"Arvind Limited's Conference Call for Analysts and Investors for Post-Results Discussion for Q3 FY20-21"

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Moderator: Good day ladies and gentlemen, and a very warm welcome to the Conference Call for Analysts and Investors for Post-Results Discussion for Quarter 3 Financial Year 2020-21 of Arvind Limited.

As a reminder, all participants' 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 touch-tone phone.

I now hand the conference over to Mr. Samir Agrawal. Thank you and over to you, sir.

Samir Agrawal: Good afternoon to all of you and thank you for participating in this call to discuss the 3rd Quarter Financial Results of Arvind Limited. Joining me today is Mr. Jayesh Shah – Executive Director and our Group CFO.

Overall, the momentum in the 3rd Quarter continued along the theme of volume recovery we have shared in our last 2 quarterly discussions as well. Sequential volume growth continued in our core textiles businesses. Unlike the last quarter, this time around, it is driven more by the domestic demand. With volumes coming back, EBITDA margins have also returned to pre-Covid levels. In terms of specific Q3 results, the overall revenue stood at Rs. 1514 crores which was 81% of the Rs. 1869 crores in the Q3 of FY2020. On a sequential basis, this was higher by about 16% over the Q2 of this year's revenues of 1305 crores. EBITDA for the quarter stood at Rs. 174 crores translating into an EBITDA margin of 10.7% compared to 9.9% in the same period last year.

In the textiles segment, Q3 volumes stood at 88% of previous year's volumes for denims and 77% for woven. Especially denim volumes in exports have crossed the previous year's levels. Export volumes for woven have been impacted by the extended lockdown and work-from-home trend in our key markets and stood at 62% of the last year's volumes. Domestic market has recovered to 74% for denims and 81% for woven in terms of fabric volumes. Domestic brands and retailers who had sharply cut down on buying have returned to placing regular orders as demand has certainly reemerged post-Diwali.

Garmenting volumes in Q3 increased to 89% of the last year's volumes. Across the board, athleisure, casual wear, essentials, and loungewear have been seeing strong market traction both in domestic and export markets.

Textile margins in this quarter came under pressure from rising input costs in several categories. You all would be aware of the sharply rising cotton prices. Besides, other input costs including dyes, chemicals, energy, packing, and transportation have also gone up materially. We have responded to all this in a very proactive manner through a combination of price increases, tight cost management, and continuing working capital discipline which we had shared earlier as well. As a result, EBITDA margin in textiles stood at 12.7% as compared to 12.4% in Q3 of FY2020.

Our advanced materials business continues to be robust and delivered Q3 revenues of Rs. 188 crores which was marginally higher than Rs. 185 crores in the same period last year. EBITDA margins in AMD stood at 14.6%. We continue to see strong demand for our AMD products. During this quarter, our net borrowings reduced by Rs. 200 crores approximately from Rs. 2279 crores at the end of previous quarter to Rs. 2082 crores. As a reference, we have started this financial year at a net borrowing level of Rs. 2371 crores as of 31st March 2020 and this had increased to Rs. 2702 crores as of 30th June. Like I said, we saw reduction to Rs. 2082 crores as of 31st December. We expect to further reduce the borrowings by about Rs. 100 crores in this forthcoming 4th quarter.

Looking ahead, we expect the domestic demand to continue improving. Traction in our export markets will depend on how the second and later waves of pandemic play out. We also expect the input cost pressures to continue at least for some time. Overall, we expect a sequential revenue growth of about 12% in Q4 over Q3 levels. EBITDA margins in textiles would be around 12% and advanced materials will be around 14%.

That concludes my opening remarks, and I now invite you to ask any questions that you may have.

Moderator: Ladies and gentlemen, we will now begin the question & answer session. The first question is from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel: A couple of questions; one, if you can highlight how do you deal with this input price inflation which is there in chemicals and also in yarn? From a category perspective, how it's been happening in the denim and also in garmenting?

Jayesh Shah: The input because it has a global phenomenon, across the board, the inputs have gone up. All suppliers of textiles have increased the prices and so have we across the board and we have been able to mitigate the cost rise or margin pressure through price increases as well as cost controls that we have spoken about in the past. As you saw, even in Q3, our margins were better than Q2 and very similar to what they were a year ago despite the fact that we are still at about 80% of our original levels. I think the pressure on inputs is likely to remain for some time as my colleague just said. And we have been able to negotiate with almost all the key buyers of very successfully ours to raise the prices and I think we will be continuing to increase prices even in Q4.

Maulik Patel: Second is on the woven side. Woven has seen relatively a slower recovery compared to the two other categories - denim and garment - and now in the opening remarks, Samir mentioned that brands have started placing the orders. Can we see a faster recovery in woven in the coming 2 quarters?

Jayesh Shah: Yes, if you saw that woven historically as well as you possibly would know has been a more domestic focused business as compared to denim and it was the domestic markets, particularly the top brands that buy from us big brand houses that buy from us, were actually selling older inventory and not buying new inventory but all the brand houses have gotten out of the old inventory and they have because of the extremely good festive period in quarter 3, all of them have started placing orders and that you saw in terms of the sharp recovery in woven fabrics for domestic market. We believe that trend will continue, and we will see even much higher utilization. Also, you saw that the prices of our woven fabrics because the top brands the type of fabric they buy is more expensive compared to what the retailers buy and as a result, the prices also were at lower levels because the average product mix was different. That has also started seeing an upper trend. So, both on top line and the utilization as well as on margins, woven is coming back to normalcy.

Maulik Patel: One segment which has been relatively stronger on the AMD side, what kind of outlook we have on the AMD in from not probably next year, but a year or two-wise, what kind of a growth we….?

Samir Agrawal: Maulik, on AMD, it is a business which we have kind of in the last 2 years, we have made it mature from a bunch of startup ideas which have been assembled over a long period of time to a concrete sort of portfolio which is now relying on fairly definitive set of accounts across different product categories and hence repeat business. Where we are wanting to take this business is to keep pushing on an effectively robust double-digit growth over the next 2 to 3 years and really build upon the foundation which we already have laid. We expect this to grow at a fairly good pace over the next 2 to 3 years on the solid base we have built.

Maulik Patel: With growth in the top line, will margin also expand. We have been reporting what's close to around 14% to 15% kind of number over the last 3-4 quarters, definitely higher than the last year numbers, but what could be the trajectory on the margin side?

Samir Agrawal: It already reached a fairly good margin and then it will expand, let us say another percentage point a year kind of thing roughly speaking for a couple of years at least. Yes, there is some more headroom in the margin expansion which we will see as scale up goes beyond today.

Maulik Patel: Over the last 2-3 quarters, management has been delivering on a debt side and whatever you have mentioned in probably Q1 or Q2 has been there in the Q3, but now with the raw material inflation and also there will be the cotton season where you generally buy the cotton during the February-March period, where do you see the debt at the end of the financial year?

Jayesh Shah: As we have guided in our note as well and my colleague spoke that we are looking at a further debt reduction in Q4 and we do not have any significant capital expenditure program called over the next at least 1 year. So, we should be looking at debt reduction going forward as well.

Maulik Patel: What kind of a debt number we are looking at right now CAPEX for the next year?

Jayesh Shah: Very minimal. I would not put a number because we haven't prepared the business plan, but it will be closer to maybe 100 crores but not more than that.

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

Prerna Junjunwala: Congratulations on a good set of numbers. Just wanted to understand our debt reduction. Apart from EBITDA and cash back that you have generated, what has helped us to reduce a substantial amount of debt in the last 3 quarters?

