"Nelcast Limited
Q2 FY2022 Earnings Conference Call"

November 02, 2021

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Moderator: Ladies and gentlemen, good day and welcome to the 2Q FY2022 post results concall of Nelcast Limited hosted by Batlivala & Karani Securities India Private Limited. 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. Annamalai Jayaraj from Batlivala & Karani Securities India Private Limited. Thank you and over to you Sir!

Annamalai Jayaraj: Thank you. We welcome all the participants to Nelcast Limited 2Q FY2022 post results conference call. From the management side, today we have with us, Mr. P Deepak, Managing Director & Chief Executive Officer and Mr. S K Sivakumar, Chief Financial Officer. I will now hand over the call to Mr. Deepak for his opening remarks to be followed by the question and answer session. Over to you Sir!

P Deepak: Thank you Annamalai. Good morning to everybody. Thank you for your valuable time in joining us for this conference call. I want to start by briefing you about the financial performance. As you are aware we have declared our results yesterday for 2Q FY2022. I think it was a very unique quarter because it followed 1Q, where due to the impact of the second wave of COVID, we had quite a bit of disruption. Fortunately I think things streamlined fairly well into Q2 and as a result of that the growth in Q2 was quite strong. At an overall level, for Q2 we had a total revenue of 242 Crores which is the highest that we have had in any quarter and as a result of that when we compare it to the previous year on a year-on-year basis it represents 72% growth and on a quarter-on-quarter basis it represents 28.5% growth. The growth came primarily from two sides. One was in terms of the increase in realization – a lot of which was recovered by pass through of the raw material prices that was there as well as the better product mix and the second impact was there was in terms of the sales. So, our sales in volume actually compared to Q2 of 2021 it was 14200 tonnes whereas in Q2 of 2021-2022 we managed to exceed 19200 tonnes. As a result of that we could definitely see that is playing an impact, so on a year-on-year basis that was 35.5% increase and on a quarter-on-quarter basis 23% increase. These were some of the factors that contributed to the growth. The overall picture conveyed that the tractor industry seemed to have a fairly strong half year because this is a peak season for the tractor and the forecast for performance was quite strong, so the tractor production numbers across the country across all OEMs were quite strong and that was something that helps drive the growth. While the medium and heavy commercial vehicle was a little bit sluggish and the first half especially post second wave of COVID, we are starting to see signs of recovery and the other growth area that we have seen in terms of exports. So our exports for the quarter were at 63.7 Crores which on a quarter-on-quarter basis was a growth of about 30% and on a year-on-year basis it was a growth of 108.75%. So really if we consider on overall year basis last year for the full year we did an export sales of about 126 Crores. This year in just the first half we have already achieved 112 Crores. So, I think this is an area that I know we have been talking about for quite some time that we anticipate to see growth and I am glad that we are able to show the results of what we have been talking about.

In terms of margins, margins were unfortunately negatively impacted by commodity price increases as well as our new plant which we commissioned last September and is still running at fairly low utilization as well as still in the stabilization mode, so as a result of that our EBITDA margin for the quarter was at Rs.8.85 per kilogram which is something that we are working on improving and we anticipate to see improvement in the coming quarters. Looking at the business going forward we do see that the commercial vehicle industry is starting to pick up, we see that the tractor industry in terms of production numbers is starting to slow down, exports we have seen some impact of the chip shortage impacting our customers and therefore we will see probably a little bit slower than what we saw in this fantastic second quarter. The rest of the industries – we are fairly glad that both the railways as well as off highway products have done well. In terms of our segment mix for the first half of full year, 39% of our sales came from tractors, around 26.5% came from medium and heavy commercial vehicles, 26.5% came from exports and railways was about 4.4% and off highway was about 3%, so that is the overall mix as we had it in the first half. So very similar to what it was last year except we have grown about 5% on the exports and medium and heavy commercial vehicles about 5%. So that is it from me I am looking forward to any questions that any of you might have. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

Saket Kapoor: Thank you for the opportunity. Just to sum up what you mentioned right now we did a volume of 19200 tonnes for the September quarter vis a vis 14200 something for the June quarter?

P Deepak: I will just tell you the numbers. The quantity what we have done for the September quarter is 19277 tonnes. In the previous quarter the sales quantity was 15667 and in the previous year second quarter was 14217.

Saket Kapoor: At what levels operating leverage starts kicking in? You have been speaking about other new facilities getting stabilized and the production from there mainly attributed to the export segment, so what is the thought process and where are we in the midst of stabilizing the facility and when will this start contributing meaningfully to our operating financials?

