

Praj Industries Limited
Q1 FY' 2011 Earnings Conference Call
July 26, 2010

Moderator: Good evening ladies and gentlemen. I am Sandhya, the moderator for this conference. Welcome to the Praj Industries Q1 FY '2011 Conference Call. For the duration of the presentation, all participants' lines will be in the listen-only mode. After the presentation, the question and answer session will be conducted for participants connected to WebEx International Bridge. After that, the question and answer session will be conducted for participants in India. Now, I would like to handover to Ms. Vinati Moghe. Thank you and over to you ma'am.

Vinati Moghe: Good afternoon everyone. We welcome you to this conference call organized to discuss Praj Industries' operating performance and financial results for Q1 FY' 2010-2011 which were announced earlier. I have with me Mr. Shashank Inamdar, CEO and Managing Director of Praj; and Mr. Surendra Khairnar, Assistant Vice-President, Finance. Before we begin, I would like to mention that some of the statements made in today's discussions may be forward looking in nature and may involve risks and uncertainties. Documents relating to our financial performance have been e-mailed to all of you. These documents have also been posted on to our corporate website. I now invite Mr. Inamdar to provide an overview and highlights of the business environment for the company. Thank you.

Shashank Inamdar: Good afternoon everyone and thank you for joining this con-call. I will begin by taking you through the numbers and operational matters, following which we shall take your questions. A brief overview: the income from operations was at Rs. 94 crore for this first quarter of FY' 11 as against Rs. 126 crore in the corresponding quarter last year. EBITDA is at Rs. 9 crore as against Rs. 28 crore in the corresponding quarters, and the EBITDA margin declined to 9% as against 22% earlier. PBT is at Rs. 12 crore as against Rs. 31 crore in the earlier quarter, earlier corresponding quarter, and PAT is at Rs. 10 crore as against Rs. 25 crore in the corresponding quarter. When we look at the analysis of the situation, the performance in terms of sales is largely impacted by slower movement of projects due to reasons including permits and other preparedness issues in India and lower intake of orders from the international markets. Although orders have been in the pipeline, many of the orders being in early stage have not fully come into the invoicing cycle. The margins are also depressed due to a far lower than expected revenue from

the international markets and an overall lower level of these. The markets are recovering, but the investments for new projects remain cautious. Also, we have observed that markets while recovering are still experiencing some setbacks, particularly like the one in EU, which was not factored in earlier. Please note that the business of the company usually has a lag in the economic cycle wherein it hinders the economic slowdown late in the stage and also emerges later from the same. In order to assist with the recovery, as shared with you, we have already introduced 2 new businesses. One of which addresses water and waste water treatment solutions and the other one customized engineering and manufacturing of process equipments. We expect that these businesses will show traction in the coming year end. The board has in its recently concluded meeting sanctioned the capex of Rs. 50 crore for the current year, and this has been planned to assist with this plan of the new business. Coming to order book, as on date, the order book remains the same as what we had at the beginning of June when we had the earlier analyst call, so it is at the same level of Rs. 700 crore. Our efforts will be to speed up project execution in the coming period. However, challenges remain in the short-term and we expect the trend to reverse when economic recovery becomes more permanent. Overall, for a company like ours which addresses the global markets, the markets have spread across regions like India, South East Asia, US, Europe. Out of this, US and Europe have been deferring fresh capital investments. This is reflected in our revenue profile as well as in order book. Coming to some of the key developments pertaining to the global biofuels industry, when we look at India, the government has initiated steps to introduce partial deregulation of fuel price. Under the new regulations, petrol prices will be linked to global prices of crude oil up to a price of 80 dollars a barrel, and beyond that price, the government retains the power to introduce price control as a measure to protect consumers. The price of ethanol which was fixed at Rs. 27/litre over a period of 6 months by the empowered group of ministers is under review for subsequent period. This is due to some comments by other ministries which are countering these initiatives considering that the landed cost of imported ethanol maybe in the range of Rs. 20 to 21/litre. However, the sugar production is expected to increase substantially which will result into abundant availability of molasses which is the primary feedstock for ethanol production in the country. So, as the domestic demand for beverage alcohol and rectified spirit continues to be strong, thereby providing opportunities for business. Coming to developments in other regions, the FAO and OECD report suggests that ethanol production and consumption will double by the year 2020. This translates into a huge opportunity from 80 billion liters to 160 billion liters. However, we will have to see how the mandates are pushed and implemented and how quickly the world economy recovers, particularly in USA and Europe. Although cellulosic