Jayesh Shah: I think as you said that one is the profits that we made and since we don't have a CAPEX program, but I think more importantly the working capital stance that we have been able to improve. I think it has almost doubled over the last 1.5 years from closer to 3 to 3-1/2 to 5 to 5-1/2 now. And I think the reason is that we have taken very aggressive call of managing working capital in a very different manner and let even some sales go but not let the working capital go up. That's one of the key reasons why you see a very sharp reduction in the debt though our earnings have not been as high as the debt reduction so far.

Prerna Junjunwala: Sir, could you just elaborate on the working capital target days that you would be looking at or how much improvement you can see further on working capital?

Jayesh Shah: I think it's going to be 2 things now. I think we have reached a reasonably high level of working capital term. There is still some room to improve, but there would be now the run rate at which we are going - for example, if you saw our guidance, we have spoken about close to 12% growth over this quarter sales which would mean that it will be closer to 1700+ crores which would mean that we are running at a run rate of closer to 7000 crores top line as compared to what we have done this time. Assuming everything remains the way it is - I am not forecasting for the future, but I am just giving you an example - basis that, I think there would be a need for increasing working capital in terms of absolute amount, but our terms may help us to not increase an absolute amount of working capital. So, we should be able to keep the earnings available to us for us to reduce the debt.

Prerna Junjunwala: If I understand correctly which means absolute value may go up but the number of days will still remain very tight.

Jayesh Shah: Yes, tighter than what we have right now.

Prerna Junjunwala: Sir, my second question is on the denim demand. What we have been hearing from various players in the industry at the trader level is that the denim demand has improved substantially. So, could you please highlight if there is an equilibrium coming in the demand & supply scenario for denim and are you looking at a better profitability and better demand scenario panning up and the lull with which this industry was going through over the last 2-3 years is now coming to an end and what are the factors helping it if at all that is happening?

Jayesh Shah: As far as the denim industry is concerned, there are a few factors which are helping the denim business for India. 1) Critical thing is that of course there is a factor of move from some of the customers who were buying exclusively or significantly from China have been buying from regions other than China and that move is though gradual but visible and real. 2) In India, there have been some weaker players for whatever reasons have actually exited out or reduced their capacities. So, there is a capacity reduction of 10% to 15% that we can see. 3) With the casualization and work from home, lighter denims have really taken a significant increase. As a result, you are right, there has been a strong denim demand, not only from India but also from international markets and because there has been some bit of a supply side change, there is I think most denim companies have done…. We have also as we said that we have been able to pass on the cost push even in denim in the domestic market despite the fact that the denim has generally been a wicker category type.

Prerna Junjunwala: So, which means that this is bringing the demand & supply on the equilibrium and we can see higher profits coming in from denim business going forward?

Jayesh Shah: I would not make a general statement like that but as of today, denim is in a relatively stable situation.

Prerna Junjunwala: Sir, my third question would be on garments. Are you seeing that kind of improvement in garments as well, the demand from China + 1 kind of a situation?

Jayesh Shah: In fact, for India the reason why Indian businesses will not grow as much as it could grow is because Indian garment capacity is reasonably low as compared to many other nations like Vietnam and Bangladesh. So, the advantage that India could get is to some extent restricted because of the garmenting capacity not being available. However, for Arvind and some of the other garment players in India, I think the orders are coming in whatever one could take and the garment capacities as a result are getting filled faster than the fabric capacities.

Prerna Junjunwala: Sir, would you be going ahead with capacity expansion in garments or….?

Jayesh Shah: Right now, we have capacity to sell for the next financial year. We are not looking at further investing into any capacity creation for 1 year.

Moderator: The next question is from the line of HDFC Mutual Fund from Saurabh Patwa. Please go ahead.

Saurabh Patwa: Most of my questions have actually been asked by the previous 2 participants, but I have 1 question. Sir, any thoughts on…. I think in the past we had spoken about non-core asset monetization which would help us to reduce debt. Any number….?