P Deepak: I believe realistically we are talking about these two to three quarters away from that because we got a lot of new product developments going on in that facility. In fact I think last year our focus on the new product development, a lot of it was in terms of heavy commercial vehicle which have taken a little bit of a downturn and the overall numbers do not look as good, but hopefully when those numbers return back while we get the benefit of that and also of the new product development activities that we have been doing. So, we are doing a lot of components that are in the off-highway space in that plant where the development is currently going on and at various stages of approvals. So, while that happens and heavy commercial vehicle demand picks up we believe that we should be in a much better position but realistically speaking we believe we are probably two, three quarters away from the plant really starting to show the kind of results that we hope for.

Saket Kapoor: Since we have mentioned that because of the chip shortage and container availability, the exports are likely to be muted for H2, so over the 112 Crores that we have done for the first half depending upon the deliverables from your key customers what should be the likely degrowth we are expecting for H2 and when this facility starts contributing to the off-growth, how likely would be the mix going forward? I think that tractors are also showing signs of saturation going forward, so going into the second half if you could give us a ballpark understanding how the likely contribution will be in percentage terms from the key segment M&HCV, tractor segments have the lion's share?

P Deepak: I believe looking at H2 and exports, we will still be okay. I do not think it is 63.7 Crores what we have achieved in Q2, I do not believe that we will achieve that in Q3 and Q4, but I believe that here that number will probably be closer to something around 45, 50 something in that range is perhaps a reasonable ballpark to consider given the chip shortage and whatever we are hearing about that so it is difficult for us to actually put a number to it but that would be the rough estimate, so I think that is what we expect on the export side. On the domestic side we have seen the commercial vehicle numbers starting to pick up particularly I think this month and we are expecting in a typical year about 60% of the commercial vehicle demand comes in H2 that is what we consider to be a typical year for commercial vehicles, so if we look at it that way then certainly commercial vehicle we would hope that we would do perhaps 50% more than what we did in the first half, which is a normal seasonality. I think the good sign at least what I am seeing in the commercial vehicle space is that in addition to the increase in diesel prices transporters are now demanding price hike that exceeds the diesel price, which means it will help improve the realization. I think when we get to that point where the realization has really started to improve for the fleet owners I think the commercial vehicle cycle will really hop into the next gear in terms of their next cycle will start and I believe that we are starting to see signs of that, so I hope that is there and the other part is of course in terms of the demand for the infrastructure segment and shallow mining segment that also has a significant impact on commercial vehicles and more so on us because I think on the heavy commercial vehicles where the most premium products are there our penetration is much higher, so as an overall picture the second half might be somewhat similar to the first half, but again we do not really know how some of these other factors like the chip shortage will play in complete that I think this information the OEMs are trying to work overtime and usually every day working on some new plants and trying to execute it so they are trying to keep their products a little bit close to the vest because they do not want to lose production for some of the shortage if they are able to manage to secure the semiconductors. So that is our best estimation for why we believe this year will be.

Saket Kapoor: Just to sum up it is only with the improvement in the utilization levels that we would be seeing, our margins will likely to improve going forward we have to wait for another three quarters only then the profit margins would commensurate to the increase in turnover business which we are doing currently because we are currently having a PAT margin of 2%-3%, correct me there and what are currently the near terms goal and the long term goals for the company and the steps which the management are taking to improve the profitability margins going forward, turnover and utilization levels have improved and it will be depending on the market conditions but other than that how the bottom line is going to shape up, what steps are you taking to reduce the overhead cost also for the power and fuel segment if you could elaborate the step going forward and the balance sheet also look slightly stressed if I may use the word in terms of the receivables going up even on the borrowing part so just on the liquidity position also if you could throw some more light on the same and what have been our net debt level vis a vis what it was for March and what is the September number?

P Deepak: I think one thing is we believe that the volume increase is coming right, we think that with commercial vehicle picking up we believe that the part of the cycle if you believe most of the experts' report is here and at least from what we are seeing on the ground is our transporters asking for price hikes. We believe that is a clear indication that might very well be around the corner, so one I think in terms of volume increase that we are doing ok. Second, we are also working on lot of productivity improvement for projects one of which is also a modernization project that we have taken up at a plant in Gudur and this is based on reducing any kind of rejections or scrap and increasing our productivity and of course in the new plant we have started to be able to run three shifts but at the same time we are not currently doing that because the demand does not require us to do so but we believe that it will by early next year and therefore we want to make sure that the staff is trained and capable to be able to run three shifts rather than running behind once the demand is there. In terms of I think the balance sheet what you are talking about in terms of the net debt position that we have I believe the net debt vision that we have at the moment is 207.33 Crores that is the overall net debt and I think if you look at the overall picture, I think you are concerned about receivables. Receivables actually have gone up of course if you compare it to either last year or to the end of the financial year. The main reason for the receivables as well as the inventory going up is because one, the cost of the raw materials has gone up so that has played an impact. The second thing specifically on receivables also is because of the growth in exports is higher and of the overall increase in sales, so at least from the metrics that we are looking at we actually believe that the metrics are very much under control.

