

Earnings Conference Call

Q1FY2016

August 12, 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 Q1 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. Joining us today from the management are Mr. N.R. Ganti – Director and Mr. Vijay Kumar – Executive Director & CFO.

Before we begin, I would like to mention that some of the statements made in today's call maybe 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 over to Mr. N.R. Ganti, thank you and over to you sir.

N.R. Ganti:

Thank you. Good evening and welcome everyone to our Q1 FY2016 earnings conference call. I have with me on call today Mr. Vijay Kumar – Executive Director & CFO. Mr. Akshay Pitti – Vice Chairman & Managing Director unfortunately is not there so he is not able to join us. 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 operational performance. We will then open the call for an interactive Q&A session.

India's Index of industrial production grew by 2.7% in May 2015 compared to a growth of 5.6% in the same period last year. This decline was primarily due to a sharp fall in capital goods and consumer goods sector. Capital goods sector which continued its downward trend recorded a growth of 1.8% in May. Delayed and deficient monsoon trends followed by unseasonal rains and limited increases in price of agriculture produce have hurt farm incomes holding back faster recovery in factory output growth. However, the manufacturing sector registering a growth of 2.2% in May while mining production picked to grow to 2.8% compared with 0.2% in April 2015. Data suggesting that the government has been actively taking efforts to boost infrastructure such as mining and electricity. Despite the softness in India's economic recovery we continue to build on our growth momentum.

During the quarter we recorded a robust volume growth of 4.6% to 5,107 metric tons compared to same period last year. This growth was driven by a strong growth in exports supported by steady performance of the domestic business. Domestic volume for the quarter was 3,224 metric tons, a marginal decline of 5.2% year-on-year due to seasonality. However, export volume increased by 26.9% to 1,884 metric tons compared

the same period last year. Demand for our stator frames also experienced a robust growth with 95 units in this quarter. As a result of this strong growth in volumes our revenue for the quarter increased by 19.0% year-on-year to Rs. 857 million. Of the total sales, domestic sales accounted for 49% and remaining 51% was contributed by exports.

Domestic sales for the quarter marginally declined by 3.1% year-on-year to Rs. 419 million. Export sales for the quarter was Rs. 433 million an increase of 54.4% compared to the same period last year. The other operating income accounted Rs. 5 million. Our EBITDA for the quarter was Rs. 94 million an increase of 21.4% compared to Q1 FY2015. EBITDA is defined as profit from ordinary activity before finance cost, depreciation, and exceptional items and includes FOREX loss or gain. EBITDA margin for the quarter was 11.0% indicating an improvement of 19 basis points compared to same period last year, improved capacity utilization, improved margin. PAT for the quarter increased by 77.9% Rs. 15 million compared to the same period last year. This improvement in profitability was driven by higher operating profit. PAT margin for the quarter was 1.7%, an increase of 58 basis points compared to the same period last year.

Moving to our leverage profile, we are quite comfortable with our current capital structure. As of 30th June, 2015 our total debt was Rs. 1,645 million which included Rs. 377 million of long-term debt and Rs. 1,268 million of short-term debt. Cash and cash equivalents for the quarter was Rs. 186 million resulting in a net debt position of Rs. 1,459 million. The overall increase in short-term debt is driven by higher working capital requirement to support increased volume demand. Long-term debt increased by around Rs. 100 million on account of CAPEX related to Pune plant. The net worth of the company was Rs. 1,187 million at the end of the quarter. As of June 30th, 2015 we had a conservative leverage profile with total debt to equity of 1.4x and net debt to LTM EBITDA of 3.3x.

Despite first half of the fiscal year being relatively slower as compared to second half during seasonality in our industry we continue to record strong performance in this quarter beating expectations. Our order book continues to remain robust which gives us the visibility for a strong performance over the medium-term. Furthermore, we also believe that the various initiatives undertaken by the government to boost Indian economy coupled with the focus on infrastructural development will drive the performance of our company in the long-term.

We would like now to open the call for question and answer session. Thank you.

Moderator:

We will now begin with the question and answer session. The first question is from the line of Ritesh Mistry from Money Bee Advisors. Please go ahead.

