"Kirloskar Pneumatic Company Limited 2Q FY2022 Post Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to Kirloskar Pneumatic Company Limited. 2Q FY 2022 Post Results Conference Call hosted by Antique Stock Broking. As a reminder, all participant lines will be in the listen-only mode. 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. Dhirendra Tiwari from Antique Stock Broking. Thank you and over to you Sir!

Dhirendra Tiwari: Thank you Tanvi. Good afternoon ladies and gentlemen. Let me welcome you to the 2Q FY 2022 post results conference call of Kirloskar Pneumatic Company Limited. To discuss results and outlook I am pleased to have with us today Mr. K. Srinivasan, Managing Director and Mr. Suhas S. Kolhatkar, CFO along with other members of the team. First, I congratulate Mr. Srinivasan and team for continued strong performance. Now, I would like to invite Mr. Srinivasan for his initial remarks. Over to you Sir!

K. Srinivasan: Good afternoon to all of you and let me thank Mr. Dhirendra Tiwari for hosting this. I am going to request our Company Secretary, Mr. Jitendra R Shah to first read out the safe harbor and then we will go to the call.

Jitendra R Shah: Thank you Sir. Good afternoon to all. The presentation uploaded on the website and discussion on the financial results during the earnings call may contain statements relating to future business development and economic performance that could constitute forward looking statements. While these forward-looking statements represent the company's judgements and future expectations, a number of factors could cause actual developments and result to differ materially from expectation. The company undertakes no obligations to publically revise any forward looking statements to reflect future events or circumstances. Further, investors are requested to exercise their own judgements in assessing various risks associated with the company and also the effectiveness of measures which taken by the company in tackling them as indicated during the discussions. Thank you.

K. Srinivasan: Thank you Jitendra. Once again, good afternoon to all of you. Let me at the outset wish you all a belated Dussehra greetings and early Diwali wishes. May this year be a safe and a happy one for all of us. Q2 FY 2022, is a quarter when we delivered record number of compressors as a whole, in spite of serious challenges with availability of controllers, which really comes on the chip shortages and several other components, but an absolute number of compressors, this was all time record, we have more than 30% higher compressors made and sold during this compared to any other time. With nearly the entire workforce fully vaccinated, the COVID related disruptions were finally behind us. We have no COVID cases in the company and its associates. Unfortunately, delivery and commissioning of projects continue to be delayed and impacted due to the sites still not being ready, this is across India. This is expected to ease in Q3 with strong order inflow and order bank as on October 1, 2021 of above Rs. 1,000 Crores we are well poised to do significant numbers in Q3 and Q4. The company delivered on its promise of compressors for the oxygen plants across the country, this is very important for us. We proudly delivered the largest number of large capacity compressors among the various companies for this application. Today, our compressors are spread across the length and breadth of the country and can deliver over half a million liters of oxygen an hour. This activity will continue through Q3 as we have further order inflows coming in.

In the gas and refrigeration space, we had good order flow from overseas projects with oil and gas prices going up, newer projects were under discussion and this is getting stronger in terms of our order bank. CNG gas package deliveries were impacted due to gas engine shortages, again coming from chip shortages; however, the order flow in this too remained strong and we expect to step up deliveries in Q3 and thereon. Sales for the quarter was Rs. 226 Crores as compared to Rs. 147 Crores of the previous year, a notable feature of this quarter is a stronger sale of compressors as equipment as compared to compression system, this makes the business less lumpy and more predictable. The company made significant progress in its development of screw compressors for refrigeration systems and booster compressors for the gas daughter stations. These products will hit the market next year. The Road Railer business had a new impetus with galloping diesel prices. The Chennai-Delhi sector which is what is being allocated for this business as of now is running full on both directions and is now being cash positive. This clearly demonstrates the viability of this business. We expect that with the 'Gati Shakti' initiative and multimodal transport that we offer along with roads and rail connection through the road rail system, this solution in terms of both efficiency and lowest environmental footprint will be seen as something that can make a big difference to the transportation sector. More players and more routes are likely to be opened up and the company will manufacture and deliver Road Railers to all of them. The order bank remains strong like we have said at over Rs. 1,000 Crores and we expect significant part of this to be executed in H2. The company is accelerating on its capex program, we actually have committed in FY 2022 and we are getting prepared for growth through FY 2023. So far we have committed Rs. 22 Crores of capex in H1 and we will complete the program as scheduled in H2. Inventory was higher at Rs. 166 Crores with the reduction in receivables by Rs. 87 Crores compared to the beginning of the year and with the increase in advances from customers by Rs. 56 Crores the overall net working capital was actually down by Rs. 58 Crores compared to the beginning of the year. The company continues to support its vendor base by reducing payables by about Rs. 20 Crores during this period. The net cash generation from operation was Rs. 32 Crores, this is netting off capex as well and consequently, the quality of earnings remained very strong.

Now, let me discuss a little bit about the various business product lines. The air compressor business now is fully established with the screw compressors being designed and built by us at Hadapsar works. We delivered most to the high kilowatt screws for the PSA plants in India and going forward to other plants abroad as well. The reciprocating compressor business, which is ousr forte, continues to be strong and we have order inflow from air separation plants, steel plants, LPG bottling plants, etc. The centrifugal compressors which is the focus area for us with a repositioning of our gear business to address this, has delivered significant quantities during the first two quarters and we have established an advantage over competition in this business in terms of performance as well.