S K Sivakumar: Regarding, Networking capital cycle there is no much change, it is about three months, the increase in receivables is in line with the increase in sales, both domestic and exports.

Saket Kapoor: When we look at last April, that last year was a very different year than what it has been, but the second half in particular was good and the inflationary trends were not that relevant at that time so looking into what we are today how confident are you that we can at least replicate what we did H2 last year in terms of the revenue and the profitability, revenue would definitely be higher because of the pass on increase in the end product prices and that would give us some understanding on a comparative basis also, how the large years as to and the current year as to if you could compare the same and on the casting part what have been the price increases that we have taken and all the pass on because of the increase in raw material into the system or still there is a lag. And on the power and fuel cost what steps are you taking I think there is some solar alliance part cooling off some resources was also there and lastly on this capital work in progress have we seen that moving up on both standalone to 10.50 Crores and on the consolidated to 20-23 Crores if you could explain?

P Deepak: I will start with the last question first, the capital work in progress that increase whatever you see is part of the modernization project. I think we talked about even in the last conference call as well as what I mentioned a little while earlier, so at our plant in Gudur where we had several manual lines we are now converting that into a fully automated high pressure lines so from a quality perspective as well as the productivity perspective that is going to have an impact. In the last call, if I recall correctly when we were talking about capex plan for the year, it was the major capex that we had talked about. It is rather than a capacity increase it is more on modernization and flexibility also because it will be identical to one of the already existing lines for the same products will be able run on this line and it is also built around the fact that we have got some new business awarded to workers and staff in the middle of 2022. So that is part of the plan that we have for the capex and that project is currently undergoing and that is what you see under the captive work in progress. In terms of the energy situation right now I think if you look at our Ponneri plant around 90% of our energy is coming from renewable sources and when we look at our Gudur and our Pedapariya plant what has been talked about is yet to start but it will cover roughly 40% of our energy requirement there at that plant.

Saket Kapoor: 90% was renewables from Ponneri and I missed the last one?

P Deepak: 40% of Gudur and Pedapariya will come from wind; we are expecting that approval to come through any time now. Ponneri is already running at 90%, Gudur and Pedapariya once the approval comes through we will get about 40% from renewables.

Saket Kapoor: Cost per unit will go down from current levels to what?

P Deepak: Due to an NDA I do not think we are allowed to disclose much.

Saket Kapoor: What is the current cost per unit?

P Deepak: The current cost per unit in Andhra Pradesh is 6.50 and in Tamil Nadu is 7.

Saket Kapoor: I will come in the queue for the follow up and a few suggestions Sir. Thank you.

Moderator: Thank you. The next question is from the line of Umang Shah from Sarath Capital AIF. Please go ahead.

Umang Shah: Congrats on the great set of numbers. The first question was do you see any trend of increase in non-tariff for aluminium castings, your end market for tractors and M&HCVs?

P Deepak: So honestly we do not really see it or anything substantial I think there are a few products that if you look across the OEMs some might be doing it in ferrous and some might be doing it in aluminium one example might be let us say for example the transmission housing but other than that largely most of the ferrous castings that I use are used for structural purposes or higher temperature purposes so I do not see that trend really anything significant in that trend other than in the case of the transmission housing where perhaps it does not require the same kind of load.

Umang Shah: Got it and also wanted to ask this question in conjunction to increase in set of electric vehicles. Do you perceive it has helped your business model because electric vehicles generally tend to have the castings less in number and also use less aluminium. So, do you think of that as a threat in the next 10 years or something?

P Deepak: When I look at the electric vehicle picture what we have today in front of us I think there are a couple of things to understand. So I think from a trend perspective we are seeing two wheelers trending move towards electric vehicles, we are seeing maybe on the passenger car that is being of course huge numbers but it will take some time as it will get over range anxiety and the infrastructure builds around it and we certainly believe that small commercial vehicles will play a fairly significant role in getting converted to electric because a lot of their usage is within cities as well as in buses. So the good news for that in all of these is that our presence in this is actually miniscule almost negligible for us in this segment. Now when it comes to medium and heavy commercial vehicle, one we believe that there is time before that transition happens, we do not believe any of the parts that we are making today will get significantly impacted or disrupted while the electrical vehicle change. The reason for that are the parts that we are largely supplying to be parts that would end up on the commercial vehicle side that would end up in a chassis for the suspension or different mounting brackets and things like that as well as in the axle. Now whatever I have seen so far the chassis is not changing substantially but the axle is changing and in fact I would say that it might actually be an opportunity for us because when the axle changes whatever I have seen the type of products that we are supplying are actually getting more complex so I believe the ability of our competitors to make these products might not be as good as our ability to make these products. Of course there are still parts that have not yet gone into high volume production, but that being said I believe that we will have advantage when that happens and even though that might be as much as 15 or 20 years away for heavy commercial vehicles to really make that switch. On the tractor segment honestly we do not see significant impact of electrification also because of the location of use being primarily rural as well as last time being relevant in the variety of uses, so we are not really seeing the trends there, but if you look at how much of our business is really related to the internal combustion engine that number would be probably less than 3%, so our concern to our business being disrupted by electrification is actually quite small, in fact in all probability over a longer period of time when the technology measures we believe that opportunity that we will have will actually be much greater.

Umang Shah: Got it. This is very helpful. One more question was India producing 11 million tonnes of castings last year and I understand that tractors and M&HCV would be a significant part of it. So would you have any ballpark number of what percentage would be coming from tractors and M&HCV. What I want to understand is your total addressable market?

P Deepak: If I look at tractor and M&HCV you are talking out of the 11 million tonnes. I will throw some numbers out, so perhaps these numbers might not be the most accurate ones but roughly I will just throw some approximate numbers out excluding engines and things like chassis and the transmissions and all of that. So I think roughly speaking it might be about 600 kilograms of a tractor and if you consider that there are about 9 lakh tractors or so, I think you can do the math on that I think it works out for around 540000 tonnes or so might be in the tractor phase, might be a slightly higher number but I am just taking a rough estimate of about 600 kilos. On the commercial vehicle, side if you were to consider that medium and heavy commercial vehicles this year will obviously be less it might be somewhere a much lower number but in the peak we have done perhaps let us say you can consider something about 400000 vehicles I would say that it is probably around 800 kilos or so per vehicle in terms of the fiber parts so that would work out for another 325 and so maybe about a million or so would be and excluding the engine block that go into these because we are not in that phase at the moment. Roughly speaking I would say about a million or so, let us say a million or million and a half something in that range might be roughly the addressable market in terms of tonnage.

Umang Shah: What I understand is your plants are almost nearly fully automated and does it give you an advantage like industries largely MSME with manual castings still the large part of it forming manual castings so do you think that they are going to compete with manual castings players or for you it is the competition is only because the way they play?

P Deepak: Honestly at the moment it is with both but we see the trend is moving more and more towards automation, we see the clients who are doing it manually have an option to either move towards automation or I do believe that in the next 5 to 10 years that is going to decline because this is something that has been demanded by customers as well. So I think that could put us in a good position and I think the other area that from a growth perspective what we are looking at is coming out of exports, some of which is direct exports and some of which is indirect exports and I think India has become in my view a very good place to be able to buy castings from an economical standpoint as well as from a quality standpoint, so I believe that our position in this and I think we can see the kind of growth numbers that we are seeing in exports is that we believe exports growth will be a huge part of the growth in the years to come.

Umang Shah: I think the company has been super smart in putting the capacity at the right time and also using them efficiently; however, the numbers do not reflect in the return on capital employed so when you are doing a metric of how to put new capacity what is the internal rate of return?

P Deepak: The internal rate of return that we are looking at is 20% but the reality is because of the cyclicality of the market sometimes the payback does get delayed beyond what you would like.

Umang Shah: Right Sir because 12% is the math that I see that our company advancing in the last 10 years so going forward just wanted to understand are we thinking more towards ROCE point of view or more towards revenue growth point of view?

P Deepak: I think at the end of the day I would deliver bottom line. I think topline is all fun and games but I think the real test is in the bottom line and we believe that we are just a few quarters away from being able to show better bottom line numbers.

Umang Shah: Alright. Thank you so much Sir?!

Moderator: Thank you. The next question is from the line of Nilesh Doshi from GL Capital. Please go ahead.

Nilesh Doshi: Sir couple of questions on the operational parameters especially on the margin side, if we see our revenue last year same quarter versus this quarter we are almost 100 Crores up in the revenue but our bottom line is terribly on the lower side, you did allude it to the cost inflation especially on the raw material side, so I just want to understand there that how this business runs because do we not get an order and tie up the raw material instantaneously where we protect our margins or do we not have a passthrough even with a lag effect of the previous supply so can you just help us to understand how the business runs?

P Deepak: The second point that you mentioned is actually correct, so we do have a quarterly adjustment mechanism with almost all of our customers where there is a pass through effect that is there but with a lag of about a quarter. Unfortunately what has happened more recently with substantial increase is the way that it turns we take average of a previous quarter and that becomes applicable starting the first of the next quarter, so if we were to take the average of April, May and June that will be applicable on July 1st and similarly, but what we have seen is when we take the average itself the spot price in July is actually higher than the average price so there has been some level of margin erosion that happens because of that when we are in an upcycle in terms of the commodity prices. When we are in a down cycle in terms of the commodity prices that is something that help us, so in terms of it is a two way thing that is there and that is the mechanism that is there with virtually all of our customers in terms of the way that it is done. I think what we are trying to do now at present is because we have seen an increase in the cost of ferro alloys were actually gone to our customers and we have asked them rather than it being a quarter we want an interim increase as well and those discussions are currently ongoing.

