“Arvind Limited
Q3 FY2020 Post Results Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the conference call for analysts and investors for post-results discussion for Q3, financial year 2019-2020, Arvind Limited. As a reminder all participant lines will be in listen-only mode and there will be an opportunity for you 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. Samir Agarwal. Thank you and over to you Sir!

Samir Agarwal: Thank you. Good afternoon to all of you, and thank you for joining in this Q3 FY2020 Earnings Call for Arvind Limited. With me today is Mr. Jayesh Shah, Executive Director and Group Chief Financial Officer.

Our results this quarter were very much in line with our plan, and we saw a clear improvement in our earnings as compared to the same period last year. More importantly, our performance improved in comparison with the previous 4 trailing quarters as well.

Broader sentiment and consumer market conditions continue to be challenging in India. Credit crunch continues to adversely impact our business through trade channels, and we are seeing increasing demands for higher and higher receivable periods.

Our export markets, though, especially the U.S., did see a better quarter, especially a record holiday season in U.S. with double-digit growth, although a lesser portion of that was accounted for the apparel.

In this context, one development, which is important, is to share with you all that the government announced that MEIS export incentive program stands canceled as of April 2019. Because of this, there's a onetime provision of Rs.34 Crores that has impacted both the top line and bottom line performance of our company. Our reported numbers include this adjustment. However, for the sake of comparison, we have excluded this adjustment and as such, all my commentary and analysis will not take into account for the Q3 numbers.

With that context, textile revenues grew up by 15% this quarter with the majority of that growth coming from garments. Excluding essentials, garment volumes grew from 7.6 million in Q3 of last year to 10.6 million pieces in this quarter, resulting in the garment revenues going up by 23%.

EBITDA margin for this business stood at 12.7% as compared to 10.5% in Q3 of FY 2019. It also compares well with the 10.8% EBITDA that we reported for Q2 of FY 2020 for this Textiles segment.

Revenues for Advanced Materials business grew by 16% for the quarter and stood at Rs.185 Crores. As we have shared in the past, Advanced Materials consists of human protection, advanced composites and other industrial products. All these businesses clocked healthy growth.

EBITDA margin for Advanced Materials improved from 10.2% the previous year to 13.5% in Q3 of this year. We are confident that this business is on track to deliver Rs.800 Crores topline for this full year with a healthy margin.

Our net debt at the end of quarter was Rs.2,537 Crores, as of December 31, 2019. For your reference, this number stood at Rs.3,024 Crores as of June 30, 2019 and Rs.2,694 Crores as of September 30, 2019. So, we have been sequentially reducing this number as we have indicated in the past.

Overall, we continue to maintain our guidance for the full year revenues to grow by about 9% and EBITDA margins for the year to be similar to that of FY 2018-2019 without adjusting for the MEIS impact. We also continue to maintain our target for the overall debt reduction from March 2019 base by about Rs.300 Crores for the duration of this year.

Now I invite you to ask any questions that you may have. Thank you.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: Thank you. Good evening to the entire management and congratulations on a good set of numbers. Sir my first question was on the Denim segment. I think we have recently indicated that the focus is on export growth and I think the volume growth there also shows that. But just moving to the domestic segment we still see that there is contraction in the volume so is it that the domestic Denim market continues to be under stress side and is there a potential of further margin pressure coming on this segment from prices contracting. I wanted your comments on that?

Jayesh Shah: The Denim segment in India particularly the B2B which is our segment where we sell other than the brands which are our direct customers the large brands continues. So, there is more than the pressure on sale, it is a pressure on, I think, account receivables collection and the cycles and the liquidity available in the market. So, we continue to maintain tight discipline on sales and elect some salesco, but we would rather focus on exports market or focus on converting more fabrics into garments and sell garments in India as compared to selling in domestic market with extended credit. So, to that extent, the pressure in the Indian market for denim continues. And we believe that, that scenario may not change in very near future. Our strategy, as we have mentioned in the past, is going to be, a, move more towards denim garments and move more towards exports.

Nihal Jham: But just checking over the last few months, I think, either the situation has stabilized or it has kept getting worse in the denim segment and the domestic business?

