Pennar Industries treads the consolidation path

PENNAR INDUSTRIES LIMITED (PIL), is one of the leading engineering organisations in India well known for its expertise in providing engineered products and services. It began operations in 1988, with a strategic decision to establish first manufacturing plant at Isnapur, near Hyderabad with an installed capacity of 30,000 MTPA to manufacture Cold Rolled Steel Strips (CRSS). Pennar increased its manufacturing capacity to 50,000 MTPA in 1997.

The series of strategic acquisitions and expansion plans, most notably among them being acquisition of Nagarjuna Steel Ltd.; Press Metal, a unit of Tube Investment (TI) near Mumbai and, the more recently, the assets of Wayne Burt Petrochemicals, erstwhile Bailey Hydro, for venturing into Hydraulic Cylinders segment. They have also established a new manufacturing facility at Chennai and have set up an assembly unit at Hosur, near Bangalore to meet the requirements of Auto Components.

Currently, the company is engaged in the following segment:

1. Steel (Cold Rolled Steel Strips and Formed Sections)
2. Tubes (Electro Resistance Welded and Cold Drawn Welded Tubes)
3. Systems and projects (Railways and Solar Module Mounting Systems Components)
4. Industrial Components (General Engineering and Automotive Components)1500 Precisely Engineered Products

PENNAR ENGINEERED BUILDING SYSTEMS (PEBS), the listed subsidiary, is engaged in the design, manufacture, supply and installation of pre-engineered steel buildings and building components. PEBS Pennar's factory was the first in India to receive a gold rating from the Indian Green Building Council and is in the forefront of the movement for a sustainable future.

The company's clients include UltraTech, L&T, HCC, P&G, Godrej, Dr. Reddy's Laboratories, ABB, JSW, Schwing, Stetter, Honda, Toyota, Ambuja Cement, Bharat Biotech, My Home Industries, Schneider Electric, Reliance, IOT Infra, Volvo, Toyotsu, Jayabheri, ACC, Schindler, Audi, Hindustan Unilever and MRF Tyres among others.

PENNAR ENVIRO LIMITED (PEL), an unlisted subsidiary, deals with Water and Environment Infrastructure business to provide turnkey solutions viz., Water Treatment Plants (WTPs), Sewage Treatment Plants (STPs), Effluent Treatment Plants (ETPs), Effluent Recycling Plants (ERPs), Zero Liquid Discharge Plants (ZLDPs) etc. PEL is pioneer in the field of additives, supplying specific premium high technology additives based on fuel characteristic requirements and specific performance enhancements.

Pennar Renewables Private Limited (PRPL), is an unlisted subsidiary (80%), engaged in the commercial generation of solar power (28 MWDC) in Telangana Ltd at a PPA of Rs 6.45/kwh. PIL invested Rs 49.54 crore in Pennar Renewables Private Limited (formerly M/s New Era Enviro ventures (Karimnagar) Private Limited), after the said investment it has became subsidiary with effect from October 14, 2015. On May 16, 2016, M/s New Era Enviro ventures (Karimnagar) Private Limited has been renamed as Pennar Renewables Private Limited. During the financial year 2016-17, the company has disinvested Rs 9.4 crore through sale of 9,45,846 shares of Rs 10 each for Rs 99.47 to Sharp Ventures Private Limited.

The board of Pennar Industries after consultation has decided to exit the business as the IRR for the project – while attractive and as per industry norms – is lower than the CAPEX initiatives that PIL has.