Nilesh Doshi: Are you seeing that you can switch over instead of quarterly to a monthly kind of a formula basis?

P Deepak: I do not think that is going to be possible on a continuous basis I think maybe on an exceptional basis we are requesting that from our customers but I think the quarterly basis seems to be more realistic considering the amount of processing and background works that needs to happen in order to do this.

Nilesh Doshi: Second to understand the China plus one story which we are observing across in every sector the entrepreneurs are talking about this is coming up, that is coming up but at the same time we are not seeing a pricing power with any of the corporates even as castings because if the OEMs really want the products from India but if they do want to give a margin how do we sustain a business because if we see we are, jokingly we are actually working for the customers we are not working for the stakeholders so do you see any kind of mindset going to change from the customer point of view as you go forward?

P Deepak: Let me just address the China plus one and what we have seen in our business. Honestly we have been hearing about this China plus one for well over the last year, year-and-a-half, pretty much since the start of the whole COVID crisis even before the last one started, in January when the first new came out and there was lockdowns in China itself before it really spread to the world. We have been hearing about this China plus one and in our business actually the type of products that we make and we have been specializing in parts with a little bit higher complexity but at the same time it is incredibly high volume type of a product, so in this honestly, we have not really seen much competition from China and we have not really felt that there was a significant change that we had seen in that section. I think that is changing. I am starting to see more and more interests for products that are much higher in volume and even lower in terms of complexities we are getting more and more RFQs and more and more interests coming from buyers across the world. In the last couple of months ever since this Chinese power crisis issue has started I think this to me seems to be a bigger de-risking strategy after especially this coal shortage power crisis whatever we want to call it I think that could potentially drive at least in the casting space the China plus one driven more not necessarily just by cost but driven by risk management because I think that has become a fairly major scene that is there. Other than that with our new line the capacity and not just a capacity but the capability that we are putting in the new line which is a very large line 2.1 meter long we have also displaced some of the castings that are currently being imported into India from China and we are now able to manufacture those castings because I do not believe that capability to produce those parts existed in India prior to this capacity being added. So these are some of the parts that I alluded to earlier about the products and the development in the new plant.

Nilesh Doshi: Typically your pricing works for ex-factory or it is once a year especially for exports and for domestic also on FOR basis, how does the pricing because there could be some element of freight cost and other handling costs would have gone up?

P Deepak: Typically I think the domestic could be a mix of both, domestic is a mix of both so it depends entirely on the customer whether they have their own dedicated logistics team and they want to manage it and try to consolidate among various suppliers in terms of material and all of that, so it changes a little bit in terms of the domestic. In terms of the export what we have been doing so far majority I would say perhaps greater than 90% of our exports is all on a CIF basis where we are delivering the goods to the customer. When we have seen this abnormal increase in freight cost whatever we have seen over the last six months of the last year we have actually gone back to the customers and we have negotiated passing through that increase and by enlarge we have been successful in that.

Nilesh Doshi: Last question again on the operation side we are commissioning a new facility for the larger casting so what kind of cost we would be currently incurring for commissioning and developing those products and vendor approval, etc., which must be going through other expenses and other development cost in the current quarter so just to understand the current operational business in terms of the margin versus the new development cost, which is going through the P&L?

P Deepak: From a capacity standpoint the capex was completed last year, so in 2020 September we completed the capex and we capitalized the asset as well so those parts are not there and when you look at it also from a year-on-year basis that is the one major difference also compared to last year to this year in terms of the second quarter. I think a lot of the new product development that is happening also in terms of the new product development once the development work is completed we also get the cooling part reimbursed by the customers so that is also something that is currently going in process. The problem that there right now is that it is running at a very capacity utilization so the plant is running at perhaps something to a tune of about 15% or so, so as a result of that additional costs are there which you cannot cover up. The fixed cost and other costs are coming in terms of power cost because obviously we have two costs to power one is in terms of the variable cost which we are paying per unit and the other one is the fixed cost that we are paying as a maximum demand. These are something I would say that are probably impacting and even the variable cost that we pay we are obviously much more efficient if we are continuously producing 24x6 or 24x7 rater than we are producing only one shift and then we have to do a cold start, so these are I think probably some of the things without getting into more specific these are probably some of the things I would say that are impacting us and that we can definitely have much better management on cost. In addition to that obviously absorption of fixed cost will improve quite a bit as we complete the new product development and as we improve the capacity utilization at the new plant, so we would expect to see quite a good improvement and hopefully with the new product developments that are planned we expect to see that sometime in the next two, three quarters.