Jayesh Shah: First of all, I think it is stable. In fact, what I am hearing is that there is a good demand for Denim fabric in India, but it is just the cycle that is affecting. So, I would not consider it to be a bad Denim market segment. It is just the liquidity, which prevents us from selling in India.

Nihal Jham: Absolutely. Sir, then moving on to the woven segment, there, the story is a bit opposite, where I see that we have seen a good growth in the domestic business and surprisingly, exports have contracted. If you could just throw some light, because as I understand, even the fabric segment in India right now is under pressure, at least the volumes are flat. So how is it that we have seen good growth this quarter? And any reasons for the export business to contract?

Jayesh Shah: Not really. Actually, first of all, overall, it has been more or less flat, it is few lakh meters here or there. But in woven as you know, 2 things have happened. A) in our own factories where we have now new garment capacities, we are converting more and more fabrics into garments, and that actually results into reduced exports of fabrics, and it gets classified as sale in Indian market. So to that extent, that proportion that you see in woven segment on that excel sheet may not give you a very correct picture.

Generally, the woven as a product is concerned or the Indian market is concerned, there has been a lot of inventory correction which is taking place by some of our customers and as a result, there has been a pressure actually or there has been a reduced offtake by some of the players in the Q3. We do not see that in Q4 based on the order book, but there was a correction that took place in Q3.

Also, there are a lot of conversions which are happening in India from the garment factories current demand for fabrics for exporting garments in woven segment also is increasing. So, it is a fairly good segment. It continues to remain strong.

Nihal Jham: Jayesh Bhai, just a couple of more quick questions. On the garmenting preoperative losses, we did mention a number, I think, of Rs.15 Crores, Rs.16 Crores for the last quarter. Is it a similar run rate? Or has there been an increase or reduction?

Jayesh Shah: See, in fact, it has significantly been lower this quarter and we believe that it will almost become almost negligible in the Q4.

Nihal Jham: That is very good. Last question from my side on the MEIS benefit, we did mention that Rs.35 Crores is the impact of reversal. I just wanted to understand then for the coming year, what is the approximate hit on margins that this could have?

Jayesh Shah: So, on a plain vanilla basis, it is, of course, 4% or 3.8% of the exports of our garments, that would be the impact. That may result into overall, and on the Textiles segment, to be like 1% margin drop. We have to make it up through the efficiency improvements, which we will get because as we ramp up the capacity. I think the issue is not about MEIS withdrawal or as a result, whether it would affect margin. Obviously, anything that goes away, which was a MEIS kind of a benefit would affect margin, but every time you are trying to sell goods, you have certain costs and benefits in mind when you are pricing it. So, a retrospective effect takes away that liberty to price it in a way you could and manage the margins. So to that extent, it is a negative because it is retrospective. I do not think we would be overtly, concerned about whether it will make garment business less viable going forward.

Nihal Jham: That is very helpful. I will get back in the queue Jayesh Bhai. Thank you.

Moderator: Thank you. The next question is from the line of Sagar Parekh from Deep Finance. Please go ahead.

Sagar Parekh: Good evening. Congrats for a decent performance. Sir, firstly, on this woven exports, I was still not clear. The exports have come down significantly. You mentioned that partly is due to inventory correction and there were some verticalization also, which led to lower exports. Am I right?

Jayesh Shah: No. Exports are lower because of the second reason, which is that much more has been sold in Indian market for conversion of fabrics into garments, including in our factories compared to a year ago. What I said is that, in general, the woven markets are strong, but for last quarter, where there were some inventory corrections, but that has not really affected us because our volumes are more or less flat.

Sagar Parekh: Yes, it is overall volumes are still down 3%?

Jayesh Shah: Yes. So they are more or less flat, I would say, because it is seasonal 5 lakh meters plus/minus will happen in a given quarter. So that will not be materially, I would call it. So what I am trying to, again, let me repeat. The market for wovens continues to be reasonably good. We have a dip in exports more because we have diverted a lot of material in Indian markets for converting them into garments, including in some of our factories, where we have expanded capacity. In the last quarter, though our sales in domestic market have increased, there has been a reduction in the demand for fabrics from some of the brands because of inventory correction.

Sagar Parekh: Okay. So that inventory correction, do you see that getting over? Or is there still...

Jayesh Shah: So, as I said in the earlier question, that we do not see that basis our order book as of today for the Q4. I was specifically talking about Q3.

Sagar Parekh: Okay, fair enough. Overall, on verticalization strategy, where are we at the moment. Would denim and woven put together versus, let us say Q2?

Jayesh Shah: So, it is similar. I mean, because we have done about 10-odd million, about 11 million pieces as compared to slightly around closer to 10 million in the quarter 2. It's ramping up. It should go even higher than this in quarter 4. And we are planning to do close to 50 million in the next year.

Sagar Parekh: This is for the garmenting division you are saying?

Jayesh Shah: That is right. I thought you asked that right.

Sagar Parekh: No, I was asking on the verticalization of denims and wovens into garments.

Jayesh Shah: So, what is that?

Sagar Parekh: How much are we internally using from the fabrics from Denims and wovens into making garments?

Jayesh Shah: Still it is much smaller, it is like 10%-12% in each case but aim is to take it to 15% to 20% in the coming year.

Sagar Parekh: Okay and on the garmenting division, if I take the revenue and the volumes, the NSR per piece is significantly lower as compared to last year which is about 12% lower. Any specific reason for this or would you probably attribute this to the MEIS going down?

Jayesh Shah: Nothing to do with MEIS. MEIS can affect only the top-line by 4%. It is a product mix. It is a product mix which will change the fabric itself, it will change the cost itself so the price for piece will be not a very correct way of looking at, I think it is a pure contribution or the profit margin that would be relevant.

Sagar Parekh: Okay so how much would that be, the pure contribution or pure profit margin per piece?

Jayesh Shah: We are not disclosing that but we are inching towards, our aim is to go double digit in the next financial year.

Sagar Parekh: With this MEIS of 4% reduction you still are confident of double digit margin in garments?

Jayesh Shah: As I said we are aiming towards it let us see we are not prepared fully the budget bottom up budget for the next year. We will talk about in the next quarter.

Sagar Parekh: Okay and on your debt reduction you mentioned about 300 Crores for this financial year you seem to be on track for that. What is our strategy for next financial year FY 2021, how much should we consider from debt reduction?

Jayesh Shah: So exceptionally we would be further reducing the debt, we do not have much capital expenditure. Again, for me to give you a target because we have not prepared a bottom up target so it will be pre-matured but directionally it would be a further reduction of debt in the coming year.

Sagar Parekh: Okay but the interest cost still continues to be higher even sequentially if I see 60.5 Crores gone to 61.6 Crores in spite of debt reduction?

Jayesh Shah: That is the fact, the reason is that we have changed some borrowing mix in these last six months and because we had a asset liability mismatch we repaired the CP's which were little cheaper than the other borrowings that we have done. But you will see the reduction in quarter 4 because the debt reduction in real sense has happened in this quarter as compared to what we were in March and the further reduction is expected in quarter 4 so you will see the reduction in quarter 4.

Sagar Parekh: Okay fair enough. Thank you.

Jayesh Shah: Thank you

Moderator: Thank you. The next question is from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel: Thank you for the opportunity. Jayesh Bhai what kind of a capex we are looking at in this financial year and the next?

Jayesh Shah: This year is slightly above 300 Crores, next year rally speaking we are not looking at any addition in the manufacturing capacity. So, it will be like close to 150 Crores, 175 Crores kind of a capacity. As I said we need to still prepare the plans but it should be in that range because currently the capital expenditure plan or expenditure that we will have to incur next year based on current orders that we have placed we do not see that number being significantly different than this.

Maulik Patel: Earlier question you replied that your pre-operating loss in garment which used to be around 15 Crores in couple of quarters but as now probably come down and probably next quarter onwards it will be almost negligible, so are we attending into that is one on the margin, any post after that will there be further improvement in margin?

Jayesh Shah: Yes. You know that we only mean that we are not losing money but that does not mean that we are making money for those plants. So that capacity ramps up as it happens to every move towards 60 million which is the rated capacity. Obviously, the margin should come and should help us to improve overall margins and that is why we said that as we move forward, we would aim towards double digit margins over next 12 months to 18 months.

Maulik Patel: Double digit on garment side, right?

Jayesh Shah: That is correct.

Maulik Patel: Okay. In terms of an ROCE because earlier the thought was that garment has been on a lower capex and it is also part of the verticalization process, our overall ROC will be much better, so what kind of ROC which probably one could look at into the garment business once you have on an margin expansion probably next year?

Jayesh Shah: See even on the existing plants, we are in excess of 20% for the plants which are matured particularly a given plant for example. Over all, we should be aiming towards those numbers for that capacity over next 12 months to 18 months.

Maulik Patel: Okay. What kind of capital has been invested into the garment business as of now and in the last even if you can give me the last two years of "inaudible"?

Jayesh Shah: "inaudible" the capex and not the total capital but the capex has been close to about slightly below 400 Crores other than that would be some working capitals.

Maulik Patel: Okay. Working capital cycle is not as stretch as what we have in the Denim business, it is the one business or is it, how the working capital in the garment business?

Jayesh Shah: In garments because it is just a short cycle of conversion of fabrics into garments, it is much smaller cycle, on a gross basis, your raw material inventory to garment inventory will be like 45 days, most receivables for exports are under LC which we factor it. So, it does not require too much of, so it will be net-net say two months to 75 days kind of a cycle as suppose to 90 to 105 days in fabrics.

Maulik Patel: Okay. Got it. Thanks.

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

Prerna Jhunjhunwala: Congratulations on the good set of set of numbers Sir. My question is largely related to inventory, now that cotton prices are lower, what will be your inventory strategy for coming period, fourth quarter or may be FY2021?

Jayesh Shah: You know on the overall inventory rather than just the cotton because cotton is something which will play as we look at how market is moving or likely to move but overall if I were to look at as of compared to March, the overall inventory that as of December on consolidated basis have come down by 370 Crores and our overall gross current assets have come down by slightly below 500 Crores and of course, the liabilities have come down because we have less liability also by about 250 Crores. So, this is one reason why we have been able to reduce our debt this year or will be able to reduce our debt as we have planned and because we have been able to contract the inventory as well as overall current assets but to answer your question on whether will buy and stock off cotton, that would be a little also it is a company, this is little sensitive information as well. So, we will rather deal with it as it comes. Our belief is that prices of cotton will remain soft in year term especially two things have happened, the once year or the issue what will happen after the US-China trade deal happens and when CCI starts buying heavily both events have happened and there has been a slight uptake in last two months but we do not think it is going to remain within a band. It will not shoot up. These are our internal assessment.

Prerna Jhunjhunwala: My next question is on input cost, you mentioned in your slides that your input cost have reduced that is why your margins have been improved, apart from cotton have you seen any correction, anywhere input prices?

Jayesh Shah: There has been also some reduction in the power cost, if you look at the overall open access power rates as the exchange, we will see that last three months to four months there has been a reduction in overall energy cost and we buy a quite a bit from open exchange, so that also has been helpful.

Prerna Jhunjhunwala: Okay. Sir could you just brief about the current capacity of garmenting and where do we see it is reaching in the next two years?

Jayesh Shah: We have invested in a capacity which will off about taking our total capacity to 60 million which should be ending this year at 40 million to 41 million and I think we would want to aim to reach 50 million next year though as I said we still have to prepare our plants but it looks like that we should be able to sell 50 million garments next year.

Prerna Jhunjhunwala: What can be the optimal utilisation of these capacities?

Jayesh Shah: It should be closer to 60 million.

Prerna Jhunjhunwala: Closer to 60 million. Okay and when do we see we are reaching margins at a historical levels or Denim demand improving which would actually mean scenario change in the textile industry and these equity scenarios changing, what do we see thing coming up?

Jayesh Shah: I think let us see what government does tomorrow. It is a question of boosting confidence in the industry and starting the consumption cycle and good thing is that it is not going down but we will have to wait and see.

Prerna Jhunjhunwala: You mean to say if demand improves then this cycle which has choked will start?

Jayesh Shah: It should. I think because ultimately the money should come from the customer to the trade and trade to the producer and secondly also in Denim already you will know, a lot of companies are going out of production because of the current market condition, that also there will be some balance that will come over next year or two years.

Prerna Jhunjhunwala: Okay. Thank you, Sir. I will come back to questions que again.

Moderator: Thank you. The next question is from the line of Deep Master from One-Up Financial Consultant. Please go ahead.

Deep Master: Hi Jayesh Bhai. I just had a couple of questions. So, on the woven side as you mentioned the current quarter saw some destocking, if you could just give some qualitative comments on the general demand in the economy at the moment for garments, is that improving?

Jayesh Shah: You are talking specifically for India?

Deep Master: Yes the domestic, yes Sir.

Jayesh Shah: Yes. So, I mean, the Diwali season was decent. I think most companies had a good like total like pre-Diwali 30-day sales grew by 8%, 10%. So that is a good sign as compared to what happened a year ago, where it actually, degrew. So that is one. Secondly, what you see this value retail players have been expanding in at a very rapid pace. And that also, in a way, is increasing the demand for fabrics from organized player like ours. So in general, there is a softness in the trade channel, but from brand segment side, it is doing fairly well.

Deep Master: Right. So, as we increase verticalization across denim and woven next year, could we expect at least a single-digit growth in the overall woven and denim volumes? Or would it be too early to tell?

Jayesh Shah: Not really. I think our game plan would be to sell almost at a full capacity in the coming year, both in woven and denim, either through conversions or through real fabric sales and we would want to aim that in the next financial year. So yes, growth will be there.

Deep Master: Okay. Great and just on the garment side, as we scale up next year, it would require a significant ramp-up in volumes, almost 35% to 40% on the run rate. So how are we sort of preparing for that kind of growth, essentially, if you could just give us some qualitative comments on all the groundwork that is being laid.

Jayesh Shah: There are 2 key things that you have to prepare yourself. One, one thing which you have to do is to create a pipeline of workers who we train and put it on the commercial machines because the attritions are high generally, you will need to do a very serious work on trying to get. So, you are putting training centers, getting people from all around the areas and trying to train them and then putting them onto machines is a one big activity that one has been doing. The other is that every time you set up a new plant, the buyers would like to do a complete compliance audit inside the factory. So that is also a very big activity because the buyers would want to make sure that everything from compliance side, be it labor, be it safety, be it other parameters, the factories come up. It is like in some ways, a pharma kind of a thing, not so rigorous but similar. That's another activity that we are undertaking, and we have got almost all our key buyers to certify practically all factories that we have set up. So, these are the 2 big things that we have been at it, and I think the progress has been quite satisfactory.

Deep Master: Great and just lastly, you mentioned your endeavors to get to double-digit margins at scale in garments. But also, the reduction in MEIS would kind of entail a direct reduction in margin of at least 3.5% to 4%. So, would it still be possible to get to those double-digit margins?

Jayesh Shah: I mean it should. I mean it is a question of, it may take some more time as you scale up the capacity, as you look at the cost differently, as you do more automation. But it is a difficult task without MEIS, but it is not an impossible task.

Deep Master: Okay. And how many years do you think it would take us to get to those to an optimal scale using the current capacity?

Jayesh Shah: It should typically take 18 months to 24 months for you to be able to reach there. So, may be another 18 months.

Deep Master: Thank you. That is all from my side.

Moderator: Thank you. The next question is from the line of Nishit Rathi from CWC Advisors. Please go ahead.

Nishit Rathi: I just wanted this clarity on this EBITDA margin that you have said, so you have said that you were looking at maintaining similar level of FY2018-2019 margins without considering one-time write-off?

Jayesh Shah: Yes. That is correct. We were at about to 10% last year, exactly below 10% and we should be around that number this year.

Nishit Rathi: So, without considering if you take the impact of that one-time write-off, it will be lower?

Jayesh Shah: It will be very marginally lower by 25 BPS possibly.

Nishit Rathi: Which means that it is possible that what we have done in this quarter will slightly go down in the next quarter, right?

Jayesh Shah: I will not like to put the number for the next quarter. I have given you overall guidelines and I think we should be around that number.

Nishit Rathi: Okay. Thank you.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for the closing comments.

Jayesh Shah: Thank you for attending the call and we will again see you in the second week of May for the annual results and discussion on the next year.

Moderator: Thank you. Ladies and gentlemen, on behalf of Arvind Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.