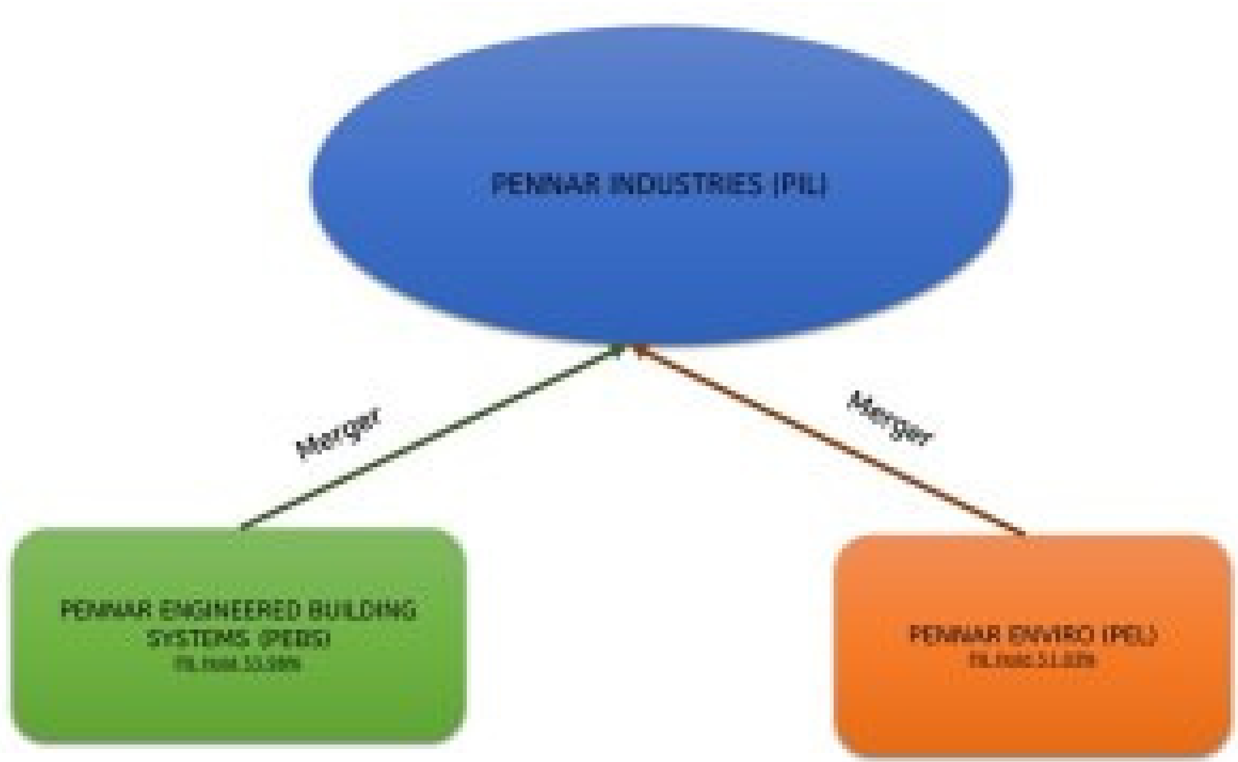
Consequently, PIL has entered in definitive agreement with a third party for transfer of its entire shareholding held in subsidiary Pending closing of conditions contained in the agreement the accounting effect is not given as disclosed in Dec 2017 quarter results. The PIL will be able to generate cash from the sale of Pennar renewable.

The Group infrastructure consists of:

1. 6 Manufacturing Plants across India (Patancheru and Isnapur in (TS), Baroda (GJ), Tarapur (MH), Chennai and Hosur (TN))
2. 3000 tools and dies
3. 2500 employees
4. 600 customers
5. Manufacture facilities of 1,500 product portfolio

TRANSACTION

Merger of PEBS and PEL with PIL from the Appointed Date 1st April 2018. The Swap ratio for amalgamation of PEBS and PEL is 23:13 and 1:1 respectively.



CURRENT SHAREHOLDING

Table 1: Shareholding Pattern Pre- Restructuring

Particulars	PIL		PEBS		PEL	
	No. of shares	%age	No. of shares	%age	No. of shares	%age
Promoters group	4,37,68,697	36.37%	32,50,357	9.48%	40,98,259	48.97%

PIL	–	0.00%	1,85,00,000	53.98%	42,70,000	51.03%
Public	7,65,80,817	63.63%	1,25,24,554	36.54%	–	0.00%
Total	**12,03,49,514**	**100.00%**	**3,42,74,911**	**63.46%**	**83,68,259**	**100.00%**

RATIONALE

1. Consolidation will help to develop and further grow and diversify with better optimisation of funds and efficient utilisation of resources.
2. PIL will have an improved capital structure which would enable it to access the capital market at better terms
3. To reduce inter-company transactions, to make sure that the company as a whole can be run with one CEO, one management team, one board, one operations team and procurement can become more efficient and there can be cost optimization.
4. Also, there is a significant holding company discount for Pennar Industries and a lot of them felt that Pennar Industries' share price does not accurately reflect its true value and the primary reason for that is because the subsidiary structure does not allow proper value recognition.

RELATED PARTY TRANSACTION

The related transaction by PIL with PEBS and PEL was approx. 25 crore and Rs 75 crore respectively.