Refrigeration compressors and systems, during this quarter we delivered several packages for food processing and meat processing plants in India. There has also been a pickup in the sales of ammonia compressors for the cold chain and ice plants across India. Exports from MENA countries have revived, this was down last year and now it is picking up, but again the oil prices going up and the economies in these countries doing well. We executed orders for vapour absorption chillers, to the pharma and paper mills during Q1 and Q2. The order inflow continues to be good in this space as well.

Process gas compression system - PGS plants, the sales of CNG packages were impacted due to shortages of gas engines as we said in this quarter; however, the situation started improving, by September we started getting gas engines now and we hope to catch up on deliveries in Q3. The company continued to run the CNG installations across the various states of India on a 24 x 7 basis and this is a major business opportunity for us.

Several major projects including overseas projects are in advanced stages of execution. With this increased inventory of Q2 we expect to complete most of these projects in Q3. Overall the compressor market globally, though impacted still with various shortages, is actually seeing a strong pickup in demand and we expect to benefit from this. In terms of outlook for Q3 and Q4 with the strong order bank and with several projects under various stages of implementation, we will deliver double digit growth both in top and bottomline. We will update our positions as we go forward, but we say on a longer term we remain committed to our aspirational target of being Rs. 2,000 Crores plus company in the next three years. Now, can I request Suhas Kolhatkar, CFO to take us through the financials please!

Suhas S. Kolhatkar: Thank you and good afternoon everyone. At the outset let me extend all of you a warm welcome to this call and greetings for the festive season. I am sure, you and your relatives and colleagues have taken adequate care to protect from the effects of pandemic, which is behind us now and enjoying a good health. By now you must have gone through the results, which we have posted on BSE website after the yesterday's Board meeting and also the presentation which we have uploaded on the company's website. However, for the benefit of those who probably did not get a chance to have a look at those results, let me summarize the Q2 and H1 financial performance of FY 2022 of Kirloskar Pneumatic Company Limited.

Apart from sales of other usual products, which we generally do, supply of screw and reciprocating compressors for generation of oxygen to treat the COVID-19 affected patients continue to contribute to the topline growth in Q2 and in H1. Sale of CNG compressors as MD said also contributed to the growth in the topline; however, there have been some delays in the supply chain which impacted the volume that we were anticipating. Growth could have been higher in Q2 had there been no delays in the supply chain. Based on the order book that we have, we expect a growth trend to continue in the Q3 also and CNG will play a significant role in that as well.

You are aware that the Q1 of the last fiscal was practically a washout due to COVID closures, therefore, H1 results may not be directly comparable with that of the previous year. Although, Q2 of CY has shown growth over corresponding quarter of the previous year when similar business conditions such as issues in the supply chain, etc., existed, but no closure. Having tracked and analyzed the company's performance during the earlier years, most of you are also familiar that the company's quarter-on-quarter performance gets influenced by the mix of the product and projects. Most of the projects get executed in Q3 and Q4 and as such extrapolation of the current results for the year end estimation may not be appropriate.

On this background, I would like to present Q2 and H1 results of the current fiscal. The topline registered a growth of over 52% as sales for the quarter rose to Rs. 226 Crores compared to Rs. 147 Crores in the corresponding quarter of the previous year. With half yearly sales at Rs. 395 Crores H1 showed a growth of about 74% over the previous year. Growth in other income represents return on increased short-term parking of funds and dividend income on the long term investments resulting out of the short term parking of funds resulted out of our net cash inflow. Material cost was at 54.2% as product mix was significantly different than the previous year; however, this percentage is in line with the annual cost percentage and comparable with the industry trends , if not better. The rise in employee related cost represents liberal increments and promotions given to all deserving employees who stood by difficult period of pandemic during the last fiscal. As a result, employee cost rose to Rs. 63 Crores compared to Rs. 53 Crores an increase in both the quarters is more or less similar. This represents roughly about 16.2% of sales as against 23.4% of sales of the previous year. Previous year average ERE cost stood at 14% and we are sure our endeavors are to bring that cost to that level if not lesser.

You would recall that the Company had availed a loan of Rs. 40 Crores in the last quarter and this has also been given in the published balance sheet of the last quarter of the previous year, as an abundant precaution to take care of any financial need just in case it arises due to COVID-19 disruption. We believe that current financial position will permit us to repay this loan in advance. Finance cost, therefore, because of this loan is higher by Rs. 1.4 Crores compared to Rs. 0.5 Crores of the previous year. We will take appropriate decisions to either repay or continue with the said borrowing in the near future considering the money market situation. Growth plants of the company and the financial needs for the second half of the current fiscal and the volume of production and the activities will go significantly higher.

At this juncture, I would like to state that the company had a net cash position of about Rs. 204 Crores as on October 1, 2021 after paying dividend of Rs. 22.5 Crores declared in the last AGM an almost Rs. 12 Crores of expenditure on the capex. Depreciation is in line with the previous year and additions to assets. Our MD briefed you that we have plans for capex of about Rs. 50 Crores in the current fiscal to support our growth and about Rs. 22 Crores to Rs. 23 Crores have been already committed so far, Rs. 12 Crores is what we had actually spent and capitalized. Consequently, there will be some impact on depreciation in the coming quarters depending upon the date of capitalization.

Other expenses are mix of fixed and variable costs and are at 19.7% of sales compared to 22.4% of H1 of previous year and 18% for full year 2021. There is no significant variation in level of expenditure and cost controls that we exercise during the previous year continue in the current year also.

