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“Kirloskar Pneumatic Company Limited Earnings Conference Call”

August 5, 2013



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ANALYST: MR. RENJIT SIVARAM

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MR. SUHAS KOLHATKAR**



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Kirloskar Pneumatic Company Limited
August 5, 2013

Moderator: Ladies and gentlemen. Good day and welcome to the Kirloskar Pneumatic Co. Limited Q1 FY'14 Post Results Conference Call, hosted by Batlivala & Karani Securities. 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 this 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. Renjit Sivaram from Batlivala & Karani Securities. Thank you and over to you Mr. Sivaram.

Renjit Sivaram: We welcome all of you to the Kirloskar Pneumatic post results conference call. We have with us the Kirloskar Pneumatic Management represented by Mr. Aditya Kowshik, Managing Director, and Mr. Suhas Kolhatkar, VP Finance. Thank you Sir on behalf of B&K for taking time-out for this conference call. We would request you to start this call with a brief on the quarterly financials, how you see the business going ahead, and also views on the current macro environment. Then we will open the floor for Q&A. Over to you Sir.

Aditya Kowshik: Okay. Good afternoon ladies and gentlemen. Like Mr. Sivaram said the first issue will be a discussion on the quarterly results. I think everybody here knows about Kirloskar Pneumatics. So I will hand it over to Mr. Kolhatkar and he will give you a brief on the quarterly results.

Suhas Kolhatkar: Good afternoon everyone. In the first quarter of the fiscal 2014 as you must have gone through our results on the website we posted a turnover of 120 Crores as compared to 148 Crores last year. We also had the other income going slightly up to 106 Lakhs that is 1 Crore 6 Lakhs compared to 98 lakhs with total income going to 121.14 Crores. As far as our material cost was concerned, we were very much in line with what we incurred in the last year around 49%, though it was much lower than the last quarter of fiscal 2013. As a consequence we had profits of 13 Crores 55 Lakhs before the other income and finance cost, which was 11.2% compared to 19 Crores 30 Lakhs on a higher turnover representing 12.9%. Other income rose to 3 Crores 97 Lakhs compared to 1 Crore 92 Lakhs and the finance cost was very low 13 Lakhs compared to 25 Lakhs. Profit before tax stood at 17 Crores 39 Lakhs, which were at 14.5% higher than the last year of 20.97, which were at 14.1%. So these are the overall results for the quarter ended. As far as segments were concerned, there was decrease in the revenue in the compression segment for 125 Crores to 96 Crores. However, transmission segment posted more or less the same level of 23 Crores compared to 22.78 Crores. In terms of profitability, the compression segment showed 19%



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

profitability as against 22% because of the lower volume essentially so these are relating to segment revenues and 16% were the transmission product segment revenues compared to 10% of the last year. The division contributed significantly due to various measures that we took internally for improving the margins. That is the overall results. The overall capital employed was 270 Crores as against 250 Crores last year and 260 Crores at the beginning of the year. So that is the overall financial performance for the first quarter. We now request our Managing Director, Mr. Aditya Kowshik for a brief on the current operations.

Aditya Kowshik:

Really nothing much to say on what the economy is or what we are facing. My guess is not news to you also that things are pretty much at a standstill in India. There is not much movement in any of the sectors that we are talking about. We see some kind of messages and statements coming out from government and government agencies about looking at investments and starting investments and pushing the oil & gas business forward. The business of ONGC renewal has been on the card for the last three, three and a half years. It is one to two or three steps ahead of what it was last year. While executions should have been started, we are still in the initial tendering stage in the sense now the tender has gone out for the large EPC contractors. They will then talk about the smaller compression systems etc. that they buy. Sorry there is not much of good news on what is there on the horizon. We still have a very, very large enquiry level, but order situation is not very encouraging. We are still at around 260 to 300 Crores. Our focus is now more on trying to see the export market in Middle East and Southeast Asia. We made some big movements there in the sense getting small 4, 5, 6 Crores. However, the big business in India is still a question mark. Everybody expected that once the gas price was rationalized things would move. Yes, Reliance is moving. There are some very strong business opportunities with Reliance for which we are very actively working. However, with the rest of the oil & gas companies, I do not see much of movement. Of course you all know about the windmill sector which has gone through a major problem. Again, strange because India definitely needs power but may be our policies were not good enough for promoting this investment. As a result one good sector where there could have been a good source of alternate energy seems to be dying out. There does not seem to be much investment. In general, the whole scenario of the engineering industry is a little wait and watch kind of thing. Those who have money are not willing to spend it. Those who did not have money are not getting money from the banks or they are thinking twice before borrowing from the banks, so overall very quiet, except the cold store business seems to be doing generally okay. May be the government is pushing a lot more points. They had mentioned last year that they are pushing into building of newer cold stores etc., etc., but food processing has also taken a hit. One does not see much investment in food processing per se. That is it gentlemen. I am open to questions; I do not have much on this.