VALUATION

Table 2: Current Valuation of all the 3 Companies

Valuation	PEBS		PEL		PIL	
	Price per share	Weight	Price per share	Weight	Price per share	Weight
Market price Approach	116.40	0.50	70.40	0.50	72.00	0.50
Assets Approach	–	–	–	–	–	–
Income Approach	143.50	0.50	78.00	0.50	74.00	0.50
Average per share	***130***		***74***		***73***	
Value of the Company	*Rs. 445 crores*		*Rs. 62 crores*		*Rs. 880 crores*	

Please Note: The market price post announcement has dropped of the both the listed companies due to uncertainty in market conditions which has resulted into arbitrage opportunity for the investors.

IMPLICATION ON EARNING

Table 3: Implication on Earning

Particulars	Post Merger		Before Merger (excluding Minority Interest)	
	2018	2017	2018	2017
Revenue	**1,72,711**	**1,54,942**	1,72,711	1,54,942
PAT after minority interest	4,297	5,854	3,442	4,665

Number of Share	15,23,57,231	15,23,57,231	12,03,49,514	12,03,49,514
EPS	2.82	3.84	2.86	3.88

There is no implication on earnings as both transferor companies were subsidiaries and its results were always reflected in the consolidation. There will be no major rerating in the market price due to merger.

IMPLICATION ON FINANCIAL

Table 4: Before merger financial of PIL as on 31.03.2017 (Rs in lakh)

Particulars	PIL (standalone)	PIL(Consolidated)
Net worth has on 31.03.2017	38,346	65,644
Minority Interest		-10,646
Adjusted Net worth	38,346	54,998
Number of Share	12,03,49,514	12,03,49,514
Borrowing	14,309	29,648
Debt Equity Ratio	0.37	0.54

Table 5: Post Merger financial of PIL as on 30.09.2017 (Rs in lakh):

Particulars	PEBS	PEL	PIL *(Standalone)*	Post Merger PIL
Assets as on 30.09.2017	57,505	8,365	–	–
Liabilities as on 30.09.2017	33,214	7,090	–	–
Net Asset/Networth	**24,291**	**1,275**	**36,828**	**62,394**
Borrowing	9,329	3,227	17,117	29,673
Debt Equity Ratio	0.38	2.53	0.46	0.48
Number of Share				15,23,57,231
Book Value Post Merger				40.95

Please Note: The above figures are taken from financial submitted to Stock Exchange for approval of scheme and are estimate it will change based on audited financial as on appointed date. There will be increase Book Value of PIL post merger however there PIL having huge paid-up capital, the book value will be lower than consolidated book value. There is no major change in debt equity ratio post merger.

CASH FLOW

Cash Flow as on 31.03.2017	PIL (standalone)	PIL(Consolidated)	Net Change at Subsidiaries Level
Operating Activities	8,560	7,545	-1,015
Investing Activities	-1,430	-995	435
Financing Activities	-8,003	-6,439	1,564
Net Cash Flow	**-873**	**111**	**984**

The subsidiaries have generated negative from operating activities. However the negative is with respect to that major fund is being invested in working capital by subsidiaries.

LISTING OF PEBS & RETURN

The merger of PEBS with PIL is at much lower value to value at the listing two years ago. PEBS was listed in FY2016 at offer price of Rs 178 per share including securities premium of Rs 168 per share. Zephyr Peacock India Fund III Ltd the Private Equity fund which was holding 6.73% stake in the company exited.

SHAREHOLDING POST MERGER

Particulars	PIL		Allotment on Merger		Post MergerPIL	
	No. of shares	%age	PEBS	PEL	No. of shares	%age
Promoter	4,37,68,697	36.37%	57,50,632	40,98,259	5,36,17,588	35.19%
Public	7,65,80,817	63.63%	2,21,58,826	–	9,87,39,643	64.81%
Total	**12,03,49,514**	**100.0%**	**2,79,09,458**	**40,98,259**	15,23,57,231	**100.00%**

Note: So the promoters will have direct control of all business. Whereas minority shareholders which were part of the subsidiaries business, now they will be part of the holding company. There is no change in promoters holding. However both the companies were not paying divided so change in dividend yield shareholders.

CONCLUSION

This is simple group consolidation. First making IPO of one of the subsidiary and getting funds from Private equity and then within few years taking decision to merger all subsidiaries shows no clarity of strategy on the part of the management. PEBS IPO was made at Rs 178 and in consolidation price considered as Rs 130 per share. Private equity fully exited as soon as the merger was announced. Last few years the group is not able to create any value for its stakeholders, though consolidation will have marginal cost savings, key for value creation is how quickly the management is able to capture growth in each of its business segment and improve EBDA.

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