EBITDA, as a result in the current quarter showed a growth of over 44% compared to the corresponding quarter of the previous year. EBITDA remained at 11.4% in the Q1, Q2 and H1 compared to just 8.5% of H1 of previous year. With topline growth coming in the subsequent quarters by execution of projects, we believe that annual EBITDA will improve further. You will recall that annual EBITDA for FY 2021 was 14.8%. PBT for Q2 in current year jumped over 83% compared to the PBT of Q2 of previous year. For H1 PBT was at 6.4% as against the breakeven in the last financial year, which shows a clear swing of over Rs. 25 Crores compared to the previous year. PAT, consequently, remained at 4.7% also showed a growth of about Rs. 18 Crores over the previous year. The company issued 11,100 equity shares during this quarter and 90,600 shares in H1 under Employee Stock Option Scheme. Consequently, paid-up share capital has marginally increased from Rs. 12.85 Crores to Rs. 12.87 Crores.

Non-annualized EPS has improved to Rs. 1.77 for Q2 and Rs. 2.86 for H1 compared to just Rs. 0.92 and Rs. 0.04 per share in the corresponding quarter and half year of the previous year. You are aware that value of the paid-up share capital is Rs. 2 and in the H1, the EPS is of Rs.2.86. The company's non-current investments resulted in net unrealized gain of Rs.16.2 Crores in H1 and that is represented in OCI of the current year.

With about 95% of the revenue coming from the compression segment it remains the only reportable segment, previous years' figures have been regrouped, wherever necessary to correspond to this reporting. The segment earned a profit of 15% in Q2 and H1 of the current fiscal. Transmission setup now supports centrifugal and reciprocating compressors business so it is not a separately reportable segment anymore. Order booking for the first half was about Rs. 540 Crores against Rs. 350 Crores in the previous year, as a result the company has order book of over Rs. 1,000 Crores, as Mr. Srinivasan explained, as on October 1, 2021 compared to just Rs .900 Crores in the previous year.

To support the execution of this strong order book, the company has built adequate inventory considering its execution schedule. Inventory level was at Rs. 167 Crores compared to opening inventory of about Rs. 107 Crores. We have added almost Rs. 60 Crores of inventory for supporting our ongoing project activities and ramp up of production. Despite this inventory level, the suppliers outstanding has been brought down to Rs. 127 Crores compared to Rs. 146 Crores at the beginning of the year. We have a strong receivable management in place and it has been working satisfactorily which has resulted in reduction of over Rs. 87 Crores in the receivable position in H1. New order flow has also improved the advances from the customers by about Rs. 55 Crores, as a result, net working capital has been reduced by about Rs. 58 Crores and the net cash improved by Rs. 32 Crores. This improvement in the cash is post dividend and post capex. Capital employed in the compression segment has been reduced by about Rs. 32 Crores and this is what is reflected in our net cash flow position.

During the quarter, as most of you would be interested to know, 45% of our business was from the projects as against conventional 60% in the earlier years and the balance was from the products. With more product sales in the Q1 the company could pass on the impact of commodity price, the pressure of which is being felt by most of the industries. To some extent, we could pass this burden to our customers by increasing the prices in the market. It may or may not be possible to do so in the coming quarters as sales from the projects will pick up, which are at fixed price. This may see some impact on margins in the coming quarters. So, I think with this I have covered the results of both Q1 and H1 and we would now take any questions.

Moderator: Thank you very much Sir. We will now begin the question and answer session. Ladies and gentlemen we will wait for a moment while the question queue assembles. We take the first question from the line of Bhagyesh Kagalkar from HDFC Mutual Fund. Please go ahead.

Bhagyesh Kagalkar: Thanks for giving me the opportunity. Congratulations for a good set of numbers. Going forward just to touch point on the commodity, the raw material prices have increased quite sharply in the first half and in Q2 also, so what is the trend because you have said that for the fixed projects it is not easier to pass on, so what is the percentage of these fixed projects now, the newer order book how are you negotiating in your competitive intensity?

K. Srinivasan: Our projects generally tend to have cycle time anyway between 7 to 12 months, so generally these are competitively priced based on tender basis. Consequently, we would not be able to increase prices once the orders are taken, so in a way it reduces margin, but having said it we have factored in cost pushes right from the time of quotations in most of these cases. The big push has come largely in copper, consequently, in the motors, in the iron and steel which has really pushed up all our castings, foundry material, etc. It is also coming up now increasingly in the controllers, electrical panels, electrical switch gear and a whole lot of things and so some part of it would have to be observed in the larger volumes that we would produce because, we would not be able to pass it on any further so that is the way it is going. It is going to be tough and that is what Suhas has mentioned the first half has the advantage that we have flipped between equipment and projects. We generally have 60 projects, 40 equipment and spares. We actually had the reverse in the first H1, but H2 would actually flip around, because a lot of projects are going to get executed so there would be some pressure in margins in the second half in spite of very significant growth in volumes and scale of business.

Bhagyesh Kagalkar: In terms of capex, to achieve the Rs. 2,000 Crores target in the next three to four years, this will be the intensity the Rs. 50 odd Crores per annum?

K. Srinivasan: Our capex intensity of sales is relatively modest. We tend to get about four to five times capex a sale, so our existing infrastructure with a few balancing equipment itself can turn out anyway between Rs. 1,500 Crores to Rs. 1,600 Crores, so we think we will be comfortable by a modest capex going forward to do our Rs. 2,000 Crores.

Bhagyesh Kagalkar: Okay thanks Sir. That is all from my side. All the best.

Moderator: Thank you. The next question is from the line of Pritesh Cheda from Lucky Investment Managers. Please go ahead.

Pritesh Cheda: Sir my question is on margin. One the operating leverage at present not to be playing out for the size of the business as we are executing some comments there and second in your opening comments you mentioned on one side that higher business will drive margins versus 14% last year and you are also commenting on material cost rise, so which one is what we should take and consider?

Suhas S. Kolhatkar: I will just put it in a different manner. The margins on the EBITDA would improve by the volumes while we might have a little higher material cost for the sales in H2. The sheer volume growth would get our margins at the desired level, so if we have got about 14.5% EBITDA level in the last year our endeavors are to reach to that level as well despite deemed higher material cost. Mr. Srinivasan did mention about the rise in all the input cost that would affect our material cost; however, the volume growth would give us the overall margins growth.

Pritesh Cheda: Then so far why is the operating leverage factor not playing out Sir?

Suhas S. Kolhatkar: It is again it is a matter of volume right. It is a mix between product and projects. We had about Rs. 400 Crores sales for the first half and if you look at the sales of the last financial year those were about Rs. 823 Crores with about 10.2% of PBT. We have already crossed 6% of PBT so volume has played to some extent in improving the PBT percentage.

Pritesh Cheda: Some of your peers are at 17% margin over yours when we improve the volume can we directionally head towards those margins?

Suhas S. Kolhatkar: Yes, directionally we are heading to the same towards that only. With an aspirational target of Rs. 2,000 Crores and the fix over it is remaining more or less same level we should have better margins coming in the future.

Pritesh Cheda: H2 for us last year was where we did a lot of booking, in your comment you mentioned that there were two contradictory comments one was base and one was also the fact that you will grow in H2 so which one is a more referable guide that we should take?

K. Srinivasan: I did not get your question; because one is order booking and other one is sales. H2 generally tends to be about 50% of our total business so we should get a larger sale in H2. The material percentage of the sale actually goes up when we execute projects, but the sheer volume would allow that the EBIT margin would go up as well.

Pritesh Cheda: So we will grow in H2 right that is how we are putting forth on our revenue side?

K. Srinivasan: Significantly grow in H2.

Pritesh Cheda: In last call, we said that the air oxygen compressor business should be about Rs. 200 Crores and it was the same am I right there and what is the size of our gas compression business, now?

K. Srinivasan: We did not specially mention Rs. 200 Crores number in terms, for us, I think the industry itself for oxygen compressor could be even bigger than that. As far as, the gas compression business we will be approximately about 45% of our total sales. Our air compression business not oxygen; our air compression business has moved up from about 15% - 18% to about 25% this year.

Pritesh Cheda: That would include oxygen as well?

K. Srinivasan: That is right.

Pritesh Cheda: Thank you very much and all the best.

Moderator: Thank you. The next question is from the line of Jaydeep Merchant from Janak Merchant. Please go ahead.

Jaydeep Merchant: Sir, thank you for taking my call. Sir I have two questions. One you mentioned that your export order booking has been good, if you can give us this number and there is a good amount of cash on the books and even assuming the good growth and given your prudent working capital management are we going to have the cash on the books?

Suhas S. Kolhatkar: Yes we will have.

K. Srinivasan: I will answer both your questions. First to Jaydeep on the export orders, I think we would probably have by the end of this month about Rs. 100 Crores of export orders, which would be the highest ever as far as export is concerned so that is looking good, but I must add a lot of projects and will not be completed within the end of this accounting year some of them will go into the next year that is as far as export orders are concerned. As far as, cash and deployment, I think you know the company has always been very prudent, our requirement of capex is fairly modest but there are always opportunities for inorganic and for improving our value chain advantage. We would continuously look at how judiciously we can deploy this.

Jaydeep Merchant: Right Sir. Sir just an additional follow up to the first question can you talk about this export business plus a little more in terms of what kind of orders we are getting in this all related to the oxygen part of the business?

K. Srinivasan: There are two parts in exports one is the traditional equipment export, which is really the bare compressors that go out. We do not directly do oxygen compressor export, because most of the exports of the PSA system actually goes as a complete package, which means the exporter eventually will have our compressor and he will do the export after he bundles it up along with the separation plants so that it becomes an oxygen machine. So we sell into this export market. Bulk of the orders that we are picking up now are for oil and gas projects in the Middle East and MENA countries, which is including North Africa.

Jaydeep Merchant: Okay Sir because the export has been planned for many, many years you are seeing this kind of number after a long time Sir?

K. Srinivasan: You will see the physical numbers of sales only during the next year, what you will see the beginning of this coming in. Order flows have come in like I repeat these orders will get executed over 7 to 12 months.

Jaydeep Merchant: Right Sir. Thank you very much.

Moderator: Thank you. The next question is from the line of Kunal S from B&K Securities. Please go ahead.

Kunal S: Good afternoon and congratulations on a great set of numbers and thank you for the opportunity. Sir my question again is around exports so what is the kind of export opportunity that we see in terms of where can the share of exports be in five years for us?

K. Srinivasan: Since Kunal you are tracking this industry you would know that there are two sets of exports that happens out of this industry. First is the equipment, the compressor that is exported this generally is based on pricing and distribution. We are fairly modest in this. This is what we were trying to do in the earlier part and we are not growing this part of our exports. What is growing for us is the project exports which means we deliver complete compression system, be it for gas, be it for refrigeration including the system designed installation, commissioning and a certain level of upkeep and maintenance, so this is where we see a competitive advantage both in terms of the knowledge of designing it and sell as packing it, installing it and running it, this is what we are taking to the export market. The initial breakeven in these projects are always difficult because you need to have what is called as proven track record because these are planned critical processes. You cannot send something unless the customer or EPC contractors are 100% convinced that our packages would meet his requirements both in terms of performance and safety. We have crossed this hurdle in the last couple of years, we will see this scaling up going forward. The good news is, the orders have started coming in, the executions will start, some part of it will happen in Q3 and Q4, but it will continue into next year as well as we see it today.