ethanol targets have been reduced in RFS2 in USA to 25 million gallons or approximately somewhere in that range due to the very slow speed of commercialization, this can be considered to be the first step. In the US, there are talks of introducing higher level of blending cap, that is from E10, E12 or E15 and this is considering the fact that cellulosic ethanol capacities are going to be delayed in being put up in US, and whether this cap is getting enhanced would be clear by the end of the year. In Brazil, there are reports that ethanol is out-setting gasoline again on domestic basis with 52% share of market. In UK, the National Renewable Fuels Agency has announced that the country has exceeded its target of 3.25% for the last year by blending 3.33% or 422 million gallons or 1,600 million liters. In Germany, the agriculture ministry announced that it is considering the plan to double to ethanol content in gasoline from 5% to 10% by the end of the current year, and EU has announced that it is getting ready to implement a renewable energy directive by the end of 2010. Philippines has E10 ethanol standard which is schedule to take effect in 2011. South and Central America continues to be committed to biofuels, and our presence in this region is fairly strong and we have been encashing on the same. Considering the growth areas, as we talked earlier, we are focused on the growth agenda with the two new businesses we have added. As discussed with you earlier, we are foraying into the water and waste water business and manufacture of customized equipment for process industry which is similar to distillation, evaporation and so on, and this is being done for sectors like petrochemicals, oil and gas, fertilizer, etc. With industrial growth and increase in population, one has seen a remarkable growth in demand of water. Environmental awareness is also creating the pull for technologies and systems for treating and recycling waste water from various sources. We are working on plans to apply our expertise in industrial processes for production of ethanol and alcohol to this area of waste water treatment systems. On the other front, the Cleantech Group named Praj Industries as its Cleantech Emerging Enterprise of the Year award winner in honoring truly disruptive cleantech innovation and the business models that underpin this. On R&D front, as briefed in our annual report, we are ready to scale up the cellulosic pilot plant to the demo commercial level. This is based on encouraging results from the pilot cane plant. With this, we will now take up your questions. Thank you.

Moderator: Thank you very much sir. At this moment, I would like to handover the proceedings to WebEx International Moderator to conduct the Q&A for participants connected to WebEx International. After this, we will have a question and answer session for participants at India Bridge. Thank you and over to you.

International Moderator: At this moment, there are no questions from participants.

- Moderator: Thank you. We will now begin the Q&A interactive session for India participants. Participants who wish to ask questions, please press *1 on your telephone keypad. On pressing *1, participants will get a chance to present their questions on a first in line basis. Participants are requested to use only handsets while asking questions. To ask a question, please press *1 now. First in line, we have a question coming in from Mr Nirav Vasa from Gupta Equities. Over to you sir.
- Nirav Vasa: Thank you very much for taking my question sir. My first question relates to the execution of this Rs. 700 crore order backlog that we have. What part of this 700 crore order backlog do you foresee executable in this year?
- Shashank Inamdar: The average period of execution for these orders is approximately 12 months. So, you can say what we look at today, it is about, we are planning to execute over the 12 months, sometimes it may go over to about 14 months in the current scenario, but around that period.
- Nirav Vasa: What will be the operating margin that you have placed on this order?
- Shashank Inamdar: We don't disclose in advance on the orders which are on hand, but we have been watching the trend of margin over the last 2 years. As we had discussed during the last con-call, the margins are currently under pressure, so there will be some separation as compared to earlier period that we have been operating.
- Nirav Vasa: You also informed that there are certain orders which have not entered the invoicing cycle, are they included in this Rs. 700-crore order backlog?
- Shashank Inamdar: They are not included. Only orders which are executable have been included in the order book.
- Nirav Vasa: Can you throw some color on this uninvoiced orders which are there in your pipeline?
- Shashank Inamdar: These are not uninvoiced orders. Orders which are not closed financially are not considered as orders.
- Nirav Vasa: What would that quantum be?

Shashank Inamdar: That is in pipeline, so we don't again specify that pipeline.

