



Praj Industries Q2 & H1 FY13 Results

Investor/Analyst Conference Call Transcript

October 22, 2012

- Moderator** Ladies and gentlemen, good day and welcome to the Praj Industries Q2 H1-FY13 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. Should you need assistance during this conference call, please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Ms Vinati Moghe. Thank you and over to you.
- Vinati Moghe** Thanks. We welcome you to this conference call organized to discuss Praj Industries operating performance and financial results for second quarter and First Half Fiscal 2013 which were announced earlier. I have with me Mr. Pramod Chaudhari – Executive Chairman, Mr. Gajanan Nabar – CEO & Managing Director and Mr. Surendra Khairnar – Assistant Vice President, Accounts. Mr. Chaudhari will cover key developments and macro environment following which Mr. Nabar will walk you through the operating highlights. Before we begin I will like to mention that the statements made in today's discussion may be forward looking in nature and may involve risk and uncertainties. Documents relating to our financial performance have been emailed to most of you earlier. These documents have also been posted on to our corporate website. I now invite Mr. Chaudhari to provide an over view with the highlights and business environment for the quarter.
- Pramod Chaudhari** Thank you for joining us on this con-call. Our performance this quarter has some improvement over the sequential quarter despite continued challenges in the operating environment both domestically and internationally. Our traditional market are still subdued with CAPEX plans progressing slowly. Projects are being planned and evaluated but the implementation has been considerably slower than what we had anticipated. As a company, we are making an all out efforts to contract maximum possible business. You will notice that in the order wins during this quarter. Economies in Europe and North America continue to face pressure, our presence in regions like Latin America, Africa and Asia Pacific have helped us gain order inflows. Domestically, the events of the last 2 weeks have been positive for the sentiment of corporate India and foreign investors to some extent. However, we expect a time lag before the impact reflects on growth. Similarly, there are expectations that there will now be a moderation of interest rates. All of these factors are expected to positively impact our business as well. I would now like to share with you, a quick overview on the global markets. During the quarter, we have seen some significant changes in the regulatory and climatic conditions in the bio-ethanol space. While the drought in the US has resulted in creating a pressure on ethanol margins and hence the viability of first generation ethanol, it has created an opportunity for the import of cane-based ethanol from countries like Brazil and molasses-based ethanol from other Latin American Nations. In Washington, the Senate's Finance Committee has put forward a proposal that

would extend a \$1.01 per gallon federal tax credit for Cellulosic fuel ethanol production.

While there have been some second generation bio fuel projects which have not been taken as per expectations, there are as many which are progressing well. One of them is our project, which we will brief you about later in this call. In Brazil, the federal government has agreed with UNICA, the association which is coordinating the cane and ethanol activities, to raise unaddressed ethanol blending in gasoline back to 25% early next year, from this current reduced level of 20% with plans for the blend to rise as high as 30% by 2020. This should see ethanol prices firming up in the international market and bring feasibility back to the projects. The European Commission has put our proposal to limit food grain based ethanol to 5%. This is also with the view to provide stimulus for second generation bio fuels which enjoy a double credit for renewable energy directives. Although the EU proposal is yet to materialize into any directives, we are following the developments under close scrutiny. We do not expect these positive changes to impact our core markets spread across Latin America, South East Asia and India.

In India, beverage alcohol is still a predominant segment. We continue to see a buildup in this market. The impact of the Rangarajan Committee's report and its recommendations have not yet been fully analyzed. But is expected to give some additional stimulus to the generation of biofuels in due course of time. We strongly believe that the goal of energy independence is high on the agenda of several countries and they will continue to harness and encourage a variety of new technologies to enhance the share of renewable energy including transportation fuel in the overall energy mix.

On the second generation front, we are now ready with the design and engineering package for the proposed commercial demo plant. We have engaged a consultancy firm to help us with the implementation of the plan. A number of interested parties have been tapped for a prospective partnership. Meanwhile, we have also entered into a preliminary MoU with a customer for selection of the site for this project. This gives us an optimistic outlook for the second generation commercial demo project. We also believe that the application of these technologies will begin to extend beyond transport fuel into areas such as bio chemicals and bio processes, thus making it a dual purpose bio refinery.

