



“GMM Pfaudler Limited Q2 FY 2018 Earnings Conference Call”

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Management: **Mr. Tarak Patel -- Managing Director, GMM Pfaudler Limited**
Mr. Jugal Sahu -- Chief Financial Officer, GMM Pfaudler Limited
Mr. Ashok Pillai -- Chief Operating Officer, GMM Pfaudler Limited

Moderator: Ladies and Gentlemen, Good day and Welcome to the GMM Pfaudler Q2 FY 2018 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.

I now hand the conference over to Mr. Binay Sarda. Thank you and over to you, sir!

Binay Sarda: Thank you, Raymond. Good Afternoon, to all the participants on the call. Welcome to Q2 FY 2018 Results Earnings Call of GMM Pfaudler Limited. Please note that we have e-mailed the Results and the Press Release and the same are also available on the Company’s Website. In case, you have not received the same you can write to us and we will be happy to send the same over to you.

To take us through the results and to answer your question today, we have Mr. Tarak Patel -- Managing Director, GMM Pfaudler; Mr. Jugal Sahu -- Chief Financial Officer; and Mr. Ashok Pillai – Chief Operating Officer.

We will start the call with brief overview of the quarter gone past and then we will go into the financials which will then be followed by the Q&A session.

I would like to remind you that everything that is said on this call that reflects any outlook for the future which can be constituted as forward-looking statement must be viewed in conjunction with the risks and uncertainties that we face. These uncertainties and risks are included but not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual report which you can find on the website.

With that said, I will now hand over the call to Mr. Tarak Patel. Over to you, sir!

Tarak Patel: Thank you, Binay. To start-up by saying that we are pleased to inform you that we have had a pretty strong quarter and we have also had a very strong order book as we continue to have a healthy backlog which puts us in a strong position for the year. As per what we had planned, we are on target of meeting both our revenue and profitability numbers for the year.

To take you through the quarter, revenue grew by 21% year-on-year and when I say, year-on-year I am comparing this quarter with the previous quarter last year, but this is net of excise because last quarter previous year results were re-casted with the excise numbers. When I take you through the numbers, I am going to give you the numbers net of excise.

So it was Rs. 76.4 crores this quarter revenue versus Rs. 63.1 crores in the same period last year and there is an increase of 21%. Quarter-on-quarter we have improved our revenue by about 10% which is Rs. 76.4 crores versus Rs. 68.9 crores previous quarter.

Our EBITDA YoY is up by 7% we are at about Rs. 11.6 crores versus Rs. 10.8 crores in the previous year and on a QoQ, we have improved the EBITDA by about 47%. As a percentage of revenue year-on-years, the EBITDA percentage is down by 3% but on a quarter-to-quarter it is up by 4% from 11% to 15%.

Profit before tax had also improved by 2% year-on-year, about Rs. 10.7 crores versus Rs. 10.5 crores and has improved by 27% quarter-on-quarter which is Rs. 10.7 crores versus Rs. 8.4 crores. The profit after tax have also been maintained YoY and quarter-on-quarter it has improved by about 25% and has jumped to about Rs. 7 crores versus Rs. 5.6 crores in the previous quarter.

So all-in-all, it has been a strong quarter, we are continuing with our growth story, as we diversify, and we focus on new product lines, we have been able to use those product lines to show some growth momentum. We are happy with the results and there are some projects that we are currently running which is expensed out in these quarters and these are non-recurring one-time expenses, so we will see benefits of these projects in the quarters to come.

Having said that let me open this call up for any questions that you may have and we would be pleased to answer them. Thank you.

Moderator: Sure, thank you very much. We will now begin with the Question-and-Answer Session. We have the first question from the line of Rohit Chawla from Axis Securities. Please go ahead.

Rohit Chawla: So firstly, I had some questions. So we saw revenue jump of 21% however, our EBITDA was flat and on the expenses front, we are seeing that cost from materials and employee and labor cost are increasing. So what are the reasons for this? Firstly, my assumption may be wrong that the contribution of non-Glass Lined is increasing as well as we had hired a consultant as well to increase the capacity. So, were these the reasons?