Kunal S: Sir is it right to assume that as per global export market projects will be a larger part of the market?

K. Srinivasan: This is a difficult question, if you talk about global market size because markets report generally the compressor sales, project sales is generally not reported as separate numbers, because this will go into the EPC contractor. Compressor business itself like I said if you include all kinds of compressors including comfort compressors, etc., is a $80 billion plus market is huge, so projects cannot specifically be specified anyway, but it is significant part of these compressors, the large sizes are generally now packaged and sold as a part of the plant, which goes along with the EPC contractors delivery. Particularly, if you are looking at newer areas and if you are talking of getting more into the hydrogen compression and other things this would all be eventually sold only as projects.

Kunal S: Understood and Sir my second question is pertaining to the domestic market, which are the areas of pockets of green shoots and which end market is showing better demand traction?

K. Srinivasan: Today, all the sectors are showing good traction. Oil and gas has come back very strongly with the kind of prices you are seeing for the liquid fuel I think gas has come very strongly. Newer emerging areas where we are seeing activity not yet translated into big numbers is in the biogas. There are nascent enquiries even for hydrogen compressors, etc., so this is a business that is scaling up very rapidly because of clear shift in the way the energy basket is being envisaged for the future.

Kunal S: Sir, lastly how should we think about the margin profile over a medium term is there any levers for us to improve our margins further, we will be bettering our last year's margins this year because of the scale, but are there still some cost levers or pricing levers left, which can take the margin up directionally?

K. Srinivasan: This is a very difficult question to answer in one simple sentence, because we have multiple project segments within it, but we have been relatively more modest in terms of our margin growth aspiration, on a shorter term basis we are driving for larger market share. If you look at the larger baskets where we play, like CNG basket. CNG is largely driven by tendering and by pricing it is predominantly bipolar, it is not more than duopoly I would say, but really there are a couple of other players as well. We are mindful of not trying to put up prices very aggressively in these markets and still would like to keep market share.

Kunal S: So there has to be a balance?

K. Srinivasan: Yes, otherwise you will unnecessarily get everybody into this market.

Kunal S: Right Sir. Thank you so much Sir and best of luck for the future quarter.

Moderator: Thank you. The next question is from the line of Shivam Prashar from SP Ltd. Please go ahead.

Shivam Prashar: I want to ask a general view that in the past industrial evolution from 2003 to 2008 we saw a tremendous growth of compressors in the industry, do you see any signs or early traces of that kind of industry demand picking up in India right now according to your knowledge?

K. Srinivasan: The compressor requirement is picking up with industrial activity. I cannot put a specific number between 2003 to 2008 versus what we are going to see 2020 beyond, but it is largely driven by industrial activity there is a standard air compressor as we talk. I must be careful that we are not a very big player in this market in India there are bigger players than us, our share of this industry is modest, but this industry is scaling up and picking up. But having said it, you must also say this is the industry which has got an abundant number of players both domestic and traders who are importing and that continues in a large scale. It is a very competitive low unit price market and it continues to grow.

Shivam Prashar: Sir the government policies of National Infrastructure Pipeline and City Gas Distribution, so if there any benefit of traces from that policy from your end?

K. Srinivasan: The City Gas Distribution is done through an auction process. We are having the tenth round of auctioning that has just been completed and this is going on for quite some time there has not been any major significant change as far as government policies in this is concerned. But what has now added on is something called for the biogas which is also now being under separate scheme, biogas producers can feed into the OMCs through the city gas pipeline of course. The OMCs have been mandated to buy biogas at Rs. 46 a kilo and that keeps changing and that is through the separate scheme that has come in. I do not know whether you are talking about this that is a relatively newer one, but the other city gas thing is now going on this is the tenth round of bidding that has just been completed.

Shivam Prashar: Okay thank you so much.

K. Srinivasan: Sorry the eleventh round has just been opened.

Moderator: Thank you. The next question is from the line of Digant Hariya from Green Edge. Please go ahead.

Digant Hariya: Sir, thank you for the opportunity. Sir my question again is on the CNG opportunity, so Sir I think there are only two players you and Atlas Copco are the leaders here, but I just want to understand that the quality requirements which would have been specified, by say the CGD company or the contractor who has taken up the contract from the CGD company would the cheap imports from China and would those kind of quality products fit into those criteria or it is very difficult that these cheap imports can come and take away ours or Atlas' market share some day?

K. Srinivasan: As far as, the specifications of the city gas distribution pipelines and the requirements of CNG packages, I think the specifications are extremely rigorous and it has got multiple steps not only technical steps, the process of execution, testing, commissioning and post commissioning, operation of these on an ongoing basis, so there is definitely a requirement to operate out of India, it cannot be done just by trading. Having said it, we must be mindful of the fact that markets of this scale and size and the speed at which it is growing and almost completely driven by large OMCs, there is definitely a strong pressure to have more and more suppliers into it and quite a few of the new entrants are people who are starting around and getting things together. I mean, they could buy a compressor from XYZ, they could do some local manufacture, they could do some assembly and they would still probably manage to qualify, so you must be mindful of the fact that this will never remain just a two player market there will always be other people trying to get into it and so we would be careful about it.