- Ritesh Mistry:** My question is regarding inventory. During the current quarter our inventory was very high, is around Rs. 14 crores, so whether it is WIP or finished goods?
- Vijay Kumar:** These are raw material and work-in-progress. To keep in mind the momentum in exports, we were imported material, hence there is a growth in raw material and work-in-progress mainly.
- Ritesh Mistry:** This inventory may not be there in the next quarter, right?
- Vijay Kumar:** Will come down.
- Ritesh Mistry:** This is related to exports or domestic business?
- Vijay Kumar:** Majority to exports.
- Ritesh Mistry:** Regarding this export-import policy, the changes, the Merchandise Exports from India Scheme (MEIS) withdrawal, so how it will affect going forward?
- Vijay Kumar:** Previously it was called FES now they are calling MEIS. They are giving 2% incentive to the exports on FOB value. That has been dropped by the government for exports to US and Europe. So that 2% impact will be there on other income. That means on the FOB 2% incentive will not be there.
- Moderator:** The next question is from the line of Shashank Kanodia from ICICI Securities. Please go ahead.
- Shashank Kanodia:** Just to reiterate your point, can you explain us what was the export incentive exactly in terms of MEIS, what is it?
- N.R. Ganti:** This incentive was introduced from 2011. The new policy 2015-2020 for this particular incentive for products to US and Europe has been withdrawn. Several representations have been made at the Ministry level and we are hoping that they may reconsider.
- Shashank Kanodia:** The 2% incentives, was this in form of interest subvention or is it in the form of the top-line that we generated from exports?
- Vijay Kumar:** DGFT will give the license. The license is tradable, we can use it for import of capital goods and import of any raw material instead of paying excise duty and customs duty etc., or we can sell it. It's like a cash equivalent.

- Shashank Kanodia:** So in terms of absolute amount what was this quantum in FY2015?
- Vijay Kumar:** It depends upon export volume and FOB, 2% on FOB will be affected. In the first quarter it has affected around Rs. 80 lakhs.
- Shashank Kanodia:** You used to classify that as a part of other operating income, or it is part of other income?
- N.R. Ganti:** It is reflected in our other operating income.
- Shashank Kanodia:** Secondly as mentioned in point number four as part of your result release regarding the movement of scrap prices. So can you please throw some light about how does it affect us?
- N.R. Ganti:** Because of the metal prices coming down universally the scrap prices also have been subdued. We are optimistic that it may get corrected soon.
- Shashank Kanodia:** This quarter gone by what was the droppage scrap prices that we realized on YoY basis?
- N.R. Ganti:** Compared to last year perhaps closer to 20-25%.
- Shashank Kanodia:** 20% was it down?
- Vijay Kumar:** Yes.
- Shashank Kanodia:** Still we clocked our 11% kind of EBITDA margins, so is this margin sustainable or given that scrap values are already weak so it's bound to decrease going forward?
- N.R. Ganti:** The margins are likely to be the same if not better because we expect our volumes to pick up. Once it crosses a certain critical operating level the profitability improves as you know.
- Shashank Kanodia:** Since the steel prices are on a downward trajectory so given that what kind of contracts do we have with our customers? Is it like fixed price contracts in terms of Rupees per tonnage or is it as a percentage of sales in our margins?
- N.R. Ganti:** Raw material prices are pass through, every quarter we adjust those prices.
- Shashank Kanodia:** Even let's say we manufacture electrical steel laminations and electrical steel prices is around Rs. 30,000 -31,000 per ton, so even the imported prices will decrease by some quantum, so in that case our absolute EBITDA is on a downward trajectory or you still maintain the absolutely figures, even in terms of margin.

- Vijay Kumar:** It will remain the same. Because of fluctuation of the raw material price will pass through. We have a price variation clause with our customers, the increase or decrease will be passed through to the customer on quarterly basis. So that will not impact EBITDA.
- Shashank Kanodia:** So absolute EBITDA will remain same even with margins 11% something?
- Vijay Kumar:** It depends on production & sales volume.
- Shashank Kanodia:** Were there any new client acquisitions in domestic or the export market?
- Vijay Kumar:** We keep on adding few customers. This is a small segment, and is not like an open market. Whoever maybe entering into India on our segment we are on touch base with them.
- Shashank Kanodia:** If you can explain us the hedging policy of the company given that to a fair understanding we were already hedged at Rs. 64 still we had some losses of Rs. 0.8 crores reporting this quarter?
- Vijay Kumar:** For FOREX, what we do is after set-off the export and import, the balance we take forward cover. So this FOREX gain or loss will arrive as per the AS11 Accounting Standard. Some of the portion is only notional and some portion is actual.
- Shashank Kanodia:** Up to what level of currency depreciation Rupee are we hedged right now?
- Vijay Kumar:** After setting off the exports and imports, we only hedge the balance on quarterly basis and we don't hedge on long term basis.
- Shashank Kanodia:** What we have observed was that for Rupee 1 depreciation what we realized was Rs. 1 crores of FOREX loss whether if Rupee appreciates with Rs. 2 odd, we realize 2 crores of FOREX gain as it was prevalent in previous quarter. So is this a fair understanding?
- Vijay Kumar:** No, depends upon how much you utilized the foreign currency loans / FLCs and all will impact the FOREX loss / gain apart from the business. Suppose we take more cash credit in foreign currency if it is not converted into foreign bill discounting it is exposed to the decrease and increase of rupee. It's a transaction basis.
- Shashank Kanodia:** In your corporate presentation you have mentioned about reaching 1,000 crores of top-line by FY2018, so if you can briefly explain us the contours about how will that happen over a period of time?