Jayesh Shah: Saurabh, thanks for coming over and asking a question. We have begun sale of a large parcel of land which is supposed to bring in closer to about 300 to 350 crores over the next 2 to 3 years. We have entered into an agreement to get that piece in a joint development. The good news is that more than 50% of the land under development has been converted into an actual sale and cash flows have started. So, over the next couple of years, we expect around 200 to 300 crores to come in, which will entirely go to further reduce the debt.

Saurabh Patwa: Sir, just one question in addition to what the previous participant had asked. When you mentioned about the improvement in the denim market, in fact historically before FY18-19, our run rate used to be very stable, close to 100 million meters every year which started dropping since FY19 quarter on quarter. And I think we made the low in Q1FY21. Since then, we have started improving. How long you believe it will take maybe like 2 years, 3 years, in your projection it may end up some whatever but….?

Jayesh Shah: We are at a good 85% to 87%, Saurabh, now. We are not too far away from 100%. And when we say a capacity of 85% utilization, we are comparing it with around 95 to 98 million meters of denim. So, we are not too far away from that. And I think over the next year or so, we should be able to sell at the full capacity. I am making a guess because Covid is still around. It's not in India, but in Europe and in America. So, subject to that, if the normal life could be there, I don't think we are too far away from full utilization.

Moderator: The next question is from the line of Resham Jain from DSP Mutual Fund. Please go ahead.

Resham Jain: I have just a couple of questions. One is on garments. Currently, I think we will end this year roughly around 1200 to 1300 crores kind of number in garmenting. What kind of headroom do we have?

Jayesh Shah: I think we are left with a good 15 million capacity, Resham, to be utilized compared to current year because current year first half was not good. Of course, we are running right now at a rate of almost as you rightly said, closer to 1400-1500 run rate. From there, if we were to use all our capacities, we would be closer to 2000+ crores.

Resham Jain: When do you think that we can do that quarterly 500 crores kind of garmenting run rate?

Jayesh Shah: We are currently not making long projections, Resham, because the world is still uncertain. For example, there were certain delays, postponement as we speak even in Q3 from Europe because of the lockdowns that you saw. So, it is difficult to make that projection but I would consider it sometime in the next financial year, you should see that run rate coming, whether it is Q2 or Q3, I don't know; just because of the Covid, it is not for any other reason.

Resham Jain: Sir, this yarn prices and fabric prices going up, are you able to pass on that in garmenting as well or is it just limited to yarn and fabric?

Jayesh Shah: No, it is across the board because bulk of our fabrics are nominated as you know, and for garment also. So, it will be the same thing. We are talking about across the board.

Resham Jain: The final question is on backward integration. What we understand is that currently the yarn prices have gone up much faster than cotton prices. So, how much backward integrated are we across all the segments? Any specific comments on that if you want to…. any thoughts on that?

Jayesh Shah: Currently, of course, for denim which is where the impact of cotton or yarn is much higher than any other fabric because of the pure weight of the fabric or cotton in it, we are almost 80 percent plus integrated as far as denim is concerned. For woven and knit, we are close to half in terms of integration. Spinning has been a cyclical business. So, there have been times where the spinning margins were extremely low, much lower than the interest rates but now they have gone up. So, we are not looking at any kind of further investment in spinning, but what we do is that we make all the special yarns where the price differences are much higher within and commodity yarns we continue to buy from outside.

Moderator: The next question is from the line of Sagar Parekh from One Up Finance. Please go ahead.

Sagar Parekh: I wanted to understand more on the woven side. Woven, if I look at 2-3 years back, it was a sizable business for us in terms of EBITDA and then FY20 actually we saw a decline in realization because of lower value-added products in that. Now you are saying that we are coming back to normalization. So, FY22 we can expect normalized realization coming back in woven or you think that like we used to do about Rs. 190 per kilo realization, Rs. 195 per kilo realization, or Rs. 200 per kilo realization in that. And EBITDA was also significantly higher in woven.

Jayesh Shah: Even now at any price that we are selling, woven margins are stable, and they have not dropped even in the current financial year or in the recent last quarter. And as we speak, the margins are intact, and they are improving only as the utilization goes up. So, we don't see any threat to woven as a business at all in any way either on volumes, on margins, or absolute profits.

Sagar Parekh: So, woven can come back to that FY19 levels in terms of realization, volumes, and profits, right?

Jayesh Shah: I wouldn't call it realization because it will depend upon the products that the customers would want, but on margins and on profits, yes.

Sagar Parekh: So, margins in percentage terms or absolute-wise you are saying?

Jayesh Shah: Both I am saying.

Sagar Parekh: Secondly, FY22 then we can see 400 to 500 crores debt reduction. I am sorry, I missed out on the debt reduction part for FY22.

Jayesh Shah: We are not putting a number for the next year. The reason why we are not putting is because the world is uncertain right now and we do not want to put a number which we cannot achieve with 100% confidence. However, we do not have a CAPEX program for now. So, whatever earnings would come, they would be utilized to reduce the debt.

Sagar Parekh: Just 1 quarter back, you had spoken about 1000 crores debt reduction in 18 to 24 months. That stays, right? In spite of 1 year of uncertainty but at least in 2 years we can see 1000 crores debt reduction.

Jayesh Shah: That's correct. If you see, we have already reduced the debt by 300 crores in 3 quarters and we are hoping that we will further reduce the debt in Q4 as well and we are focused on reducing our debt by 1000 crores.

Sagar Parekh: One more thing on this China + 1 strategy. You mentioned that it is happening across the board actually - denims, garments, and woven as you are seeing the impact of that, right?

Jayesh Shah: Yes.

Sagar Parekh: Garments, you said, can reach 500 crores quarterly run rate by next year sometime run rate-wise and denims also you are quite hopeful of reaching 100% utilization because of this. And on the woven side, what is the certainty level or how certain are you in terms of….

Jayesh Shah: No, we are not certain on anything because we don't know about the Covid. What I am trying to tell you is that we are not far off from the full utilization. If you look at the guidance we have given, we have said that we will grow the top line by about 12% in Q4 which will take us closer to 7000 annual run rate of top line. Where we will end next year will depend upon a lot of factors and most importantly the international situation on Covid. So, we want to wait for, I think, at least a quarter before we can give a guidance for next year.

Sagar Parekh: In terms of cost reduction, what is the target for FY22 and are we on track for FY21? I think we had spoken about….

Jayesh Shah: I think we are on target and we saw that there has been a significant cost push, but we have been able to maintain or improve margins. And that one of the key factors in margin improvement is the cost reductions that we have been able to not only achieve but maintain.

Sagar Parekh: So, next year also, in spite of growth, then over FY21 we will be also maintaining….

Jayesh Shah: There are structural cost savings that we have been able to do. So, 10% to 12% cost reductions that we have been able to do is here to stay.

Sagar Parekh: So, about 100 crores cost reduction is here to stay for FY22 also, right? on a 7000 crore….

Jayesh Shah: That is correct.

Sagar Parekh: On the True-Blue subsidiary, I think you were looking at unwinding that subsidiary so that losses from that should also come down next year, which was about 25?

Jayesh Shah: It is very negligible now. It's in fraction of a crore. So, it is very small, and yes, that's correct.

Moderator: We will take the last question from the line of Bajrang Bafna from Sunidhi Securities. Please go ahead.

Bajrang Bafna: Congratulations for a decent set of numbers. Sir, in the budget, we have seen the proposal is for 5% duty on cotton. So, what sort of import that we are doing for the cotton and whether this raw material price increases have any sort of impact structurally on our margins going into future period?

Jayesh Shah: India typically imports long staple cotton because we don't grow too much of long staple cotton.They are for very superfine fabrics. Limited quantity but that is the kind of imports the country does. And on that, the duty will get applicable. For routine fabrics - 30s count, 40s count, 20s count or lower counts - which are for denim or most of the woven fabrics, it is only the Indian cotton that all the Indian companies use. So, to that extent, the impact would not be so significant, but yes, in general any import duty would in a way makes the inputs costlier and as a result will make companies to increase the sales prices to pass on that cost portion.

Bajrang Bafna: So, this increase that has happened in the domestic market also, in future also, any increase or decrease whether that will impact our margins meaningfully? Because this quarter, we have been able to show the margins that we have guided….

Jayesh Shah: It is a purely demand & supply situation honestly. So, any cost push one cannot assume that it will always get passed on, but as of now, most textile companies have been able to pass on the cost increases to the consumers. That's all that one can say. In future, one really doesn't know the market condition at that point in time to be able to give you a definitive answer as to whether margins will get impacted should there be a cost increase.

Bajrang Bafna: Last question from my side. Broadly, structurally, you have talked about China + 1 strategy and all and we are seeing a lot of inputs from the government's side in terms of mega textile park which has been announced in this budget and a lot of duty cuts on CTA and the nylon part also. So, there is a lot of push. Broadly if you take 3-4 years kind of view and since we are fully integrated in the value chain of woven, denim, and garments also, what sort of trajectory that could be visible from a longer-term perspective? Because what we have seen in 2013-14 what had started for chemical, the similar experts are guiding now that thing is visible for textile. Since you are an expert in this sector, can you guide the broader strategy from next 3-4 years' perspective including….?

Jayesh Shah: For the country, I think textile is an important sector and I think government has recognized it and they are taking all effective steps. One of the largest areas where India is almost noncompetitive, or existent is noncotton fabrics and garments. We are a predominantly a cotton garment makers or fabric makers. And the government has taken a note of it. We have been in the forefront of representing to the government that man-made fiber and fabrics out of man-made fiber, technical textiles, and industrial fabrics are areas where India has a lot of opportunities and those are the areas where the government is now giving a lot of thrust and focus. And I think those areas would significantly improve the total business of textiles rather than just remaining cotton textile based country. So, I think the government has taken correct steps in increasing the basket size of fabrics and garments or textiles that India can make by taking the correct steps.

Bajrang Bafna: In terms of new customer acquisitions, what that we have seen in the last 3 months or maybe what is that we are targeting over the next 1 year kind of time frame?

Jayesh Shah: I think, we have solid strong set of about 15-20 customers. We always add a couple of more customers and we have been able to add…. as I said that some of the customers who were not buying or not buying enough from India and they were more heavily buying from China have started buying and we are seeing it clearly in the kind of orders we have got and you saw that despite the fact that Europe has been significantly impacted in the last 3-4 months but still our exports have been quite strong. And this is because we have been able to add a few customers and a few product categories for our existing customers, more importantly for US markets.

Bajrang Bafna: Lastly, on the standalone debt and the consolidated, still there is some variation that we have seen in this quarter also. Sir, broadly when can we expect this consolidated level where the losses which are there are to significantly reduce for us. One subsidiary you talked about, but still in this quarter, there is a variation in terms of profits. If you could guide that, it will be really helpful, sir.

Jayesh Shah: The entire business that we are doing in subsidiaries is largely the garment business which is in Ranchi, in Gujarat, and in Ethiopia; and that was the business which was severely impacted because of the lockdown and nonavailability of the people, and as a result, you will see those losses. We believe that as we reach the optimum utilization in garment capacity, you will not see those losses. But that will be a question as to when we will reach there.

Bajrang Bafna: Hopefully next year if the situation normalizes and the Covid is nonexistent? I am just putting a cross mark.

Jayesh Shah: Let us wait for things to…. I am also as optimistic as you are. Let us hope things will settle down very quickly.

Moderator: I now hand the conference over to Mr. Samir Agrawal for closing comments.

Samir Agrawal: Thank you everyone for joining us today. We will see you in 1 quarter from now. Thank you and have good evening.

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