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

- Moderator:** Thank you very much. Ladies and gentlemen we will now begin the question and answer session. First question is from the line of Samir Raj from Reliance Mutual Fund. Please go ahead.
- Samir Raj:** Good afternoon Sir. Sir in your last quarter remarks you had mentioned that the overall outlook is not good with various cost-cutting measures and export focus which you are planning. You were still hopeful that overall you will be able to maintain the performance. So looking at the current environment, have you made any changes in your outlook?
- Suhas Kolhatkar:** In terms of profitability as we said we were pretty sure that with various measures that we would undertake in the company we will be able to maintain the profitability percentage which we have demonstrated. Last year we had about 14.1% PBT level, which we have improved to 14.5% this year. So pretty much maintained at that level though the top-line would get hit because of a very uncertain and sluggish environment. However, the margins have been maintained.
- Aditya Kowshik:** I think Samir you should consider that inspite of a large drop in top-line we have been able to maintain cost, which is what I said that our cost-cutting measures are very aggressive so I think we will be able to maintain PBT level.
- Samir Raj:** Right. Sir as the things stand and as stock markets are really gloomy, is there any hope on the horizon that something could bounce back. However, on the real economy front what is your feeling.
- Aditya Kowshik:** What real economy, you mean you are not in the real, you tell us what you hear more in the market. We meet only limited customers, oil & gas etc, etc. We could also have some information from you as to what is happening.
- Samir Raj:** Whatever the information, you will get depressed, but on oil & gas you also touched upon in your remarks that finally something is happening there.
- Aditya Kowshik:** Something is not happening there only- Reliance seems to be happening, but the other oil & gas everything is still pending, pending, pending. Look at this, even CNG we are having a problem, which is supposed to be the driver of the country. No decisions have been taken anywhere.
- Samir Raj:** Right, so given the current environment have we made any changes to our CapEx plan or you still maintain it?



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

- Aditya Kowshik:** We maintain it.
- Samir Raj:** Okay. What about the steps you have taken on the export front and encourage focus on the spares. When do you think we can see some meaningful numbers in terms of, top-line?
- Aditya Kowshik:** You would know if you had attended our AGM and read our Chairman's speech. Getting oil & gas business in the export market is a three-year story. We have started last year, we first have to get ourselves approved and then they will allow us to quote, so it is going to be at least minimum two years before you can see anything there.
- Samir Raj:** And about spares Sir?
- Aditya Kowshik:** Of course, there is definitely a focus.
- Samir Raj:** Lastly on the gear business front, I think we should have done really well given the overall environment, so are you still hopeful of continuing this good performance in the coming quarters?
- Aditya Kowshik:** Yes, may be not the same kind of growth but definitely the performance will continue. Growth wise only government of God can tell us.
- Samir Raj:** Great Sir that is all from my side, all the best.
- Moderator:** Thank you. Next question is from the line of Manish Goel from Enam Holdings. Please go ahead.
- Manish Goel:** Sir if you can highlight regarding order with Reliance i.e. basically in what segment you are working and what could be the potential size of that and what kind of competition you are seeing there?
- Aditya Kowshik:** Competition is the whole world. I guess this is the only business that is being finalized in the world from the last four months to the next three or four months. Everybody in the world is quoting for it, obviously everybody desperately need jobs, and obviously it is going to be a very, very price-sensitive business. I cannot tell you the value of the contract as such today which is still in the enquiry stage. They are exploring various options but I would believe that by December they would be finalizing what their real requirement will be.
- Manish Goel:** Okay, but for us where would we be seeing opportunity in what segment?



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

- Aditya Kowshik:** Oil & gas that is where we are. In the gas compression segment, we are in oil & gas and CNG that is refinery, petrochemical, and fertilizers.
- Manish Goel:** Only by December you would possibly know what is their requirement and after that you would be quoting, is it right?
- Aditya Kowshik:** It may not happen so late, but they will be able to finalize things may be in another two months or so. Today we are still talking conceptualization, but that is moving quickly.
- Manish Goel:** What is the order book currently Sir?
- Aditya Kowshik:** Between 260 and 300 Crores.
- Manish Goel:** How has it moved in the last three to six months Sir?
- Aditya Kowshik:** Gone down, not because we lost orders but because there were no orders.
- Manish Goel:** In transmission segment, how is the outlook in terms of the railways?
- Aditya Kowshik:** It seems to be steady. Railways are the main customers so that is steady. We have made some new entries into industry gearboxes also, not the very large one but a smaller one, so that has been accepted very well in the market. Windmill is dead; we do sell one, two, three, four whatever, but not the main business. We still have technically a huge order board, but without money I do not consider that an order board today.
- Manish Goel:** As far as industrial gearbox is concerned what is the kind of revenues or probably we would like to elite in to what kind of market share you would be probably looking?
- Aditya Kowshik:** Very difficult we are just entering it now. We had exited this market a long while ago, we are entering it again, so give us a year or so to be able to finalize which section we can actually fit ourselves into.
- Manish Goel:** Okay. Apart from projects, and standalone products like screw compressors, how are we looking to approach the market with new products? Generally what we see is competition has relatively done well in the last quarter, so as far as our company is concerned if you can highlight what is our strategy for products, screw compressor and other products, because what we see is that competition has done well last quarter in domestic market. Just wanted to get a sense, is there any new product launch that is being planned.



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

Aditya Kowshik: Comparatively our screw compressor for air has done very well in the last quarter, but technically our market share is very very small, so it is not really very significant, but compared to what we did last year of the same quarter or compared to what we did in whole of last year we have done exceedingly well in this screw compressor business, so the market is accepting our products. As I said some new products would be introduced this year also may be towards the end of the year. This is really the right time when we can spend our time and effort in developing products because you do not have too much of pressure from the market, so that is going on definitely, which is why we have not cut down on our investment cost.

Manish Goel: If you can provide update on the road railer project Sir?

Aditya Kowshik: The road railer, the rake is ready we now have to conduct the emergency break distance test which is scheduled to be around October 2013 and once that is done then the rail will be formally allowed to run on the Indian Railways for actual movement of goods.

Moderator: Thank you. The next question is from the line of Gagan Talreja from Comgest India. Please go ahead.

Gagan Talreja: Can you give your views on the outlook in the defense segment related to your markets?

Aditya Kowshik: Last year there was a major cut in defense spending. Maybe they wanted to cut down the expenditure or whatever but there was a huge cut in defense expenditure. However, I do not see that impacting too much by way of business, but yes on timeline wise that is going to effect, because most of the defense plans are pretty much in the essentially needed category so it might be delayed by a month or a year or so, but that is something we are very interested in and we keep tracking it. It has not grown like it is supposed to grow, but the business exists.

Gagan Talreja: Do you foresee the budget 3 allocation for defense this year again going in for cut towards the end of the year?

Aditya Kowshik: That would not be very wise, I cannot say what the government is going to do because we have given up or trying to predict what our government will do, but I think that would be a very unwise move if they ever do it.

Moderator: Thank you. The next question is from the line of Manish Goel from Enam Holdings. Please go ahead.