Digant Hariya: This selection of compressors which companies will select is it done by or rather your contracts are ordered by say the investors gas or the CGD companies or the contractors who are building the gas stations and the pipelines, who actually ends up paying you for this?

K. Srinivasan: This is all done by specifications by the CGD companies; payment is by the CGD companies.

Digant Hariya: Is there any reference for Make in India or like is there something mentioned in the contract that Indian companies should be preferred or something, because I think in the past in the pump sector we saw a lot of cheap Chinese exports and then the government policies changed and then the Indian companies started doing better so is there anything which projects Make in India kind of manufacturers over others?

K. Srinivasan: There is no absolutely open specification that it should be Made in India, but the way the whole thing is structured in terms of design, installation, commissioning and upkeep, going forward for 10 years, unless you actually make them in India, you have no chance to be in this business.

Digant Hariya: What is the progress on the screw compressors like how would have been the acceptance and where do you think we can position ourselves in large market?

K. Srinivasan: I started this with the first thing saying that, we have now the finest screw compressor running in the country for the larger capacities like 75 kilowatt and above and we have a high share of this operating in the market. Our screws in terms of both, reliability and efficiency, have established themselves and on the back of this that we are now getting screw compressors also into the refrigeration segment as well, which we expect to launch in the next year, our screws are doing very well, short answer.

Digant Hariya: Right Sir thank you so much and all the best.

Moderator: Thank you. The next question is from the line of Vijay Karte from Bryanston Investment. Please go ahead.

Vijay Karte: Thank you, for giving this opportunity. Currently, our mix of revenue between air, refrigeration, gas and gears, is 25%, 25%, 45% and 5%, so at the sales target of Rs. 2000 Crores where do we see this mix moving?

K. Srinivasan: Tough question Sir. It is extremely difficult, like I said between last year to this year, our air segment has scaled up at least in the first H1 and we see all segments growing, so we see big opportunities in the air with our screws settling down and scaling. We see big export opportunities both in refrigeration and gas, so the easiest answer to say that broadly it will still remain in the range of about 25% to 30% and 40% to 45%.

Vijay Karte: Got it and our business as you had spoken during the last conference call is not capex intensive but it is a little working capital intensive, if I look at the working capital to sales and they have been between 18% to 20%, so moving ahead also it will remain the same and where can we see the trade receivable days settling?

K. Srinivasan: We have to look at it a little differently compared to any other business. In our business there is no intermediary, our products are directly installed and commissioned by us. The equipment sale, which is really, what we sell as the KC series of compressors going into the refrigeration business and pumps, alone go through a distribution, which I think the total would be less than 10% to 15%, so 85% of our business is directly from Kirloskar to the customer, there is no intermediary in between. Consequently, this is the business where you will see a significant amount of advance, you will see order cycles are varying between anything from 6 weeks to 12 months and consequently, there is going to be an inventory. There are a couple of other model people work on, saying that let us say for projects they do stage dispatches and then they commission it overall. We have not found that a good method for liability. We do the entire package, we do the testing at our plant and then we dismantle, ship it and commission it. We find it far more efficient, far more reliable and far more predictable for the customer. Consequently, our model is actually driving our inventory being what it is. Having said, all this there is a bit of inventory that will be taken up when supply chains get more predictable, there is a certain level of inventory that can be reduced with better process management in terms of our inventory planning and so on, but that is not going to be significant. The big change can only happen if we change the business model and we will think it through. At the moment it seems efficient for us and reliable for us and we will see how to handle this.

Vijay Karte: Got that and beyond the 8,000 CNG stations and the Rs. 6,000 Crores opportunity what is beyond that, what is next and who are our customers in the CNG package business?

K. Srinivasan: The CNG package business goes to the oil marketing companies. I think all the city gas distribution companies, all of them are our customers. It would be GAIL Gas, it would be HPCL, Torrent Gas, there are a whole lot of them, Adani Gas so whole lot of them are there right from Indraprastha Gas in Delhi onwards, so everybody is there, Gujarat Gas and a whole lot of them that is as far as the customers are concerned, but to answer your first question, the CNG gas is now it is becoming a gas economy base. What will or what is being targeted is 15% of that gas would have to be over a period of time biogas which will be mixed with this, so there is an opportunity on which we are working on biogas which is also what we have mentioned. There is a later down the line an opportunity to get more into hydrogen. At the moment it is WIP, we are not talking about it, but even in the CNG there is another compressor system called the daughter station hydro booster compressors. We have said that we will enter this business from the next year, the protos have been developed, tests are going on and we hope to enter that in the next year. In terms of size or in terms of numbers that would be as big as the CNG business.

Suhas S. Kolhatkar: Just to add Vijay to what Mr. Srinivasan said, I am sure you must be tracking the PNGRB site where you get the details of various rounds of bidding. I just wanted to draw your attention that up to eight round of bidding PNGRB 92 GAs were allotted covering about 124 districts and in the ninth round of bidding about 86 GAs were allotted which gave about requirement of 4,300 gas stations and for the tenth round bidding there were 50 GAs with 3,500 odd stations so the 8,000 numbers that we always have been speaking about were covered in the ninth and tenth bidding alone. Now, in the month of September just last month tender for the eleventh bidding has been released, which covers 65 Gas, so we expect another 3,500 to 4,000 CNG stations would come up maybe in the next about seven to eight years time. This is in addition to about 8,000 numbers, which are required to be completed by the end of March 2029, so that is the opportunity in CNG alone.

Vijay Karte: Got it.

Moderator: Thank you. The next question is from the line of Amit Shah from Antique Stock Broking. Please go ahead.

