Railway and also we are hearing a lot of things happening on Indian Railways in the news so, are we planning to enter into the Indian railway market like cater to the Indian Railway market?
- N. K. Khandelwal:** No, we are not planning to enter directly with the Indian Railways but we are supplying parts through various vendors of Indian Railways. So, this is a regular business for us which we are doing and that will be actually in the form of machined casting only.
- Rita Tahilramani:** Okay. And like what are the problems do we face while we had executed one order for Indian railway, is that clearance issue or funding issue what were the issues that we had faced earlier?
- N. K. Khandelwal:** No, we have not faced any issue, we do not actually approach Indian Railways mainly because of the way it works.
- Rita Tahilramani:** Okay. So that has not yet improved.

- N. K. Khandelwal:** No.
- Moderator:** Thank you. We have the next question from the line of Kauval Bubna from SKS Capital and Research. Please go ahead.
- Kauval Bubna:** I am just curious what would realizations per tonne be like for this small lamination business?
- N. K. Khandelwal:** For small lamination realizations would be around Rs. 80 per kg.
- Moderator:** Thank you. We have the next question from the line of Shashank Kanodia from ICICI Securities. Please go ahead.
- Shashank Kanodia:** What will be the volume of stators in this quarter and last quarter, Q2 and Q1 FY2017?
- N. K. Khandelwal:** Okay, that was 36 versus 110.
- Shashank Kanodia:** 36 is in this quarter?
- N. K. Khandelwal:** No. In Q2 it was 110 and in Q1 it was 36.
- Shashank Kanodia:** Okay. And this 110 run rate is sustainable going forward Q3, Q4?
- N. K. Khandelwal:** Yes, we expect that it will be sustainable this second-half also.
- Shashank Kanodia:** Okay. And sir, is there any tax benefits which are available to us because of some losses that we incur last year any, we have full corporate 33% tax to paying company?
- N. K. Khandelwal:** No, since last year we had a loss so, definitely there will be benefit this year but MAT has to be paid.
- Shashank Kanodia:** But the tax rate for us will be 33% or will be the guidance on the tax rate for us then?
- N. K. Khandelwal:** It will be less than 33% because there will be a benefit of brought forward loss.
- Moderator:** Thank you. Ladies and gentlemen, as there are no further questions, I would now like to hand the conference call over to Mr. Ganti for closing comments. Thank you, and over to you, sir.
- N. R. Ganti:** Thank you, all of you. In case you have any further more questions, please reach out to Churchgate Partners where you can send your query by e-mail, we will answer them as quickly as possible. Thank you.
- N.K. Khandelwal:** Thank you.

Moderator: Thank you very much. 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

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