- Vijay Kumar:** We are having almost Rs. 650 crores to Rs. 700 crores capacity as on date. We are expecting within three years we will cross. And we are also having some inorganic plans in pipeline, which are yet to be finalized. With this we are expecting to achieve cross Rs. 1,000 crores within three years.
- Shashank Kanodia:** Like you mentioned your laminations business will contributing Rs. 570 odd crores, casting Rs. 150 crores, so presently in FY2015 what was the top-line of the casting business?
- Vijay Kumar:** FY2015 top-line is around Rs. 50 crores.
- Shashank Kanodia:** Bottom line PAT level?
- Vijay Kumar:** The audit is underway and yet to conclude.
- Shashank Kanodia:** So this Rs. 50 odd crores you are planning to take it to Rs. 150 odd crores in two years' time.
- Vijay Kumar:** Yes it will happen, lot of activities now picking up.
- Shashank Kanodia:** What kind of margins do we realize into this segment?
- Vijay Kumar:** 8-10% margins will be there. It depends upon the product mix.
- Shashank Kanodia:** We are sticking to our guideline of 24,000 tons of laminations tonnage for this year?
- Vijay Kumar:** Yes.
- Shashank Kanodia:** And Rs. 440 crores of gross sales?
- Vijay Kumar:** Subject to steel prices, USD rupee parity, job work quantity and product mix.
- Moderator:** The next question is from the line of Priyakant Dave from Axis Securities. Please go ahead.
- Priyakant Dave:** On the GE order front just wanted to understand from you, we have around Rs. 600 crores worth of the order visibility from the GE as per what I understood and that will be spread across three years. So first of all would like to understand a breakup of the order. I mean to say in terms of the vertical which are the area we have got or is this one single order or spread across various orders?

- Vijay Kumar:** It's a three year long-term contract with GE for three calendar years 2015 to 2017. That is an assured business. Per annum you can say that Rs. 200 crores minimum. So it all mix up, lamination business including all types of models in the Pitti Lamination, stator, rotor, stator bodies and barrels all together.
- Priyakant Dave:** In terms of the end-user industry I am asking.
- Vijay Kumar:** For them it is the transport and mining division.
- Priyakant Dave:** Any percentage break-up?
- Vijay Kumar:** Majority is going to transport 60-65%.
- Priyakant Dave:** Another is mining you said?
- Vijay Kumar:** Yes. Mining, off-highways vehicle, etc.
- Priyakant Dave:** Now when you use this word assured business, so what is the meaning of that? I mean we have any security or guarantee return, in that lines?
- Vijay Kumar:** We agreed some quantities.
- Priyakant Dave:** So there is no chance of a cancellation of the part of the order kind of a thing?
- Vijay Kumar:** Cancellation may not be possible, there is a possibility of deferment. Sometimes it may defer one quarter to other quarter.
- Priyakant Dave:** So we have that surety that the cancellation is unlikely?
- Vijay Kumar:** 3 months to 5 months they may defer, it also based on their order inflow.
- Priyakant Dave:** In terms of the payment received how we get the payment from GE particularly, in terms of the time lag?
- Vijay Kumar:** Time lag means they will pay after receipt of the goods, they will pay after 120 days.
- Priyakant Dave:** Is this higher compared to the other customers or in line with other customers?
- Vijay Kumar:** On domestic customers 90 days means it is only immediately 90-95th day but whereas an export customer means the goods will reach there by 60-70 days, from there quality

check in, all put together it will take 180 to 200 days. We cannot compare with the domestic customer.

Priyakant Dave: But largely can I assume that for the export volume our dependency is on GE or are we also in the pipeline of adding new customers?

Vijay Kumar: Domestic we are adding.

Priyakant Dave: No, in the export. First of all in the export are we totally dependent on GE?

Vijay Kumar: It looks GE for you but we are having three different companies of GE group. GE Transportation is one, GE Power is another, mining Section is different, for us it's a different group companies of GE.

Priyakant Dave: Now coming to the domestic market, looking at the current situation of China what you see threat from China in terms of the supply of a similar line of product what we supply. So are we getting a similar line of product from China in Indian market?

Vijay Kumar: No, we are not getting anything like that. Suppose we are 100% suppliers to certain customer then it's not so easy for that particular customer to migrate to another supplier because the development time for required product will be long.

Priyakant Dave: No, what I mean to say, when China start dumping any product, may be rotor and the lamination set what we are into the business then definitely there must be a price gap between our pricing and the price at which China supply.