Nirav Vasa: Some idea approximately.

Shashank Inamdar: No, not until it becomes a firm order, we don't take it on order book.

Nirav Vasa: Okay, now my next question pertains to your Rs. 50-crore capex for the new business initiative that you are undertaking. This Rs. 50 crore of capex would be for investment in machineries or in factories. Can you just throw some light on that asset?

Shashank Inamdar: The current sanction is for two major aspects, one relates to the customized engineering and manufacturing business for which additional manufacturing facility is planned, so that is one area, and the second is for the new consumable chemicals business, for which another manufacturing facility is planned. So, it mainly pertains to these two. Capex related to the third area of water and waste water treatment plants is not yet included in this.

Nirav Vasa: So, this Rs. 50 crore is meant only for process engineering business?

Shashank Inamdar: No, for two businesses, as I said, one is the consumables business, where we produce certain nutritional and bacteriological agents and these are used in biotech industry, so that is the manufacturing facility for these products, and the second one is for manufacturing equipment for the process industry.

Nirav Vasa: Have you finalized the blueprint in terms of the location of the plant, the amount that would be decided for these plants?

Shashank Inamdar: Yes, once those aspects are chosen, they will then be announced.

Nirav Vasa: How do you plan to get the manpower for these new business initiatives? Is it through training of inhouse manpower or getting fresh ones from the industry?

Shashank Inamdar: We will be doing both. Some of the existing manpower is trained and some are hired from the operating field and we are also recruiting people from outside, from the relevant industry.

Moderator: Thank you very much sir. Next, we have a question from Jigar Shah from KIM ENG Securities. Over to you sir.

Jigar Shah: My questions are pertaining to the order book. The current backlog, can you give me a split between the local orders and the global orders?

Shashank Inamdar: We have in this order book, about 45% from overseas and 55% from domestic.

Jigar Shah: So can we say that all this 55% of the local orders are for the beverage alcohol and the rest are for the fuel alcohol?

Shashank Inamdar: Not exactly. Domestic orders are for beverage alcohol as well as for beer plants and also for some other areas. And among the overseas also there are some which are for beverage alcohol.

Jigar Shah: Okay, there are some beverages.

Shashank Inamdar: Yes. That proportion is much smaller for overseas.

Jigar Shah: Can you give a sense on what is happening in the beverage alcohol market? What are the kinds of new orders? I think earlier the issue was about the feedstock not being available, but now that the sugar production is like to be in abundance, what is the prospect you see for yourself?

Shashank Inamdar: What we see is this sugar production and hence molasses production is going to significantly rise over earlier years. With this availability of molasses, the prices of molasses are going down, and that helps in viability of alcohol plants, not only viability but because of good availability, there is a propensity to invest into these areas including that from the sugar mills. So, this should augur well for our business.

Jigar Shah: Have you noticed any kind of changes in the behavior of the clients after this, you know, in the last months it has become pronounced?

Shashank Inamdar: The enquiries from molasses based have gone up in the last few months.

Jigar Shah: Okay. Are there any specific biddings that have happened or any any kind of contracts that are there in the pipeline?

Shashank

- Inamdar: Yes. There is a good level of enquiry base which has been generated.
- Jigar Shah: Okay.
- Shashank Inamdar: And which is under active discussion.
- Jigar Shah: And when do you think it will, you know, result into some conversion, what time it will have like, 3 months, 6 months?
- Shashank Inamdar: Usually, it is not possible to give exact timeline for this. However, we believe that since the molasses production is going to come up from this November, so people will take early actions in this regard.
- Jigar Shah: I think you have already given an overview of the fuel alcohol situation outside India. When do you think, would it be safe to say that the FY' 11 second half should restart these order cycles?
- Shashank Inamdar: In European with the news of the banks coming back on track, the European scenario should start improving in a couple of quarters, and that should give now, you know, change the sentiment for investments in Europe. So, that is what is expected in the coming period.
- Jigar Shah: But in the US and Brazil, etc., you do not expect anything major?
- Shashank Inamdar: We discussed a little while ago that in US the cap is likely to be increased from E10 to E12 or E15.
- Jigar Shah: Right.
- Shashank Inamdar: Now, if that happens I think that will open significant doors to fresh investments in corn ethanol plants, etc. So that will be a good sign.
- Jigar Shah: Do you think that the BP event is having some impact?
- Shashank Inamdar: Indirectly yes. People who would like to, you know, bank more on renewable sources, than on petroleum.
- Jigar Shah: On the new businesses, do you think that in the second half, you will have some orders or some revenue in the new businesses?