Tarak Patel: Right. So you are actually right. We are running a process where we have external consultants who are helping to increase our throughput in the Glass Lined business and that is long seven month project that we are working on. And obviously, we are seeing some of the benefits now. But the benefits are more long-term as we jump our production capacity. There has also been a change in the product mix. The non-Glass Lined business is more material intensive as well as the cost increase because of contractual labor as well. So, you are right both the change of product mix as well as the external consultants have increased the expenses. Having said that, also, there has been a slight incremental increase in energy cost as well because the incremental production has now come out of the Electric Furnaces. As you know we are in the process of installing a new Gas Furnace and that should happen by the end of the year or may be January or so and once that happens all the incremental production will come through only the Gas Furnaces and that obviously, will have a big impact on our profitability making our cost structure much more competitive.

Rohit Chawla: Okay. So how much percentage point will this Gas Furnace reduce our raw material cost by?

Tarak Patel: So, I cannot give you an exact percentage because we will only be using it for two months this year. But again, it is a long-term benefit that we will have. But we will see some margin improvement in the last two months. But the real benefits will come in the following years.

Rohit Chawla: Okay. So we expect our capacity to increase from 1,400 vessels to 2,000 vessels by the end of this year or this quarter, the current quarter?

Tarak Patel: By the end of this year.

Rohit Chawla: By the end of this year, okay. So what is the capacity utilization in the Glass Lined business currently?

Tarak Patel: So currently we would be about let us say 80% or so and with the additional changes that we are making we could probably free up some capacity as well. But we would be about 80% to 85% right now currently.

Rohit Chawla: Okay, that is correct. So where are we seeing demands, which end user industry? So I think Agro Chemicals and Specialty Chemicals or the pharmaceutical space?

Tarak Patel: Yes, that is correct. I mean the pharma industry is down with all the issues that we are having. So that slack has been taken up by the Specialty and Agro Chemicals which are still very strong.

Rohit Chawla: Okay. So do you think this pharma slowdown bottoming out and there is some visibility in demand which already going forward?

Tarak Patel: It is difficult to say, it may take some time before they recover and where the markets are expecting before they can get back to the margin level that they had and also to get the markets they have lost for the short-time. But there is talk of the company that usually has held expansion. There has been some talk about them going ahead with projects; obviously we have not seen it happening yet. But at least they starting to think and talk about it.

Rohit Chawla: Okay. And again, that thing on pharma is progressing now so anything from that end?

Tarak Patel: There was actually supposed to be some meeting last to last week. I have not heard anything, but probably in the next few weeks we will hear something on that.

Rohit Chawla: Okay. Also on the exports front, I think we had repeat orders from our parent Pfaudler, so did that contribute in this quarter?

Tarak Patel: That had contributed not in this quarter, it contribute in next quarter.

Rohit Chawla: Okay, next quarter. Okay. So this quarter how much that export constitute of our revenues 1% or 2% maybe?

Tarak Patel: So again, export is not a big number, we do have a decent amount of exports in our backlog more than what we normally had last year at this time. But again, I would just like to remind everybody that 90% - 95% of our business is domestic. But exports are increasing and we will see probably more exports this year than we did in the previous year.

Moderator: We will take the next question from the line of Vishal Tandon from Kedia Shares. Please go ahead.

Vishal Tandon: Most of my questions have been answered as questioned by the earlier guy. So the left over is the book keeping question. Can you just give me the figure of the order book?

Tarak Patel: So we do not share the order book numbers, Vishal. But what we can say is we do have a very healthy backlog, it is definitely higher than what we had in the same time last year. And it gives us enough visibility to at least tell you that we are confident of making the numbers that we have planned for this year.

Vishal Tandon: Okay. So, let it put in this way. The visibility for next 6 months or for next 12 months?

Tarak Patel: Yes, may be a little bit more than that we do have visibility.

Vishal Tandon: Okay, that is great. Can you just also give me some brief outline about this proprietary product and the market potential?

Tarak Patel: So proprietary products, you know it is complementary product line to our Glass Lined business, so it goes into the same customer base that our Glass Lined the business goes to. So, we have very strong relationship with these customers and definitely we can leverage that. We also do a lot of intercompany transactions with our subsidiary in Switzerland; they buy a lot of components from us in these proprietary products division and that helps them become more competitive in the European market. There is also mixing systems which we consider for our proprietary products and we have seen good amount of traction in that. We have got a few large orders this year and we are definitely going to be much better in performance in those segments than we were in the previous year.

Vishal Tandon: And any idea about the margin profile in this proprietary product?

Tarak Patel: So margin profile is probably slightly lower than the Glass Lined profile. But again, you have to differentiate yourself and you have to probably focus on more critical applications where customers will pay you a premium for your application as well as the surrounding the technology that you bring in.

Vishal Tandon: So can we see going forward say in next two years - three years this segment of business taking over the Glass Lined business?

Tarak Patel: Probably not. Not in the similar rate. The Glass Lined is still going to be a bread and butter and still accounts for about 65% to 70% of our total revenue. But the Glass Lined market is only so big while the other markets definitely have a good growth potential.

Moderator: Thank you. The next question is from the line of Sanjay Shah from KSA Securities. Please go ahead.

Moderator: Due to disturbance in line of Mr. Sanjay Shah, we will move to the next question. The next question is from the line of Nikhil Mathur from Ambit Capital. Please go ahead.

Nikhil Mathur: I do have a couple of questions. The first question would be that how do you see the CAPEX shaping up in the next couple of years, given that in Glass Lined you are now 80% - 85% of utilization where do you see that, I mean there has been increase in CAPEX in the last couple of years but again, do you see a rise in CAPEX in 2018, 2019 - 2020 maybe?

Tarak Patel: No, we do not see any major CAPEX happening in the Glass Lined division for the next couple of years, our CAPEX is going to be limited to just maintenance CAPEX because all the CAPEX that we wanted to do for Glass Lining will be done with the Gas Furnace that we ordered and which is getting installed and commission by end of year or early January 2018.

Nikhil Mathur: Okay, thank you, sir. And my second question would be, I understand that margins in your non-Glass Lined profile are improving I mean quarter-on-quarter they are above I think, 1.6 percentage points. How do we see this margin shaping up given that you are utilizing more capacity in the non-GL space, is there further room for your margins going up in heavy engineering business?

Tarak Patel: Yes, I believe so. If we can pick and choose the orders you know we are continuously learning. There are orders in the past that when we wanted to grow this business, we would not take now. We also kind of understand that there is a different material out there. There are exotic materials which give you more value and simpler jobs, those are the kind of jobs that are focusing on and we are also focusing on export orders in this business line. And we have found a lot of traction with the Pfaudler network. We have recently received order from Europe for a €250,000 for a heavy engineering product as well and there are quite a few opportunities open right now around the world. I think we can convert them into orders that will really improve the profitability profile of the heavy engineering business.

Moderator: Thank you. The next question is from the line of Sunil Jain from Nirmal Bang Securities. Please go ahead.

Sunil Jain: My question relates to you said that you got second order from the parent company. Is this a bigger order then what you got a trail order earlier?

Tarak Patel: No, the same size. So they just sold first ordered equipment to end customers and they placed the same size order again.

Sunil Jain: Okay, of the four vessels

Tarak Patel: 6 vessels.

Sunil Jain: And sir, where you see margins in heavy engineering business. No doubt that is growing very well. But with the growth what we are seeing, what is the scope of improvement in margin in this?

Jugal Sahu: Last year same period we had about 6% margin. Now our margin improved to 9% since our revenue is almost doubled.

Sunil Jain: Yes, true. But do you see that this is moving somewhere at least in double-digit with this improvement in the revenue?

Tarak Patel: So I believe that is possible. There are many companies out there in heavy engineering space that make very good margins and that definitely our aim. Obviously, we are new entrant to this market. So before we can pick and choose the order that we want to do, we have to build some capabilities within ourselves, we have learned from our mistake that we have done in the past. In the coming quarters you will probably see more margin improvement be the orders we have been able to pick and choose because we have had a strong backlog, so we did have the flexibility to pick and choose and let go some low margin orders. So that is something that we are continuously doing and margin improvement is something that even for next year we have plan of improving margins even further both by improving our the efficiencies and our process as well as increasing prices in the market.

Sunil Jain: And sir, last thing this proprietary product, here the margins are quite low. Considering the name that proprietary product generally people expect the margin to be very good. So why this is so low compared to all our other businesses?

Tarak Patel: So in the proprietary product again it is a bunch of different products, there could be some strategic initiatives or entering some markets or taking some orders which could have reduced prices. But on the longer-term I think they should fall back in line with the other profitability numbers which are

closer to the Glass Lined space. Again, you are right proprietary products by its nature should have more technology and once, we are can differentiate ourselves and sell technology as well as process knowledge; we can probably improve our margins there.

Sunil Jain: Sir, last question about this Mavag which is our subsidiary, can you throw some light on how was the result in nine months?

Tarak Patel: Six months.

Sunil Jain: Yes, six months, sorry.

Tarak Patel: Yes, the Mavag results are good. They are on track of the plan for the year. Obviously, we do not share Mavag numbers on a half yearly basis. But may be to give you more visibility from next year we might start thinking about giving consolidated numbers. But in general, to say that they have a very strong backlog as well. And they will definitely do better than they did last year.

Sunil Jain: Whether they can show companies like standalone growth type of thing, is it possible for them Mavag?

Tarak Patel: Yes. So they will show some growth this year both in the top-line as well as bottom-line. They will improve their revenue and profitability as well.

Moderator: Thank you. Next, we have a follow-up question from the line of Rohit Chawla from Axis Securities. Please go ahead.

Rohit Chawla: Sir, as you said we will growing going forward and technology also will play a major factor. So, are we investing more into R&D or something or like Furnaces as you said, any other technological front we are investing because you have cash on our books?

Tarak Patel: So we are not investing, but we are building capabilities, so we are adding resources that are different skill set current resources that we have. So, when we look at what we have currently basically the mechanical engineers that we have and the design engineers.

Rohit Chawla: Okay. So, any acquisition is being planned, anything on the table?

Tarak Patel: No, acquisition is planned as of right now. (I think the telephonenumber has gone to mute) I just want to finish what I was saying so, I said in the past, we have had mainly mechanical engineers, we are now moving towards having process knowledge and the process engineer. So that is a whole different skill set that we are bringing in and these guys have a different amount of knowledge that can help design complete systems and processes which obviously will give us better margins and more credibility with the customers. What was the other question, sorry?

Rohit Chawla: Yes, second question was acquisitions.

Tarak Patel: We are always open to acquisitions you are right, we are sitting on cash in our books, we are looking at different options available and hopefully something will work out

Rohit Chawla: Okay. Sir, in terms of order backlog, can you say percentage terms that how much the increase from last year, so for the next six months are we 40% higher on the order backlog or 50% higher on that front?

Tarak Patel: No. I think, we started the year with about a 50% increase in order backlog and now we are above let us say a 25% increase over if you compare the H1 of last year to H1 of this year about 25% - 30% higher.

Rohit Chawla: Okay. Q4 being our best quarter, do we expect to for the H2 do we expect double-digit bottom-line and top-line growth both for the H2?

Tarak Patel: H2, yes. H2 is always stronger than H1 and as I mentioned we are on track to beat the number. And we have the visibility so most likely we will do quite well and we will come very close to the numbers that we have planned for the year.

Rohit Chawla: Okay. And lastly on the Mavag again, a percentage Y-o-Y increase can it be shared?

Tarak Patel: I do not have those details with me right now. But again, as I mentioned that they have also grown and they will continue to grow and their numbers for the year look better than what they would have been previous year.

Moderator: Thank you. We have the next question from the line of Pvs Sreekanth from Spark Fund Advisors. Please go ahead.

Pvs Sreekanth: Just wanted to know the nature of expense that you were mentioning in your opening remarks.

Tarak Patel: Right. So there are two expenses that we have incurred which are one-time non-recurring expenses. We are working on some throughput improvement and we have external consultants who have been contracted for seven months, that project ends next month and obviously those expenses would not be coming after that. So that is the expenses that we are talking about. And there is also an external consultant who is helping us with engineering. So that is also an expense that is one-time non-recurring expense.

Moderator: Thank you. The next question is from the line of Nikhil Mathur from Ambit Capital. Please go ahead.

Nikhil Mathur: Sir, one question I had on other expenses which had already been answered. Final question I would be having is that your gross margins have improved sequentially; I mean this might be a repeat of what has already been answered before. Do you see your gross margin going up even further given that your utilization rates especially in the Glass Lined business are at near some of the peak levels, I mean is there further scope for gross margins going up?

Tarak Patel: So gross margins will only go up now when we reduce our costs and that will happen when the new Gas Furnace comes in. So, we will see a significant improvement there because right now for the incremental volume they are using our Electric Furnaces and once the new Gas Furnaces are commissioned we would not need to use any Electrical Furnaces. So that is significant amount of money.

Nikhil Mathur: So I mean the gross margins can shape up even north of 60% in the coming quarters I mean probably in H2 or start of next year?

Tarak Patel: Not only 60% was the number, I think, gross margin in Glass Lined is...

Jugal Sahu: Our EBITDA levels are around 15% and as far as Glass Lined is concerned it is about 20%. I do not know from where you are getting 60%

Nikhil Mathur: I am talking about the overall company level gross margin around 58.7%.

Jugal Sahu: So that is by reducing sales minus raw material consumption.

Nikhil Mathur: Yes.

Jugal Sahu: That is about 60%, yes that will continue at 60% and as our non-Glass Lined business grows our cost will increase further due to higher. Material consumption in NGL segment and therefore, the gross margin will reduce.

Nikhil Mathur: And this is despite the benefits of Gas Furnace coming into play?

Jugal Sahu: Yes that is there. Glass Furnace is going to reduce our power cost which is part of other expenses. You are not anywhere considering in your calculation now, when you say sales minus raw material consumption.

Nikhil Mathur: So if I reconcile other expenses then you will have the benefits of lower gas costs coming in then you will also have the non-recurring expenses ready to consultant and all, not coming through in quarter four and next year onwards, so that would be a pretty huge decrease in other expenses, right?

Jugal Sahu: That will improve our EBITDA by 2%.

Moderator: Thank you. We have the next question from the line of Gaurav Nigam from Catamaran. Please go ahead.

Gaurav Nigam: I have two questions. First one on the capacity utilization where are we and in terms of increase in capacity utilization for the next year where do we see going forward? And second one is, in our cost structure what percentage of our cost structure is fixed cost and what percentage is variable?

Tarak Patel: So in terms of our capacity utilization by the end of the year I think we still be 80% of the capacity in Glass Lined. And what was the question you had asked apart from it?

Gaurav Nigam: Second one the cost structure, how much percentage is fixed cost and how much is variable?

Jugal Sahu: It is about 25% fixed.

Gaurav Nigam: Okay. And rest is raw material and the service?

Jugal Sahu: Raw material and other variable costs like power, fuel, labor charges, contracting,

Moderator: Thank you. There are no further questions. I would like to hand the conference back to the management for any closing comments.

Tarak Patel: Thank you very much for your involvement and questions and hopefully, we will see you again in the next quarter. Thank you very much.

Moderator: Thank you very much. On behalf of GMM Pfaudler Limited, that concludes this conference. Thank you for joining us, Ladies and Gentlemen. You may now disconnect your lines.