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

- Manish Goel:** If you can help us with the data points on what was the projects revenue for the compressions and what was the product revenue for last year and first quarter of this year Sir?
- Aditya Kowshik:** We traditionally used to be 60:40, but that has come down now.
- Manish Goel:** For FY'13 what was the ratio Sir?
- Aditya Kowshik:** It went the other way around last year, it was 40 projects and 60 products, and I think this year first quarter is somewhere in between.
- Manish Goel:** Just to clarify when we say this ratio you are giving this for compression business only, not including transmission?
- Aditya Kowshik:** I was giving you the KPC figure.
- Manish Goel:** Company as of whole?
- Suhas Kolhatkar:** Yes.
- Moderator:** Thank you. The next question is from the line of Renjit Sivaram from B&K Securities.
- Renjit Sivaram:** I have some questions regarding the business if you can help us. Sir if you can throw some more clarity on the CapEx, like what are the opportunities in the highland gas front, in ONGC and others. Can you give us some clarity on a medium to longer-term perspective?
- Suhas Kolhatkar:** I can give you one other figure, our enquiry level is close to about 1200 Crores that is the only thing I can give you. I looked pretty stupid for the last two years because saying that this is going to happen this year, this year, this year I keep saying, and I have said it for the last two years and we are still carrying that enquiry level, so I would not like to put my foot in my mouth again and say this is going to get finalized this quarter or that quarter.
- Renjit Sivaram:** Sir regarding that cold storage opportunity like how do you see that, are you optimistic regarding this FDA in retail and that percolating into orders for cold storage or is it a long way?
- Suhas Kolhatkar:** FDA in retail is not really our kind of business because our cooling is not the retail kind of cooling because we are more in the rural sector, which is in the cold stores for primary agriculturist rather than the distribution section. We are in the large unit. You see what



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

happens to the retail food malls or super markets, etc., these cold stores are very very small and multi-cold stores, some of ice creams, some of this, some of that; these are all very small. These are taken up by the small compressors like Copeland, etc, the kind of window air conditioner kind of compressors or the refrigerator kind of compressors. We are larger in the industrial segment, we give compressors for the potato cold storage where they have 10,000 tonnes of potatoes stored, or the chilly cold store where they have 5000 tonnes of chilly, onion, and mangoes, fruit etc. That sector has been steady because there is a lot of encouragement and subsidies that the government had promised for setting up these kinds of cold stores near the farmer that is where we come in. We are not really in the urban small cold stores, but one of the effects of this FDI in cold storage is those people are going to insist on more and more food being stored properly after harvest before it is transported, so obviously that will give a boost to the rural cold storages also.

Renjit Sivaram: Okay, that was useful. Regarding this road rail project if you can elaborate a bit on how do you see this business and what kind of challenges we are facing in terms of railroads?

Aditya Kowshik: The first thing that has to be done is get the train approved for the speed and breaking which happens in October. It is a unique concept; nobody has done this in India. It is coming in for the first time. All our potential customers that we have spoken to are pretty much excited in seeing this technology coming into India. We are obviously going to be dependent on Indian Railways to move this over the tracks, so those agreements are in place, a little tweaking has to be done now and then for all these places. We think it is a good opportunity but like we said you would have to see it operating towards the end of this fiscal year and after the EBD is over of course. EBD means emergency brake distance test. Once that is done then there will be a lot more to talk about.

Renjit Sivaram: My final question will be regarding the CapEx plan for this year, how much and where are we planning to invest?

Aditya Kowshik: We are planning to invest in all the divisions pretty much equally, same as last year, around 40 Crores.

Renjit Sivaram: For railroad do we intend to invest anything more?

Aditya Kowshik: We have not yet finalized. We can decide only after the EBD test is over, what capital requirement would be required, we would be able to assess only after the EBD test is over.

Moderator: Thank you. As there are no further questions I now hand the conference over to Mr. Renjit Sivaram for closing comments.



Enriching Lives

Kirloskar Pneumatic Company Limited
August 5, 2013

Renjit Sivaram: Thank you Sir, thank you for taking your time out to participate in the conference call and thanks for all the participants who participated. Thank you.

Aditya Kowshik: Thanks a lot for helping around in this and thanks everybody who are listening and asked questions.

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