In the diversified industrial segment, we see growth in the pharmaceuticals, biotech, food and beverage, cosmetics and personal care industry. A projected 3 to 5 year CAGR of 15-20%, will provide an interesting opportunity for the emerging businesses of water waste and critical process equipment and systems. While Neela may have seen some short term corrections, the opportunity remains robust. The levers for emerging businesses are beginning to see a certain traction, details of which will be shared by Mr. Gajanan Nabar later in this call. We are now looking at 2 distinct business pillars that are clearly getting defined in our portfolio. One is that of ethanol, alcohol and beer plants business including the second generation ethanol. The other is the process solution suite, which will cover the water & waste water treatment solution and the critical process equipment for variety of industries and civic application. Our enquiry pipeline continues to witness a healthy activity level. The sense we get from our customer is back, the financing cost is not the only factor impacting the speed of their investment decision. The reading of demand environment and enhanced levels of volatility are forcing perhaps them to proceed with a greater caution. Globally and in India, the period ahead is likely to continue to be volatile. This will continue to create certain challenges for growth and profitability which we had envisaged. We will look at every opportunity to achieve the goals that we have set for ourselves. I would now like to share some of the corporate developments.

During the quarter, we have set up a subsidiary in the Philippines called Praj Far East Philippines Ltd, which will oversee our business development and goals in that region. We have also increased our stake in Neela Systems by 9.8% for consideration of Rs.12.5 crore. Our agreement for the acquisition of 50.1% stake acquired last year incorporates a clause for us to acquire an additional 10% stake for each year in the future.

The first phase of manufacturing facility for production of biobased products based on technology developed and supported by Praj Matrix, the R&D center is now ready and will be commissioned during the 3rd quarter of FY13. The sales and marketing activities will commence in the last quarter of this fiscal. Henceforth, the distillery performance enhancers will also be manufactured in this plant.

In the quarter ended March 12th, the company made a prudential provision for an estimated liability arising out of the proceedings conducted by the Income Tax department under section 132 of the Income Tax Act 1961 and on the basis of information and facts available with the company, an applicable legal provision. However on 1st October, 2012, the company has received a notice under section 153A (a), of the Income Tax Act 1961 to file the relevant tax returns. The company is in the process of compliance with filing of this tax return. We continue to believe that the provision of Rs. 25 crore which was subsequently paid out in the first quarter of this fiscal would be adequate. With this information now, I hand over the floor to Mr. Gajanan Nabar who will share further details with you on the business front. Thank you.

Gajanan Nabar

Thank you Mr. Chaudhari.

Now I will take you through the key developments in the business area for the period. The stand-alone income from operations was at Rs.187.55 crore. This translates to a sequential quarter growth of 12%. Of the Rs.187.55 crore stand-alone income, 58% was domestic and 42% from international contracts. Ethanol plant business accounted for about 82%, and non-ethanol for 18%. The EBITDA excluding other income is at Rs. 13.88 crore when compared to Rs. 19.29 crore in the corresponding quarter of FY12. However, we do see an improvement in the quarter over quarter operating margin, at Rs.17.4 crore which is a 40% growth over the previous quarter. This leads us to believe that the initiatives that we have taken have started yielding results. We have held firm, with the PBT margin at 11% at Rs. 19.93 crore as against Rs. 25.36 crore in the corresponding quarter of FY12. PAT for Q2 for FY13 is at Rs.16 crore as against Rs.20.53 crore, with the PAT margin of 8%. For the quarter, the consolidated income for operations, was at Rs. 205 crore along with execution subsidiaries. Now a quick view of the half year for fiscal 2013. The standalone income for operations was at Rs.351.48 crore in the first half of the fiscal 2013 vs. 393.61 crore in the same period the previous fiscal. Our EBITDA was Rs.28.47 crore in the first half as against Rs. 34.97 crore in the first half of FY12. We registered a PBT of Rs. 34.95 crore in the first half of FY13 vs. Rs.42.62 crore in the corresponding period of FY12. This was at 9.9% of sales. PAT stood at Rs. 28.06 crore in the first half of FY13 vs. Rs. 34.16 crore in the first half of FY12. During the quarter, we had an inflow of 52% from domestic and 48% from international. Of which, we derived 57% from the ethanol business and the remaining 43% from the non- ethanol business.