N.R. Ganti: Mr. Dave, this is not an off-the-shelf item, what we manufacture, specifically made to order, engineered for each of our customers. Our customers have the IP for entire motor design. They share that with us. So we manufacture to the specification of what they want. That calls for a lot of understanding of what they need and also adherence to certain quality standards and also adherence to on timely deliveries. China has not been able to come into that picture at all.

Priyakant Dave: So we do not have fear from China?

N.R. Ganti: No.

Priyakant Dave: Also within the domestic market this industry does not have a price war kind of a situation?

- N.R. Ganti:** Domestic players are present in both industrial sector as well as domestic sector. Domestic sector is actually very vulnerable for price sensitivity and competition because it's a standardized and manufactured in bulk and have them off-the-shelf. Like for instance if we look at ceiling fans or ACs and so on which have internal laminations, so those are easy to fall prey for competitive pricing. But industrial motors are all different. They are designed and manufactured for a particular project. So we are basically into industrial motor manufacturing. There are only two or three other companies in India who actually compete with us in our space.
- Priyakant Dave:** We are also planning to start manufacturing the entire motor and sell in the market rather than supplying rotor to the motor manufacturers.
- N.R. Ganti:** I don't know where you got that from. Our intent is to be facilitator to our customer and try and give as much value added product as possible to an extent where they simply have to label it and then sell it as their own motor. We have no intention of making motors on our brand name and sell into the market. We do not compete with our own customers.
- Priyakant Dave:** I don't mean to say brand name but in your presentation only you said the new revenue line around 24-25% of the revenue by FY2018.
- Vijay Kumar:** That's right. That is our forward integration plan. When we thought of the targets to have inorganic growth,
- Vijay Kumar:** We keep making value addition and we want to achieve that majorly. Suppose if you take a big motor, 70 to 80% job we will complete at our end and rest we will give it to the customer to do at their end. We don't want to come into the motor manufacturing and keeping our labels and competing with our own customer base.
- Moderator:** The next question is from the line of Chirag Shah from ICICI Securities. Please go ahead.
- Chirag Shah:** I just wanted to know the absolute value of scrap sold during the quarter.
- Vijay Kumar:** Approximately Rs. 9 crores.
- Chirag Shah:** Coming back to your domestic business you said it has got some seasonal flavor to it, the first half being soft and things picking up in the second half. So are you getting any sense from your domestic customer like ABB, Cummins, or Siemens that things are looking bright for second half so that your domestic sales pick up?
- N.R. Ganti:** I think so. I think there are lots of positive signs.

- Chirag Shah:** Because whatever commentary we have come across for all these players they are still not that gung-ho about a CAPEX recovery even in this particular fiscal?
- N.R. Ganti:** It is true that they are not adding capacities. However we are increasing our share of the pie.
- Chirag Shah:** Finally some color on your operations of the Pune plant, have they stabilized and are they working on a normal pace and what are the kind of savings that we are registering because earlier our motive to set up this plant was to save on logistics cost and have a better customer proximity so are we getting traction on that particular front?
- Vijay Kumar:** We have already producing reasonable quantity and to scale up we have imported some machinery. Those machines have to be erected and commissioned soon then the scalability will increase.
- Chirag Shah:** So in your guidance of Rs. 440 crores of revenues what proportion of revenues are you expecting to come from the Pune plant just for this year?
- Vijay Kumar:** Pune plant about Rs. 50 crores.
- Chirag Shah:** What was the figure in first quarter?
- Vijay Kumar:** First quarter not much. In fact we have started commercial production in mid April only so the actual momentum started in June-July.
- Moderator:** The next question is from the line of Dixit Doshi from Whitestone Financial Advisors. Please go ahead.
- Dixit Doshi:** We have a long-term agreement with GE so entire this Rs. 600 crores will be for the export?
- Vijay Kumar:** Yes exports only.
- Dixit Doshi:** GE recently had started the multi-model plant in Chakan and we also are present in Pune so is there any possibility of getting orders from that Chakan facility also?
- Vijay Kumar:** Yes we are exploring.
- Dixit Doshi:** So we can expect in domestic market also order from GE's new multi-model plan?

- Vijay Kumar:** Yes, new models, it takes some time to develop the models also. Because it's not over overnight, we need minimum 9 months for development.
- Dixit Doshi:** But we are actively looking at that approach?
- Vijay Kumar:** Yes we are in touch base with them.
- Moderator:** As there are no further questions I would now like to hand floor over to Mr. N.R. Ganti for closing comments.
- N.R. Ganti:** Thank you very much for your participation. If you have any further questions, please don't hesitate to reach out to our IR advisor, Churchgate Partners and they will get back to us and we will in turn answer all your queries. Thank you.
- Moderator:** Thank you. 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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