Amit Shah: Thanks for the opportunity. My question was more on the order backlog side so when we look on a sequential basis our order backlog is more or less flat and we endeavor to reach a revenue target of Rs. 2,000 odd Crores, so Sir just wanted to understand which are the areas which can help us ramp up this order back log somewhere in the range of Rs. 1,500 Crores to Rs. 1,600 odd Crores which will help us to deliver Rs. 2,000 odd Crores of revenue so where do we see the growth opportunity coming in and how do we see our order backlog shaping up from the current level of Rs. 1,000 odd Crores?

K. Srinivasan: Thanks for the question. I think what we wanted to convey with this order backlog is actually, last year there was a bit of piling up for non-execution, but this time we are executing in the first half and still we have orders a little more than what we had in the last year so the orders are actually being flowing in well. Our execution cycle in the first six months has been much faster because of the equipment sales, so we expect it has to be healthy balance we want to have an order backlog, which is approximately equivalent to about to six months of our sales, we do not want too much because then we are not able to balance our pricing and other things so we are comfortable with this order backlog. We have actually as we speak significant orders still coming in, so orders are strong. At Rs. 2,000 Crores still we should have about Rs. 1,000 Crores to Rs. 1,500 Crores order backlog at the most beyond that it will be very difficult. We are trying to get our execution cycles better and that level of order backlog should be reasonably good to manage.

Amit Shah: Sir which are the areas, which can help us improve execution is one thing which will definitely help us reach the Rs. 2,000 odd Crores with Rs. 1,500 odd Crores of order backlog, but where do you see significant ordering happening, one is the CNG thing or the CGD gas pipeline thing but barring that which are the other areas which can help us ramp up this particular order backlog?

K. Srinivasan: The order backlog per se would come from project exports. Projects generally have longer cycle like, I keep saying gas systems and refrigeration systems, all of them where we have packages which we deliver between 7 to 12 months actually creates a pipeline of orders. Today, we have only been doing largely in India. First time we are picking up major orders for exports and that is where the pipeline is going to build up.

Amit Shah: Sir, so over the next one or two years can we expect this export orders to be somewhere in the region of say Rs. 300 Crores to Rs. 400 odd Crores?

K. Srinivasan: That is what we are planning at the moment. Like I said, this year we will definitely have an order booking in exports of over Rs. 100 Crores, which is our first target and we will achieve that. We are almost there and if this starts moving in the way we are expecting it to, then we will definitely see the kind of numbers that we are mentioning.

Amit Shah: Sir majority of the order inflow would be flowing in from the Middle East region right Sir that is our target?

K. Srinivasan: At the moment, because, oil and gas is significant, the second is the EPC contractors and the execution is largely done by Asians, so they require and prefer us. We will see this also happening in the MENA countries and Africa, because we compete there against execution from other Asian companies and we see that as well picking up, but like you said this is going to be in these kind of countries may be South East Asia to some extent, Indonesia and other places, but this is not expected to be in Europe or in the US.

Amit Shah: Sir for the newer geographies do we require any prequalification or you would be directly qualifying and we can directly bid for the project?

K. Srinivasan: We have been going through this for the last three to four years. We need to have lot of proven track record, we have to show them how we have done similar projects in other sites, it could be in India and other places and all this is what helps us to qualify.

Amit Shah: Sir, my last question was on this screw compressor side, I think that is one of the biggest market in India and we have been trying to enter this particular market over the last couple of years and recently we are getting a success rate over there, so just wanted to understand how does our revenue mix change over the next one or two years because, we have recently entered this particular market and secondly, the refrigeration products that you talked about how big is that particular market if you can just throw some light?

K. Srinivasan: The revenue mix will not change by too much. Like I said, overall air compressor business will move from 15% to 20% to 25% that includes screws, centrifugal compressors, which is also a great product for us, as well as, a traditional business,so we all will grow in tandem and overall, air compressor business will go to about 20% to 25% that is the big growth that we will see. The other ones are growing as well. If you look at the refrigeration business, we have been historically giving the ammonia compressors, as we call these are reciprocating compressors, now we are launching the screw compressors again with ammonia or other refrigerants again for the pharma, food and ice plants, dairy, etc. That is another market which could be anyway between Rs. 200 Crores to Rs. 500 Crores. It is growing in India with a lot of food processing coming in. These markets would all add to the overall refrigeration business. Because, refrigeration also is scaling up in defence areas, particularly in the ship, submarines, and other things. So none of this would only grow, so that the market share shift will not be very big between refrigeration, air and the gas business.

Amit Shah: Okay Sir that is it from my side. Thanks a lot Sir.

Moderator: Thank you. The next question is from the line of Kunal S from B&K Securities. Please go ahead.

Kunal S: Sir, I just wanted to quickly understand about how is the competitive intensity shaping up especially after the Ingersoll Rand and John Deere deal globally, so are we seeing more consolidation or are we seeing more aggressive?

K. Srinivasan: It is a question that is difficult to answer, from the point of view that, we have always been one of the few companies which is doing most of the work in India. We cut our own impellers for centrifugal, which nobody does. We are the only people doing centrifugal with 100% of our own casting and our own impellers. We are probably one of the two companies, who do our own castings, our own screws, and a whole lot of things on the air compressor business. Our philosophy has been to build the business with value chain advantage. Consequently, we would have to look at ourselves as how can we be taking more market share. There are several players, as you mentioned a few. There are a lot more but these are all players where the strategy is done elsewhere and they are executing somebody else's strategy here, so that is the way it is going to be because we are going to be very India specific, in terms of value chain, which is going to make things a little more, let us say longer time scale to start up, but once we start implementing and executing, we would be far more competitive than others and we can sustain it over longer period of time. That is the way we are approaching it and we expect to be very competitive in this business.