We had an order win for a brewery from overseas, which involves setting up a turnkey brewery in South East Asia. This is the result of our strategy to take the brewery business overseas. We also saw order wins in water and waste water treatment systems for cogen plants, chemical and pharma sectors. The order backlog has also shown a movement at Rs. 820 crore as on date with a net addition of Rs. 220 crore during the quarter. Of these orders on hand, 53% of the

orders are from the domestic sector, and 47% are from the international sector. And 25% of these orders are coming from the non-ethanol sector.

On the non-ethanol and non-brewery business front, we do see an enquiry pipeline with investment cycles showing some signs of revival, albeit slowly. We are working towards converting these enquiries quickly into orders, as cycled time for the order to sales is fairly short in comparison. We are continuing the process of integration of Neela Systems. We are currently seeing some head wins but the order book in Neela Systems is building up. The performance of Neela in the first two quarters in the result of lower sales coupled with rise in overheads, which one feels should be easily absorbed when the sales build up. The business environment continues to be challenging but Praj has held quite steadfast with a strong balance sheet.

Cash on the book is Rs. 239 crore. Also, our current preparations hold us in good stead, when the tide turns fully. As mentioned by Mr. Chaudhari, we are clearly looking at 2 major pillars of business. Going forward, we can see our sales as a significant player in the emerging businesses of water & waste water and critical process equipment and systems businesses along with the Neela Systems business. We are working on a strategy and are ramping up relevant resources that will lead us to critical business gains. Our aim is to leverage the process engineering expertise in hygienic sectors, with Pharma, food and beverages and cosmetics. In the water and waste water businesses, we see Neela leading the hygienic sector for high purity water and for non-hygienic applications and water & waste water treatment solutions, Praj will provide the leadership.

For business development, we have already worked out a system wherein we will draw synergies. As shared, Praj will initially focus upon industrial segment of water and waste water treatment, where in it will offer specific technology driven solutions that will add definite value for its customers and by their means to Praj. Praj is also drawing a plan to enter into a wider segment of common effluent treatment systems, which will be the larger ticket size orders. We would see some results of this flowing in strongly over the next 2 years. It will be our effort on behalf of the management to see that we deliver on growth in the short term though we continue to see challenges. With this we will now take questions. Thank you very much.

Moderator	Thank you very much Sir. We have the first question from the line of Mr. Ankush Mahajan from K R Choksey. Please go ahead.
Ankush Mahajan	Can I get the quarterly numbers for Neela in this quarter?
Gajanan Nabar	Neela's revenue was at Rs.10.3 crore and it had a loss of Rs.2.5 crore for the quarter. I would like to add that after acquiring Neela, we are working on the quarterly basis of sales and the results on quarterly basis. But going forward, we are seeing the order book build up and hopefully in the next two quarters this performance should clearly show signs of improvement.
Ankush Mahajan	If you consider the consolidated sales, the revenues stood at Rs. 228 crore and the standalone is at Rs.188 crore, so what has contributed towards this difference of Rs.50 crore?
Gajanan Nabar	There are a couple of things. Of course, we have Praj standalone and the local execution companies, through which we are executing projects worldwide. So, this is the difference between Praj standalone and the local execution companies' sales plus some of the subsidiaries that we have in the Far East and Africa along with Neela, which contribute to the consolidated sales.