- Shashank Inamdar: Yes, we expect to start getting revenues though the proportion may not be significant yet this year, but next year I think it should pick up.
- Jigar Shah: So, you should not build much into the forecast for this year.
- Shashank Inamdar: Yes, that is right.
- Jigar Shah: In Business India, there was an article and where it has been quoted that the company will achieve more than Rs. 1,000 crore revenue in FY' 11. Do you think that that still holds good?
- Shashank Inamdar: As we don't comment on exact figures, I will not be able to give a response to this, but this must be very old news because I don't remember having seen this kind of news.
- Jigar Shah: I think it came in after this financial year, I guess. I think it must be in April or something.
- Shashank Inamdar: This refers to the earlier discussion, not the latest discussion. Earlier, before the slowdown, three years ago, we had this plan. Unfortunately, we also discussed in between that the plan got derailed because of the economic slowdown.
- Jigar Shah: Can you also give an idea what is the cash currently with you?
- Shashank Inamdar: Yeah, we have Rs. 388 crore of cash on hand.
- Jigar Shah: Any inorganic acquisition or anything on the anvil?
- Shashank Inamdar: As we discussed last time, yes. We are actively exploring for the water and waste water treatment and these kind of opportunities.
- Moderator: Thank you very much sir. Next, we have a question from Nirmal Shah from Alchemy. Over to you sir.
- Nirmal Shah: I just wanted to get some more sense on your new businesses. One area you mentioned was customized manufacturing. Other was water and waste water, and the third one you mentioned about consumables, can you throw some more light on it?

Shashank
Inamdar:

These are products which we use in different biotech industries including distilleries and breweries, and these are performance enhancers. These are nutritional products and other products which are related to microorganism growth, etc.

And these are the products which we have now taken up for production in wider variety for both domestic as well as international market, and that is why a new manufacturing facility is planned. We have already started selling these, so we will see some traction during the current year itself for these products.

Nirmal Shah:

How big is the opportunity in this business?

Shashank
Inamdar:

We are targeting an opportunity eventually in time to come of Rs. 100 crore or so.

Nirmal Shah:

In the three new businesses, do you expect the consumable business to start generating revenues?

Shashank
Inamdar:

Yes.

Nirmal Shah:

And the other two businesses probably in 2012?

Shashank
Inamdar:

The other two businesses will also start generating revenues, but significant proportion will not come through this year. We expect that from next year.

Nirmal Shah:

Secondly, regarding margins, if we look at the margins, definitely the revenues have been more in favor of domestic projects, so that is one reason, but on an overall basis, do you see that margins what we have seen in the past at least not sustainable in the medium term, in the future orders?

Shashank
Inamdar:

Yes, in the short-term, they are not sustainable, as we had discussed even earlier that competitive pressure is currently high.

Nirmal Shah:

But, earlier there was a differential of around 5% to 6% between domestic and international orders, so does that differential exist even now or are they on the same par with domestic projects?

Shashank
Inamdar:

It does exist.

Moderator: Thank you very much sir. Next, you have a question from Manish Goel from Enam Holdings. Over to you sir. Manish, you can go ahead with your question.

Manish Goel: Just couple of questions. One on this US is, we see improvement in blending from 10% to 12%, what kind of demand do we see because we are already at 12 to 13 billion gallons production run-rate and mandate earlier was 15 billion gallons.

Shashank Inamdar: Yes.

Manish Goel: So, how do you see that what kind of capacity build up can happen going forward in US?

Shashank Inamdar: See, if you see this 12 billion gallons which is there, we will have to expand to 18 billion gallons if it goes to 12%.

Manish Goel: Okay.

Shashank Inamdar: So, there will be a gap of 6 billion gallons. The capacity which was under construction or half finished was between 2 to 3 billion gallons, so if it goes to 6 billion gallons, then it does create that gap and that demand gap will help in creating demand for new plants.