Nilesh Doshi: Specific reason for the new capacity operating at just 15% kind of a thing?

P Deepak: Because there is a lot of new products that are currently under development and validation all of that.

Nilesh Doshi: If I look at next year FY2023 what kind of utilization we are envisaging?

P Deepak: The numbers we believe that we should be able to get up to is something around 50% or so.

Nilesh Doshi: That would result into tonnage?

P Deepak: The total capacity in that plant is around 60000 tonnes currently, so roughly estimate about 20000 tonnes next year.

Nilesh Doshi: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Anand S. Please go ahead.

Anand S: The first question is you mentioned railways was about 4% of revenue this quarter, in last quarter it amounted to 3% of revenue and generally the commentary we hear is that the railways is not picking up well with a strong revenue growth. What is the key driver as the production levels increase and what is the outlook?

P Deepak: Railways for us is primarily we are only in two specific products in railways, one particular product that we do is base plate which is used by all the metro rails so this is a plate on which the actual track is sitting and the entire clips and fastening systems to hold the track down is assembled on to the slate, so this is one of the products what we are supplying and I would say that perhaps if you were to go around anywhere on any of the metro rails somewhere between 80, 90 or even higher than 90% chance that the track is fastened to one of our plates and we have been supplier of this in phase 1 of the Delhi Metro, so this is one product that we are doing, so this is not really related so much to the Indian Railways but the execution of metro projects. I have more and more projects keep getting executed whether it is Bangalore going through an expansion or whichever is the next city that is going through it Ahmedabad went through one last year, we see Cochin I think went through one, so whenever there is a instillation of a metro project or there is expansion of a metro project at that particular time these plates are required and this is one of the things that contributes to our railways number. The second product that we are doing for railways are the brake disc that we are doing, which is used on what they call LHB coaches which are primarily Rajdhani and Shatabdi and Indian Railways called high speed coaches. So this of course what we have seen a major shift happening about I believe two years ago where the Indian Railways from a safety perspective decided to go away from the traditional coaches and go start exclusively manufacturing only the LHB coaches, so we saw this happened a couple of years ago and obviously the number of coaches manufactured will be what drives our sales, so these are the two things it is not we are not in many of the other areas like locomotives and other things. So these are the two products that we are producing for the railway sector and depends on these metro projects are going and depending on how many coaches are getting built that drives our railway business.

Anand S: What is about size that we have in railways?

P Deepak: I think it is fair to say that this current number of 4%, 4.5% something in that range is roughly where we see for the full year.

Anand S: Any rough estimate of the order book size for the next two years?

P Deepak: It is hard to estimate, a lot of that will depend on what new projects may come up in terms of metro rail because I know there is a very large pipeline of projects that are there, so it will depend on that, it would be very hard for us to given an estimation right now. Typically these orders will get finalized perhaps three, four months before the start of supply it was not that the order book for 2023 is known yet.

Anand S: How are the new orders and new customer additions in the recent times?

P Deepak: We have added a couple of new customers like as I said one of those that we have with the new line is because the size of the line and the number of suppliers available and their existing suppliers cannot make it so that has given us the opportunity to work with customers who perhaps be might not otherwise have been able to make an entry into and so we have at least two new customers that we have added I am talking about in the last few months, so this is primarily got producing the larger products.

Anand S: What is the difference in margin profile for segments, domestic versus exports, tractor, M&HCV and other segments? Which would give a higher margin?

P Deepak: I think exports are probably from a margin perspective fairly higher margin product. I think rest of the domestic is fairly similar whether it might be tractor or medium and heavy commercial vehicles but I think in the heavy commercial vehicle some of those higher in value added products I think those we are able to achieve has better margins as well and so if we start to see really the infrastructure segment taking off and we start to see heavy duty tipper sales doing well I believe that on a medium and heavy commercial vehicle side also our margins can go up.

Anand S: Are you looking at any acquisition opportunities as there were lot of acquisitions?

P Deepak: Honestly at the moment nothing and it is not that we are opposed with I believe that what we see is we see a tremendous growth over the next couple of years organically and that is how focus is on executing that growth and perhaps after that we will certainly be open to looking at what might be the best opportunities to add value to all our stakeholders but certainly at the moment and I believe for the next year-and-a-half or so our focus is on execution because we see a great runway for growth over the next two years.

Anand S: Thank you Sir! I will call back in the queue.

Moderator: Thank you. The next question is from the line of Saket Kapoor from Kapoor and Company. Please go ahead.