Ankush Mahajan	So, if you see the difference in the PAT. The standalone PAT is Rs.16 crore while the consolidated PAT is 13 crore. Since there is a loss of Rs.2.5 crore on Neela, are the rest of the subsidiaries not contributing to the PAT?
Gajanan Nabar	No, I think there is also a goodwill amortization and Neela's loss should be taken on a prorata basis. So that contributes to the difference.
Ankush Mahajan	So, what is the tax rate that Neela is paying?
Gajanan Nabar	33%
Ankush Mahajan	In the balance sheet, the short term provisions stand at Rs. 123.50 crore. How is this related to our business,?
Surendra Khairnar	Provisions which we are supposed to make for the business, if will include our overhead provisions as well.
Gajanan Nabar	These are normal provisions for overheads and other expenses including gratuity and leave encashment.
Ankush Mahajan	In short term loans and advances, we have grown by Rs.40 crore. Where has this money been utilized?
Pramod Chaudhari	That is out of the provision of income tax which we have paid in the first 6 months. The amount of Rs.25 crore is included in that.
Moderator	Thank you. The next question is from the line of Mr. Mahesh Bendre from Quantum Securities. Please go ahead.
Mahesh Bendre	Last year, Neela Systems reported around some Rs.90 crore of sales. And the profit was around Rs.12.5 crore. So why is there a loss in the second quarter?
Gajanan Nabar	I think it's about catching up on the order book to revenue cycle. So to share information on the order book, currently the order book is around Rs.60 crore and we are continuing to see an order intake on a regular basis. For Neela, the order cycle is short at 3-4 months. So whatever we get in this quarter also contributes to the revenue for the year and at Rs.60 crore worth of orders, we are seeing that the results would be at least at par with last year or slightly better than last year, in spite of the challenging environment.
Mahesh Bendre	So do you expect that for the full year this company will be able to at least report the numbers that they have reported in terms of sales and profit, during the last year??
Gajanan Nabar	Absolutely.
Mahesh Bendre	In the standalone business, our sales have declined by 11% for the first half. Our operating profit has also declined by 19%. So do you think a similar trend will prevail for the remaining of the year and there could be an uptake in FY14, from a direction point of view?
Pramod Chaudhari	We don't expect that kind of a decline to continue this quarter or for this year. As I always say, our business being measured quarter on quarter is not a very prudent practice and I think what you are trying to say is in line with that. I don't expect this quarterly trend to be a representative of our annual trend.

Mahesh Bendre	So is it a fair assumption that our sales will be better than last year?
Pramod Chaudhari	That would amount to our preparations and directions.
Mahesh Bendre	You mentioned about the amortization of the goodwill. So, what's the goodwill for and over how many years will it be amortized?
Pramod Chaudhari	The goodwill is for the acquisition of Neela. The price we paid is above the book value i.e. the net asset value which is roughly about Rs.50 crore., whereas the amortization is over 10 years.
Moderator	We have the next question from the line of Mr. Balchandra Shinde from B&K Securities. Please go ahead.
Balchandra Shinde	The employee cost as the percentage of sales has increased in first quarter and in second quarter also remained at the same level. So do we expect it to continue for the whole year? Have we given a wage hike and salary hike to the employees?
Pramod Chaudhari	We have given a salary hike because we are definitely neither expecting this year nor this quarter as a representative. We are also trying to rationalize some of the activities, especially in our new businesses. Those new businesses are still passing through certain gestations and the ratio of output to employee cost is definitely not so favorable. But going forward, looking at the potential and the preparedness for the coming period of next 12-18 months, we feel this employee cost is not alarming.
Balchandra Shinde	With regard to the FOREX loss, do we have any hedging policy in the company?
Pramod Chaudhari	Yes, , as per the accounting standards we have to report this against the outstanding debtors. But hedging is there and when the money arrives at that time that it will be hedged. So part of the portions will be definitely nullified when the debits are actually received because of the forward cover.
Balchandra Shinde	How much is the hedging??
Pramod Chaudhari	Our hedging is around 50%. There is some natural hedging because of our imports. So, 50% is the actual cover taken and we get a 25-30% in natural cover depending on the situation of imports.
Balchandra Shinde	Why exactly was our other income high for this quarter when compared to the last?
Pramod Chaudhari	. It is mainly due to the treasury operations. There was a write-back of about Rs. 2 crore, which has also contributed towards this.
Moderator	Thank you. We have the next question from the line of Manish Goel from Enam Holdings. Please go ahead.
Manish Goel	Can you share some finer details in terms of the CAPEX for the second generation project? Also, when do we see the project starting and what would be the benefits of the same?
Pramod Chaudhari	Our position remains the same. We would like to definitely aim for breaking the ground towards the early part of next calendar year or the last quarter of this financial year. We have already identified the site. As I said, we have a provisional MoU with the end-customer and now we are in the process of forming of the

strategic partner. We have already appointed a consultancy agency firm from one of the big fives to help us prepare the IM and we hope to mobilize the funds for supporting this project. We would like to take the special purpose vehicle approach and not include the entire project in our books. That is our preliminary thinking. So, once we are ready with the complete IM which is being processed, I think I will be in a position to share the further progress.