Manish Goel: Okay, but by when do you see this order flows or enquiries starting for and incremental demand?

Shashank Inamdar: Some enquiries have started coming in, in anticipation, but real inflow will start when this matter is clarified before end of the calendar year.

Manish Goel: And coming to India, you just mentioned that the landed price of ethanol is expected to be around Rs. 20 or 21 per liter and then in such a scenario, how do you see investment despite strong sugarcane crop, do you see investments happening into ethanol projects?

Shashank Inamdar: No, we don't expect that the price will be Rs. 21. The ministry is saying that it will be Rs. 20 to 21 and we don't expect that because the current price range in Brazil itself is between Rs. 22 and 24 a litre, anhydrous is in fact Rs. 24, hydrous Rs. 22 rupees a litre. So, landed rate here will not be anything less than Rs. 25 to

26 a litre, but ministry has been saying that this is likely to be lower.

Manish Goel: But I am little confused over there because on one side last year we had tremendous shortage on industrial alcohol. So, going forward, what kind of molasses production do you see which will in turn satisfy the demand of the chemical industry as well as fuel ethanol if in case 5% is added?

Manish Goel:
Shashank
Inamdar: Last year, we had a production of 1.6 billion litres in India approximately 1.5 to 1.6 billion litres. In the coming year, this is likely to go up as high as 2.2 to 2.4 billion litres. However, last year, we have to note that there was hardly or zero consumption for industrial chemicals. With the prices coming down, there will be consumption for industrial chemicals, which earlier used to be to the extent of up to 1 billion litres. So, you know, if that comes back, then there will still be a good gap between supply and demand.

Manish Goel: We have seen significant fall in margin at operating level from 19% to 11%, now I agree that incremental turnover or large part of the turnover is coming from domestic, but the margin fall is looking very high, so do you expect this to correct little bit going forward?

Shashank
Inamdar: The margin fall has been on two accounts. One is of course the reduced level of sales turnover itself, and second was that the margins in these orders were a little lower. Going forward, we expect for the overall year, this will get corrected upwards.

Manish Goel: Okay, and I missed the number on the cash position currently.

Shashank
Inamdar: Rs. 388 crore.

Moderator: Thank you very much sir. Next, we have a question from Gagan from B&K Securities. Over to you sir.

- Gagan Thareja: Sir, my first question pertains to basically your capacity utilization as in both the two plants. Could you broadly throw a ballpark number of capacity utilization?
- Shashank Inamdar: As we discussed during the last analyst call also, we have been at a capacity utilization of around 65% to 70%.
- Gagan Thareja: And the total capacity would stand at 13,000 tonnes?
- Shashank Inamdar: Yes approximately.
- Gagan Thareja: And the capex of Rs. 50 crore which you announced on the customized engineering and consumables, when does that get operational?
- Shashank Inamdar: We expect that it will be anywhere between 9 to 12 months for that to be operational.
- Gagan Thareja: And should we consider that these ventures would be in a position to give a double digit in crore turnover next year or would I be missing the mark by very much by saying that?
- Shashank Inamdar: Double digit, can you elaborate a little?
- Gagan Thareja: Let us say above Rs. 50 crore each.
- Shashank Inamdar: The expectations are, I mean, quite high.
- Gagan Thareja: Okay, so I am basically underestimating in a big way.
- Shashank Inamdar: No, I did not say that.
- Gagan Thareja: And you also mentioned in the last quarter that couple of orders had gone on hold. Have they gone on hold or have they been completely scrapped. What is the status of those orders? I think it was worth Rs. 177 crore
- Shashank Inamdar: As we had discussed last time that the orders which have gone hold for a long time have been completely dropped from the order book, so those are not being counted. So, that figure that we have talked of was orders which we had dropped out because they had gone on hold for a long time.

Gagan Thareja: Also, in Europe, the renewable energy directive is supposed to be implemented by December 2010, and I think the EU member states are supposed to put in their action plan or were supposed to put in their action plan by June 2010. Could you possibly throw some light as to what the status is? Has the action plan to be given by the member states already being given or is it still under discussion. Second, I think there is also a debate as to what happens if indirect land use change patterns are also included in calculations of greenhouse gas emission. Is the EU considering ILUC change in their mandates also for sustainability of ethanol?