Kunal S: Got it Sir. Thank you for such an elaborate answer and best of luck.

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

Nikhil: Thanks for the opportunity. I hope I am audible. My question was Sir, during the discussion you mentioned that 17% is the target or the direction in which we want to achieve, now would this be driven more by a larger volume base as we keep growing our volume or would it also be a part of changing mix as exports or some of the segments where we are not present as we scale them up there would be better margin than margin businesses and what we are already doing so just getting some idea on how this trajectory will be driven?

Suhas S. Kolhatkar: This margin growth will come practically from every side wherever it is possible. Number one, the topline would add to the margin, secondly, the export business should also contribute significantly to the improvement in the margins. Third thing is that, the R&D in the company is continuously working on VA and VE that should bring down the cost of material and that should also help in getting the improvements in margin. So margins would not come only from one effect it will be a combination of several steps that the company is taking. Lastly, the product range that now the company has actually addressed, the entire market, be it the reciprocating compressor, be it the screw compressor or air application or gas application or the refrigeration application, so with the product basket now full, we will be able to add the different areas where we were not earlier supplying and these increased volumes would add to the margins for them.

Nikhil: Just one thing Sir, you mentioned that in exports earlier we were selling equipment but now we are focusing more on projects this question could be made but would this also include EPC project and good that we are diluted to what we were already doing earlier or the project business provides a better margin than just selling the equipment just getting some handle on how this works?

K. Srinivasan: When we talk about the equipment sale we were largely selling ammonia compressors, some screw compressors, and reciprocating compressors and these what we call as largely best air compressors. The compressors are sold by us and somebody does the packaging locally, so that is what we were doing predominantly. We continue to do that and that is also growing, so I must add there, that will also grow but what we are now entering after a lot of efforts getting the approvals, etc., is to do projects. Here, let us say for a petrochemical complex or oil and gas plant we would end up doing either a refrigeration project or a gas compression project. Here we would get orders from the customer, but the execution could be through an EPC contractor who would have more than this project as a part of this package.

Nikhil: Okay got it. So we would not be doing the execution, the EPC contractor would be doing the execution but we would be providing the complete kit?

K. Srinivasan: We will do our part of execution. The EPC contractor generally takes the overall execution but specific to our basket or our product plant we will do the execution. We will have to deliver it, commission it and run it.

Nikhil: Sir what I am trying to understand that if the part of the projects which we do the payments we would be directly getting from the contractor?

K. Srinivasan: We would get it from the customer. These sub packages which are of significant size, the customer would order it and he would pay us but the overall responsibility in most cases would be with the EPC contractors. There are some cases where our project is very small compared to the total, then the EPC contractor would place the order and he would make the payment as well.

Nikhil: Thanks a lot Sir. Thank you for the explanation.

Moderator: Thank you. The next question is from the line of Shivam Prashar from SP Ltd. Please go ahead.

Shivam Prashar: I am tracking the company for the seven to eight years but one thing that I am seeing is the return on capital employed has been significantly low from like if we can say 2014 till date it should be around 30% to 40% and now it is even below 20%, so is there anything significant that you are doing to improve the return on capital employed?

K. Srinivasan: Just give me a minute so we will understand your question better, because I believe our ROCE last year was about 22% to 23% and we expect to be even higher than that this year. At the moment we are not, but by the time we complete the year, because we generally have a 40:60 split in sales and may be a 80:20 split or even more than on the profits, so you will get back to 23% to 24% plus ROCE in the full year, but I think some of the numbers you probably looking at is including the cash in the system and of course the Road Railer business, so we will just see where it is coming from.

Suhas S. Kolhatkar: I think it would be better if you look at the segment results and look at the segment profitability vis-à-vis the capital employed in the segment that would give you a better indication.

Shivam Prashar: If we can leave all that aside what are the measures you are taking to increase the return on capital from this level going on?

K. Srinivasan: I think all that we mentioned now, actually increases both the profit and the ROCE, like we said, we are not going to put in a lot more capital in this business, it is not a capital intensive business and consequently, the ROCE would go up. There is a working capital challenge that we will continue to handle because, that is the way the business is being structured as of now, unless we change that, we would not get a big change but ROCE 25% plus is what we are targeting and we will comfortably get it.

Shivam Prashar: Thank you so much.

Moderator: Thank you. That was the last question. I now hand the conference over to Mr. Dhirendra Tiwari for closing comments.

Dhirendra Tiwari: Thank you Tanvi. Let me thank Mr. Srinivasan, Mr. Kolhatkar and members of the management team for giving us the opportunity to host you. I would also like to thank all the participants for taking out time. Mr. Srinivasan, would you like to have any final words before we close Sir?

K. Srinivasan: Just a thank you to all of you and once again wishing you all a great Diwali and I think I know that the numbers from KPCL are always a little difficult to understand and far more complicated, because for the size and nature of our business, we have too many moving parts, but hopefully from Q3 onwards we will become a little more predictable. I think a lot of the variables are getting more settled, I think from Q3 onwards we will get a little more predictable and it will make it more easier to understand our business. Thank you all for your patience.

Dhirendra Tiwari: Thank you very much Sir! Thank you all participants and now we can close the call.

Moderator: Thank you very much. On behalf of Antique Stock Broking that concludes this conference. Thank you for joining us and you may now disconnect your lines.