Manish Goel So for the MoU signed with the customers, we probably need the raw material for....?

Pramod Chaudhari We need land, license, raw materials, and utilities. So, we have identified one of our existing customers who were keen and are trying to execute this project next to their existing distillery.

Manish Goel You mentioned that in the US, the cellulosic fuel tax credit has been finalized as \$1.01.

Pramod Chaudhari Yes, on a per gallon basis.

Manish Goel How is the progress in US in terms of second generation?

Pramod Chaudhari In US, there were some couple of projects which did not progress as well. But there are a few projects coming up. Also, everybody is looking forward to the project that is coming up in Italy. That is going to be the perhaps world's first commercial project. In the US as well, there are three projects which have been finalized or getting ready. So general interest level is pretty high with respect to the cellulosic ethanol because on the first generation they have already reached the corn-wall and there is no credit on the corn ethanol but the corn prices have gone up. So, the entire focus is now on the second generation ethanol. Even if they have to reach a level of 10% or 15% blending, I believe second generation is the solution. So, the entire focus is on that. Companies are following different routes such as biomass, waste gases and thin gas. So there are multiple proposals are being structured. The general trend is that by 2015 we should have a reasonable quantity of second generation fuels getting available for their application in transportation.

Manish Goel For the Australian order we had already bagged the designing part. Has there been any progress on the equipment side?

Gajanan Nabar Yes, as I had mentioned earlier, this order was to be received in 2 phases. We have already received and are executing the first phase, which is of a pre-engineering kind. We are expecting to definitely get some results on the second phase by the end of this calendar year. So around the December-January timeframe, we are expect this order to become critical, in all likelihood.

Manish Goel Would it be possible to share the size of the opportunity?

Pramod Chaudhari I think we will wait for 2 months. It will be a sizeable chunk. I'm not referring to the number they have declared. They have declared the number for the project, we have to consider our portion.

Manish Goel To clarify on order intake, you had mentioned Rs. 220 crore worth of orders were received in the quarter and out of which, ethanol was at 57% while non-ethanol constitutes the balance. That means non-ethanol orders have picked up very well in this quarter.

Gajanan Nabar This is also because of the timing as we have some of the orders which were in the pipeline. To share with you a few critical orders of the quarter, we have an order coming from ethanol sector from the URC Group in Philippines. In non-ethanol, we had an order in South East Asia for a brewery which I already mentioned in my presentation. It was a fairly a longish order with larger scope. We have also received an order in India from the UB Group. Additionally, we are seeing a good traction, critical to our water and wastewater treatment business by getting an order from AB Birla Group for our wastewater treatment project for their new plant. Also, there are some key orders of significant sizes from the pharma sector as well. In other areas such as critical process equipment and systems, critical applications-oriented customers like Linde and Bayer have put their faith and given us some orders. So those are the main reasons for the traction this quarter.

Manish Goel That means the large part of the non-ethanol business has been contributed by an overseas order.

Gajanan Nabar That was one order for a brewery. But we are also seeing some orders in water areas as well as in BHA.

Manish Goel You mentioned an equipment company. How big that would be?

Gajanan Nabar These orders are of medium size. Since, we are executing orders for very critical equipment, those are not worth hundreds of crore. But they are in the range of Rs. 10-15 crore.

Manish Goel And more importantly are they in line with the company's current EBITDA margins of 10%?

Gajanan Nabar In this business, as the criticality of the equipment increases the margins improve. Our efforts since the last few months have been to bid for more critical high thickness, exotic metal kind of orders and that is what we are into now.

Moderator Thank you. The next question is from the line of Nishit Rathie from Trust Capital. Please go ahead.

Nishit Rathie To confirm, the order booked at the end of the quarter was Rs. 820 crore.

Gajanan Nabar Yes.

Nishit Rathie And of that, how much did ethanol contribute?

Gajanan Nabar The split was 52% and 48% for domestic and international operations, respectively. Whereas, 25% was non-ethanol, so the remaining 75% was ethanol, of that stack of Rs. 820 crore.

Nishit Rathie At the beginning of the quarter, we had about Rs. 800 crore. Have we converted orders of Rs. 180 crore and also, have we got fresh orders worth Rs. 220 crore?

Gajanan Nabar We have converted orders of Rs. 205 crore on a consolidated basis.

Moderator Thank you. We have the next question from the line of Mahesh Bendre from Quantum Securities. Please go ahead.

Mahesh Bendre	Last year we booked the order inflow at around Rs. 1000 crore. Given the last 2 quarters , do you think based on inquiry flows and your own understanding we will be able to cross that amount this year?
Pramod Chaudhari	I think answered this question. We do not want to go for speculation on the year-end numbers at this time.
Mahesh Bendre	I am not looking for any numbers as such, but just general views.
Pramod Chaudhari	We would like to but I do not know as to what will happen in the interim,. There are a lot of uncertainties which keep on cropping up. So, I think let us not speculate on that.
Mahesh Bendre	In the opening remark, we were told that the cash we have around is Rs. 239 crore. Is this the cash after the acquisition i.e. the 10% we have paid for Neela?
Pramod Chaudhari	Yes, after removing the Rs.12 crore.
Moderator	Thank you. The next question is from the line of Ankush Mahajan from KR Choksey. Please go ahead.
Ankush Mahajan	The trade receivables/debtors have come down from Rs.257 crore to Rs.195 crore in 6 months. I want to know as to how this procedure works. How many of the debtors are from the overseas market and what is the time that we need to collect from the debtors/ sundry debtors?
Gajanan Nabar	Overseas is normally on LC basis. It is not open credit at all. So it would constitute a very small portion of the total debtors. Of course, there are some debtors in that but it will constitute a small portion and as for the mechanism, it is such that for each project we track the overdue outstanding with the customers. The project manager is completely accountable to take the call in terms of what kind of exposure or what kind of overdue limits within the corporate guidance that they can have and based on that we progress on the project.
Ankush Mahajan	What is the time period in which you need to collect from the debtor?
Surendra Khairnar	See the time varies from customer to customer. Presently, our average days outstanding are around 80 days.
Moderator	Thank you. The next question is from the line of Deepak Malhotra from Silverstreak. Please go ahead.
Deepak Malhotra	From a longer term perspective, if we were to look at over the past 5 years, we had strong margins. Not that we do not have strong margins now, but they have come down. Now going ahead do you see an uptrend in this and what steps are you taking internally to improve that, apart from obviously what the market is dictating?
Pramod Chaudhari	One of the major initiatives is going to be the next generation ethanol, wherein the value for technology development and engineering is supposed to get paid for and that is how we are looking at it. There are lot of internal measures which have been in the offing and which have been implemented and being achieved for improving the margins as well. Last time, too we said that the first idea was to at least catch up on the top-line. Having done that, our entire thrust and focus now is on enhancing the margin. I don't know whether it will touch the same levels or not. But I can only say that we are definitely aiming to reach the levels which are much

higher and better. We also feel that current margins are not representative of our nature of business.

Deepak Malhotra

When you say that what would be the margin that the other top rated players in the competition would be making, say internationally?

Pramod Chaudhari

I think we will have to go back to the basic story on the kind of area where we are operating. We have no single apple-to-apple competition in this area. They are all scattered. If you look at our competition in USA, they are in a very poor shape because the US business is not doing good. They are really having a tough time. about Brazil; they are finding it difficult too. Due to our spread, despite difficult situation of the headwinds, we are still able to get a good market share and reasonably good margins. That is the way I will put it. So we are not benchmarking on that count. This can be taken off-line, if you can come here to discuss this at length. But your question is very valid - . Where the inflection is going to come or where we are going to ramp up and catch up? Where there will be a more technological play or where we will be able to do it much better?

Moderator

Thank you. On behalf of Praj Industries that conclude this conference.