Shashank Inamdar: The RED aspects have been or the implementation plan has been turned in by many of the states, member states. Few of them have asked for some more time in view of the economic slowdown, but most of them have turned in and they are hopeful that it will start from end of this year. On that ILUC aspect, there is still a debate going on in EU on how to deal with this issue and there is no specific resolution of the matter at present.

Gagan Thareja: In any case, with or without the ILUC, is it rational to think that sugarcane based ethanol would stand out as better than most as a feedstock under the sustainability criteria that EU puts in?

Shashank Inamdar: Yes, it does, but the sugarcane crop is not relevant to Europe. So, that aspect is not being considered in Europe.

Gagan Thareja: And would it also be correct to think that if action plans are put in now, and RED implementation comes through in December 2010, then this period between June to December should see, enquire and order flow picking up from Europe?

Shashank Inamdar: We expect the enquiry flow to pick up. As we discussed last time also, as compared to the earlier year, there is some movement in the enquiries, positive movement in the enquiries.

Gagan Thareja: Okay, and is it also the case that in Germany, biodiesel is being substituted by bioethanol?

Shashank Inamdar: This is a big question that we have also been discussing and it is being considered everywhere that biodiesel is not going to meet its requirement of 10% by energy content blending, so that part for liquid fuels will become available as an extra opportunity for ethanol blending and which will take the opportunity 2-1/2 times greater than what it is for ethanol alone.

Gagan Thareja: You have discussed the EU and the US status in great detail, could you possibly, throw a little more light on what is the status of blending mandates in countries in South Asia and South America, are they going in for further improvement and if country-wise at least for some of the bigger countries, you could discuss in both these continents.

Shashank
Inamdar:

In South East Asia, there is a mandate for E5 right now in the Philippines and next year it is going to be E10 that is already in place. Thailand is blending currently 10% and is on the path right now to go to 20%, and the third country is Vietnam, where the government has put in place a program for setting up a plant based on cassava, and they have this, in Vietnam, mandate may not be of importance, but the governments will, which they have declared, is quite firm. So, this is in South East Asia. Australia also has demonstrated that gradually they are going now from New South Wales has already put in and Queensland next in line, and in South and Central America if you look at Columbia, which already has 10%, and they are looking at increasing this to 20%, and the President who is now elected is supportive of this idea, so this is likely to go ahead in the time to come.

Gagan Thareja: Sir, which country are you referring?

Shashank
Inamdar: Columbia.

Gagan Thareja: Columbia?

Shashank
Inamdar: Yes, and Peru is next in line, where they also have announced that they are going in for this blending program with a mandated backup, so these are some of the countries that you can see that they are pushing these programs ahead.

Gagan Thareja: Are these all targets for the next year?

Shashank
Inamdar: Yes.

Gagan Thareja: And do you think that the December 2010 deadline will be met by EU for its RED?

Shashank
Inamdar: Not in entirety, as I said earlier, some of the states have asked for exemption for some period because of the slowdown.

Moderator: Thank you very much sir. Next, we have a question from Jyoti from Wealth Managers. Over to you ma'am.

Jyoti: I wanted to know if there are any government orders in the order book. Orders which have not been executed in the last 6 months or so?

Shashank Inamdar: Not in this.

Jyoti: Okay, and you said that the international order book is 45%.

Shashank Inamdar: Yes.

Jyoti: Can you give us the breakup geography wise?

Shashank Inamdar: Usually we don't give the breakup, but traditionally on a gross overall level, 1/3 from South East Asia, 1/3 from Europe plus Africa and 1/3 from the Americas.

Jyoti: 1/3 from Europe and Africa?

Shashank Inamdar: Yes.

Jyoti: And 1/3 from America?

Shashank Inamdar: Americas.

Jyoti: Yes thanks a lot sir

Moderator: Thank you very much ma'am. At this moment, I would like to handover the proceedings back to Ms. Vinati Moghe for final remarks.

Vinati Moghe: Thank you all for joining us. If there are any further queries which have gone unanswered, we apologize, but we would like to close as of now, and we will take up any additional queries on the emails. Please send it across. Thank you very much.

Moderator: Thank you very much ma'am. Ladies and gentlemen, thank you for choosing WebEx's Conferencing Service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you.
