"Arvind Limited Q1 FY22 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 1 financial year 2021-22 of Arvind Limited.

As a reminder, all the participants' 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 for 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 thanks for participating in this call to discuss our results of Arvind Limited for the 1st quarter of FY22. Joining me today is Mr. Jayesh Shah, our Executive Director on the board & group CFO.

This quarter was marked by a strong sort of headwinds which our businesses had to weather and I am very happy to say that we delivered a relatively strong performance in that backdrop. There were 4 sets of challenges which were faced at our businesses. First is related to the lockdowns. The garment factories, especially in the Southern India including our own factory were closed down for a large part of this quarter, which led to the loss of business volume as well as pile up of textile and garment inventories. Factories which were open including those in Ahmedabad area faced significant absenteeism as wave 2 impacted our employees and their families.

Overall sentiments remain subdued in April and May in terms of domestic market which led to the deferment of buying by domestic buyers both at the retail level as well as at the wholesale level. So, the closure and reduced off take in the domestic business drove higher inventory levels which reflects in our working capital as well. The exports business did well but they faced continuing challenge around logistics availability and high freight cost. Overall, all input costs including fuel, packaging, and freight charges – of course, including cotton and yarn as well – continued to put a lot of pressure on our bottom line.

On the other side, in terms of positives, what we see is that the bounce back in June has been quite assuring and July continued the positive sentiment at the retail level. We have also started seeing initial traction on the revival of wholesale buying from our large domestic customers. