"Arvind Limited

Q2 FY '23 Earnings 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 Quarter 2 Financial Year 2022-'23 Arvind Limited. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded. I would now hand the conference over to Mr. Samir Agarwal. Thank you and over to you sir.

Samir Agarwal: Thank you, and good afternoon to all of you for joining us in this call to discuss the second quarter results of Arvind Limited. Joining me today is Mr. Jayesh Shah, our Executive Director and Group CFO; Mr. Swayam Saurabh, Chief Financial Officer of Arvind; and Mr. Kaushal Shah, Head of Investor Relations.

Before I get into specific results, I just wanted to share a few observations around the macro environment in which our businesses are operating today. From our vantage point, the export markets continue to be volatile. As we scan through the results, disclosures and guidance's issued during August, September timeframe most of our key customers, the metrics we have picked up indicate a clearly weakening demand outlook given the inflation issue and the interest rate hike. While many of the revenue numbers for the key brands have been near flat or even shown minor increases, they indicate an underlying volume degrowth, because behind those numbers are price realizations which are higher.

Secondly, the Russia-Ukraine war continued to take its toll on the European brands and retailers. Many have reported store shut downs and consequent loss of revenues and volumes. As we are hearing in the media, India has been an exception. In our industry as well, most of the large domestic retail players in fashion and apparel space have reported 40% to 60% growth in their Q2 results. This also indicates a continued shift in demand from the unorganized to the organized players in our country. Some of the momentum was related to the festival season warranty after two COVID-impacted years. And this is expected to continue well into the wedding season starting this month.

On the cost front, input costs have certainly been on a downward trend. Cotton prices, which had crossed INR1 lakh per candy are now quoted between INR 60,000 to INR 70,000 per candy and still stay volatile. We expect them to continue moving in that range in the near future. Other input costs have been on the lower side as well, especially the ones which are imported from China or elsewhere are enjoying the benefit of reduced inbound shipping costs.

Energy prices continue to stay firm. So in this facto context, our Q2 performance was broadly steady and flat. Overall revenues were up 3%. And our EBITDA was up 1.5% compared to the Q2 of last year. Operating margin from continuing operations was 9.3% compared to 9.5% in the Q2 of last year. Profit after tax before exceptional items stood at INR 85 crores. And final reported PAT was INR 125 crores.

Our note clearly explains these one-time adjustments, which arise from the sale of our interest in Arvind Internet which we had announced last quarter, provisions for potential losses in trade receivables from our Water Treatment business and potential loss in land sale related to one of our land parcels. Textile revenues were up 3% at INR 1,758 crores. Woven and knitwear fabrics saw steady volume, while denim volumes saw a sharp decline.

Garment volumes were also lower than planned at 8.1 million pieces as our customers continue to defer their buying given the uncertain demand outlook, and to some degree, continuing inventory correction. Price realizations increased by 38% for denim and 24% for woven fabric categories.

AMD continues to do well. The revenues were up 5% in Q2 of FY '22. But if you take overall H1, because in last year, what happened is that a bunch of deliveries had spilled over from Q1 to Q2. And hence, an H1 is a better comparison. So compared to H1 of last year, this year H1 is 20% up in terms of revenue growth. And this is very much in line with the full year guidance we have provided earlier for this business.

So we continue to get good traction for all AMD products across the board. As an example of our Composites business have started supplying parts for this Vande Bharat program, train program, to the coach factory. And we're executing the first order, which is about INR 80 crores. And we expect subsequent phases to continue coming to us as well. AMD margins have improved to 12.3% as input cost pressures and also eased a bit and helped continue scaling up these businesses.

Overall, our operating discipline remains quite tight and this helped us achieve a reduction in working capital requirements as well. Net working capital turns improved from 5.6 turns in Q1 to 6.1 turns in Q2. Looking forward, we see demand environment for textile exports especially to continue to remain uncertain, while domestic demand will be robust, especially in Q3. AMD should be on track to deliver 20% growth in H2, as I said before.

Overall, softening prices and a weakening rupee should start contribute to our margin numbers, especially in Q4. We continue our plan to reduce the borrowings, especially the long-term debt. So far, in this year, we have reduced the long-term debt by INR 83 crores. And we should kind of reduce it by almost INR 300 crores by March 2023.

So this concludes my opening remarks. And I now invite you all to ask questions.

Moderator: We'll take the first question from the line of Mr. Abhishek Nigam, B&K Securities.

Abhishek Nigam: So a couple of questions. First, I do understand the demand is being what it is right now, but US was having a bit of a pipeline issue in terms of the inventory, which got piled up over there. Is there some sense that you have in terms of -- is that getting cleared out now? And could that sort of provide some support for demand in the coming months? So that's my first question.

Samir Agarwal: So we definitely expect the inventory build-up in US to start to improve. It's just that entering into quarter three right now, we don't have complete visibility on when would it normalize. Our current estimate says by mid of quarter four is when we should see a normal level of inventory fully returned. I think it will start to get more clear once we have the holiday season results out.

Abhishek Nigam: So basically sometime in January or so?

Samir Agarwal: Yes. We'll have a better visibility around that time only.

Abhishek Nigam: Yes, I do understand that's a very evolving situation. The second question that I have is in an overall macro environment which is kind of getting picky and pent-up, what I'm actually seeing is, okay, raw material costs are lower, logistics costs, container shipping costs, those are sort of normalizing lower. So your first half deals weren't sort of the talking points on why margins are suffering. And so these are now sort of getting better.

Demand I do see as sort of maybe at a stable level now. But do you think it will translate into EBITDA margins sort of moving up from here on slightly or do you think that it will probably be just remain where it is right now?

Swayam Saurabh: So other than these two factors, and the first one also includes cotton, which at this moment is extremely volatile. To give you a reference, historically, our business has been at about 29% to 30% of, let's say, gross margin, which has now shrunk to closer to 25%. We do see that perhaps in the next two to three quarters, we start to inch towards these margin levels. And those improvements should start to reflect in EBITDA.

Abhishek Nigam: That helps. Last question for me, just on the debt side. So are there also any progress on the land sale or is this debt reduction just coming from the operating cash flows?

Swayam Saurabh: So as on H1, we have collected close to INR 40 crores of cash, which is essentially the advance which is coming out of land. And we have maintained that we should get about INR 100 crores, which should basically contribute in our overall long-term debt repayment in this year. We think we are broadly on track.

Abhishek Nigam: So that INR 100 crores is by the end of this year, is it?

Swayam Saurabh: Yes, correct.

Samir Agarwal: Yes, INR 40 crores we have got, another INR 60 crores we expect. So from a full year basis, we expect INR 100 crores to come in from the land sale out of the total expected INR 300 crores. So INR 200 crores will be from the operating cash flow and INR 100 crores from the land sale.

Moderator: We'll take the next question from the line of Prerna Jhunjhunwala, Elara Capital.

Prerna Jhunjhunwala: The performance has largely been great in terms of margin, it's what how I read it. But I would like to understand what's helped you to achieve better performance on the margins front in this quarter, because the demand was weak and costs were high. So could you just explain how you managed a 9.5% kind of margins in this quarter? Whether it was the purchase of yarn -- lower price yarn helped you in this period or whether it was higher realization from earlier order book, and going forward, we should expect some contraction on realizations going forward? So just wanted to understand the business environment a little deeper?

Swayam Saurabh: So first on quarter two results. By design, a large part of our revenue is sort of part of an order book which is frozen in advance. So we do have visibility of one to three months forward, which is how we indicated in the last call that quarter two will be a bit muted, which is what we have largely delivered. What we also see going into quarter 3 is, looking at our order book, we expect the performance to be at a similar level, slightly muted from these levels given the uncertainty. Deferment of number of orders we see, for example, some orders from quarter 2 moved out to quarter 3. And we will have to wait and see if customers are actually picking those volumes which we forecast right now in quarter 3. But balancing all of that, we do expect while the external factors remain uncertain, given that we have better price realization also supported by currency, we would largely have similar quarter going into quarter 3 which is what we see right now.

Prerna Jhunjhunwala: And are customers revising your existing orders based on the input price correction or it will only happen in the new orders?

Swayam Saurabh: We think there is a larger play from demand side, as Samir explained in his opening remarks. The US part of market, which is fairly large for us, all large brands and retailers are sort of in the phase of reducing inventory, inventory which has been built up for the last two quarters. And that translates into sort of lower order book for us going into quarter 3, also partly in quarter 2. I mean, this is one reason which would keep quarter 3 flat. Other one is the energy crisis in Europe and general economic sentiment around it. So while we do see new order and also see repeat order, we think these are the two factors which are sort of counterbalancing our total order book, which translates into a flattish quarter, which we see ahead.

Prerna Jhunjhunwala: I have a question on garments. So in the garment business, we were quite confident that our Q2 is not seeing any major pressure, but our volume suggest that we witnessed pressure in the garment business also. So though you've highlighted that there were pressures in the key markets. Could you give some sense if there was, how was the profitability in the garment business? And should we expect similar volumes in the garment business also?

Swayam Saurabh: So let me address the profit part and Samir can come in on volume. Profitability, if you look at H1, we have delivered about 9% EBITDA, I mean, 9% to 10%, which is low-single-digits. We expect that to improve going forward also in future quarters. As far as volume is concerned, volume is really a result of deferment of orders. It's largely tied to what we told you about the US market still adjusting their inventory, looking at not so strong demand outlook. And hence, most of the key customers, if you see their commentary also going forward, they're all revising it down. One quarter back, they were all less pessimistic, but all the disclosures in September timeframe talk about revising it down. So it's a result of that that they have deferred a bunch of orders. And on the supply side and the capacity side, we have shared in the past that we are shifting part of our capacity from Ethiopia. So that's the working progress as well.

Samir Agarwal: But it's largely customer deferment, a combination of inventory equalization as well as partly Europe situation, which we think will start to normalize as we go into quarter 4.

Prerna Jhunjhunwala: Last question from my side as of now. On provisions for water treatment business in Ethiopia. So wanted to understand the nature of this. And whether it is done for the entire receivables or we can see any further provision on that front again?

Samir Agarwal: So let me explain the background to this. See, our water treatment business has executed four projects in Ethiopia over last three year to four year timeframe. And the nature of these projects is that they were installed as common effluent treatment plant in industrial parts. So Ethiopian government has been for last five years, six years pursuing a strategy of economic development basis like industries, like textiles, pharmaceutical, like electricals and so on. So they have established multiple industrial development parts where they invite tenants from across the world to setup factories.

In four of such parts, our effluent treatment solutions were chosen as the CETP solution, Common Effluent Treatment Plant solution. So we've installed those, and in some cases, we also have the contract to operate those. Now the expectation was that as these parts get populated with tenants and their monthly fee that the tenants will pay off on the investment and the other payables which were committed by the government. Because this whole plan sort of fell apart with this whole civil war and law and order and political situation, the whole chain of expected events did not play out the way it was designed to be. And hence, we kind of got into the situation and we expect that actually things are resolving there and some of this money might come. But on a prudent step, whatever is potentially the full exposure, we are taking that as a provision right now. We don't expect, I mean, there is no more amount to be kind of discussed. It's in fact, some of it may not fructify or create actual loss….

Prerna Jhunjhunwala: So we can see write-backs also going forward from this amount?

Samir Agarwal: Yes.

Moderator: [Operator Instructions]. We'll take the next question from the line of Mr. Sagar Parekh from OneUp Financial.

Sagar Parekh: Decent performance, at least on the margin side. A few questions from my side. One, on the denim side, we have seen volume decline both on exports as well as domestic. Exports, I understand, as you said, on different seasons in US and Europe. But on the domestic side, I'm really surprised to see a decline in volumes. So if you can explain that? And going forward, how should we think of denim volumes for Q3 and Q4? Q3 will be similar about 13 million, 14 million pieces, I mean, 13 million, 14 million meters or do you think that worst is over for denims?

Samir Agarwal: Right. So on export side, denim is largely impacted by inventory build-up in US, which has translated into customers like Gap and few other deferring shipments till they clear inventory. And within the denim portfolio, US has a very large percentage of revenue, which is one large reason for this impact. This we believe is also temporary. Once inventory starts to clear up, we think they should start to normalize perhaps later part of quarter 4. Then there is another smaller impact in exports, which is related to European energy crisis, where we see some of the brands are slowing down the order intake, but we will have to wait and see. Although this is not very large as large as US, but we will have to wait and see how quickly this can normalize.

On domestic front, we see a pretty unique situation. A large volume of our domestic goes into trade. And from there, it gets supplied to mid-tier value brands, which are neither Levi's and Pepe nor mass market. What cotton prices has done is taken their basically USP away in the sense that the differentiation is less while the brand's ability to take price hike to maintain their margin has come down because of the input costs going up. That's where we see a volume shrinkage. And as cotton has started to normalize, although it is still very volatile, we do expect that it should correct itself in next one, one and half quarters, and this would follow how cotton normalizes.

Sagar Parekh: So in terms of volumes, quarterly volumes for denim, can we expect pickup now going forward or do you still think that...

Samir Agarwal: As I said, these three large reasons, European energy crisis, we will have to wait and see. We do expect some positive uptick in US market going into quarter 4. And the domestic, while we have shown that we could compensate part of the volume loss by moving into other channels, but it will entirely depend on how quickly cotton goes back to stable normal level. We are hopeful that in the next one, one and a half, two months, cotton should normalize. And once that happens, then you should see that improvement as well.

Sagar Parekh: My second question is on the, just this thing, you mentioned that on garments your profitability was 9% to 10% in H1. Did I hear it correctly? It's just the questions that Prerna asked on the garment side. Did you mention that the profitability for H1 was 9% to 10%? And we expect the profitability to improve from H2 onwards?

Swayam Saurabh: Right. So what I referred was actually textiles. Garmenting are at low-double-digit right now, which we expect to inch up as our factories are better loaded, as our benefits are loaded and as volume picks up. We do expect this to go closer to double-digit.

Sagar Parekh: We expect the margins to go to double-digit in H2 then?

Swayam Saurabh: That's correct.

Sagar Parekh: And how should we think of overall volumes for garments for the year? So I think H1, we are still seeing some growth in terms of garmenting volumes. We will still be growing for FY '23 or...

Swayam Saurabh: So in value terms, we believe we will have a growth. Volume as the single largest reason is deferment of orders which we also see continuing into Q3. We will have to see. We believe quarter 4 onwards, the volumes should start to get better. And that's how we see right now. Samir, do you want to add something?

Samir Agarwal: Yes. I think on the full year basis, we should be broadly in the same zone as last year because of all of what we are going through. I don't expect any significant change in a full year number.

Sagar Parekh: My last question would be on the capex. So we have done about INR 100 crores capex in H1. What should be the capex number for H2? And have you finalized any plans for PLI scheme for garments as well as for Advanced Materials Division yet?

Swayam Saurabh: So on a full year, we expect to be between INR 150 crores to INR 180 crores range. That's our current visibility for this year. On PLI, we have taken all initial preparatory steps, including the process of formation of company. But we are still internally sort of finalizing our capital allocation also given that businesses like AMD, which is very attractive and finding that balance. So perhaps in the next quarter call, we will have more clarity on capex for next year or so. And of course, when PLI-II comes, we will definitely apply.

Moderator: We'll take the next question from the line of Mr. Amit Kumar from Determined Investments.

Amit Kumar: My question was just answered. So that's it at my end.

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

Samir Agarwal: Sure. Thank you all very much for joining us today. We'll meet you in one more quarter. Thank you. Bye, bye now.

Swayam Saurabh: Thank you.

Moderator: Thank you. On behalf of Arvind Limited, that concludes this conference call. Thank you for joining us. And you may now disconnect your lines.