Saket Kapoor: When you say that you are looking at the run rate of growth that come in two years what message are you trying to deliver, what are the pillars on ground that led you to make this observation and how confident are you that the factors which would enable us are there on grounds and it is only the time factor that we would be able to grab those opportunities going forward?

P Deepak: I will elaborate a little bit what we see as the runway for growth for the next couple of years. I think the first thing that is there is in terms of our export sales, so I believe that we have in terms of exports I am looking at business that has already been awarded to us that are in various stages of development I am not talking about potential business that we have quoted and I believe that our exports will grow significantly from FY2022 to FY2023 as well and especially in the second half of FY2023 we will have a fairly good growth in terms of exports and this is driven by certain orders that we already have that is coming from the North American region. This comes both from the North American truck industry as well as from their light vehicle industry which is there what they call truck and SUVs and we are launching a new product next year so that is the one area where we are seeing growth. The second area where we believe growth will happen is we believe that the commercial vehicle cycle will turn around and we will start to see growth in commercial vehicles after probably two, three pretty bad years, so we do believe that there is demand, we are seeing signs of margin improvement in terms of freight, so I think that is the second thing as well. The third thing that is there is also on the heavy side we have some new business there also in a few different areas, one area is in terms of certain products that the end customer is actually producing clips, which is a business that we have not been in and this business is largely be coming in 2023. The second area is also in terms of the axle, so what we are seeing is on the four-wheel drive axle for tractors and commercial vehicles the front axle which is a very large component among several of the products that we are manufacturing, which are currently products that are already running and being imported into India from China primarily so we see as this product development cycle gets completed over the next few quarters that will also impact. So as a result of these factors I very strongly believe that we are on a very strong growth trajectory that we will see over the next year-and-a-half to play out. So our focus is on execution.

Saket Kapoor: These are the orders in hand which you will be delivering say one year down the line these are only the product development is underway that is the reason that once they are approved like in world are the products have been approved and now we are just planning the execution where are we in that space?

P Deepak: We are in different parts of the cycle depending on the products. We are currently developing the product which means the tools are being manufactured, in some cases the product is under testing where we have already submitted samples of the product and are currently under the testing process and in some of the cases the testing of the product is also completed and there is a certain cycle in terms of the start of production date which is somewhere in the middle of 2022. Somewhere between these three is where most of it is and I would say probably 50% of the new business what we are expecting is in that final thing where setting is also completed and the products are approved but the start of production does not start until somewhere in the middle or end of 2022.

Saket Kapoor: All these product developments which we have done are going to be from the new facility only the one which had been just set up last year?

P Deepak: No, both the existing facility and the new facility so it is not just the new facility. Some of these products are being made at the existing facility and that is part of the reason also why we are going with this modernization project at the existing facility.

S K Sivakumar: It depends upon the casting model and the casting weight which determines the factory.

Saket Kapoor: If we take the unit wise contribution currently can you give us the utilization for the other unit you mentioned about 15% is from the Pedapariya unit and what are the utilization levels for the other one?

P Deepak: Currently our Ponneri plant is running at about 80% utilization and our Gudur plant is running between 50% and 60% utilization, part of that is the accreditation that is going on is also impacting our ability to run at a high utilization, once we complete it then we can ramp it up further.

Saket Kapoor: What is the timeline for this accreditation to be done?

P Deepak: It will be completed by the end of financial year that is what we are targeting.

Saket Kapoor: For H2 the utilization levels are almost in this vicinity only depending upon deliverables which we have planned for H2 the utilization levels are going to be in this vicinity only 80% for Ponneri, 55% to 60% for Gudur and 15% for the new unit?

P Deepak: I think it will be largely similar perhaps because Ponneri from a product mix perspective has a little bit more tractor mix in it, it is possible that, that number might be slightly lower and Gudur that is a little bit more of a commercial vehicle mix so that might be slightly higher but largely in line with this what we expected, potentially a little bit because of product mix might change.

Saket Kapoor: The other income component if you could clarify what is this for 4 Crores that happens now on a concurrent basis, 4 Crores for the June quarter also and 4 Crores for September?

S K Sivakumar: Mainly contribute export incentive because with more and more exports you get export incentives and it consists of interest income and FOREX income also.

Saket Kapoor: Just to conclude as and when this capacity enhancement the utilization levels improved then only we can see the operating leverage to come into play and until and unless that we will be in the vicinity of 2% to 3% PAT margins as you opposed that it is the bottom line that matters at the end so we as an investor would like to have that and understanding until when are we in this phase of 2% to 3% of in a manufacturing business 2-3% PAT margins are not remunerative in anyways is my understanding is correct when is this expansion in margin at the PAT level can go into come up, our PBT numbers might look better but then the interest and the depreciation component are higher in proportionate to that?

P Deepak: I can give you in terms of the PAT margin where we certainly need to be and we are working for it being at a higher level than whatever might be the current numbers today and I think looking forward what we do see is if we are able to get a capacity utilization numbers I think if we are able to get a capacity utilization overall to a 70% to 80% kind of a number I think we will be looking at a very, very good prospect in terms of what the bottom line looks like because I think the economies of scale will start to see that and we will start to see the fixed cost then you have the better will also start to see that, would not really see much change in terms of depreciation and would not really see much change in terms of interest cost other than some working capital that might be added for substantial growth. So what we certainly believe is that we should be able to get to that point within the next year and year-and-a-half and all of these businesses that I talked about are fully operational and into regular production, so I believe that we are not far away from there.

Saket Kapoor: My suggestion was that when we come up with our results for at least the business updates, the volumes and the utilization levels it is a small write up can also be produced for investors post their numbers before the conference call then we can have some understanding how the quarter was in terms of what was the exports mix and what is the current market condition and also looking for investor presentation also going forward if we have to improve our investor days that is for the objective also, so these factors must be looked into and also the provisions now that COVID weaning away that plant visit should also be arranged so that the interested investors or analyst community can have a look at your facility and we have been educated of what these can contribute going forward.

P Deepak: Yes Saket. All of your suggestions are good suggestions and we are intending to look that.

Saket Kapoor: The understanding is we are done with the first half and the second half looks similar from what the H1 is but the exports contribution would be lower and it will be the domestic mix that will be keeping us and just talking about the tonnage part we did around 15000 something about for the first half so around 34%, 35% something like that so this is what the tonnage?

P Deepak: The first half is actually just below 35%.

Saket Kapoor: H2 depending upon the deliverables and the muted H4 will be in this vicinity or can we expect some growth on the tonnage?

P Deepak: I think it is hard to project at this point but we should be something in this vicinity. If we see growth we will see a small growth but I do not think it will be a substantial growth. I do not foresee that we will do significantly worse than this either.

Saket Kapoor: What were H2 numbers last year?

P Deepak: about 38000 tonnes.

Saket Kapoor: Depending upon today's conditions and the continued availability and muted export we would be slightly at a closer or lower than that?

P Deepak: Something similar to that.

Saket Kapoor: But there was a significant margin expansion for H2 that is not going to be the case for this year since the raw material prices are significantly higher and the margin compression is there or can we see margin improvement or margins with complete pass on going forward?

P Deepak: This is a difficult thing to offer as well because of the lag that was there in the pass through of raw material prices I think the challenge that for us to handle for that particular reason is that we do not know what it will look like, so if we saw some reduction in raw material prices things might look better, if we see further increases that were happening earlier in the quarter for raw material prices it could be worse than last year, so very difficult for us to predict the real number but we hope that material prices can stabilize I think that is the most important thing we want stability and I think that will help us.

Saket Kapoor: It is the scrap prices only that constitute the majority of these raw material prices?

P Deepak: Yes still scrap is by far the largest section but what we have seen also in more recent past since the power crisis in China is that other alloys ferroalloy like ferrosilicon, ferrosilicon magnesium, these have also had a fairly significant increase.

Saket Kapoor: Anything you can give year-on-year what was being the increase what have been the impact on account of price increase because of the scrap and the other components?

P Deepak: I do not think we can really quantify that precisely because these are based on different agreements with different customers so I do not believe it will be possible for us to quantify that.

Saket Kapoor: Thank you for all the elaborate answer Sir and we hope that as per your understanding that it is going to be the next financial year wherein we would be actually seeing the economy was kicking in and the contribution margins improving with these all sorts of abnormalities in the export market and achieve surplus going down we could be able to get to the through potential at least it would be a starting point for us. That should be a fair assumption Sir?

P Deepak: I think that is a fair assumption. I think chip shortage I do not believe that full solution to the chip shortage will happen perhaps until the end of next year, so I think while there might be some small improvement will happen, I believe for us to start talking about chip shortage is at least year or so away, so I believe early 2023 is when nobody will be talking about chips anymore, so I hope for the new capacities to come online for the silicon manufacturing. We will have to understand the full impact of the chip shortage but we hope that things will only improve from here.

Saket Kapoor: Thank you. For the plant visit also and we have been looking forward meeting your Sir. Thank you for the extended time and all the best and Seasons' greetings and happy Diwali to all the team.

Moderator: Thank you. Ladies and gentlemen due to time constraint that was the last question for today. I would now like to hand the conference over to Mr. Annamalai Jayaraj for closing remarks.

Annamalai Jayaraj: I would thank all the participants. We thank most of you for the follow-up and answering all the questions.

Moderator: Thank you. On behalf of Batlivala & Karani Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines.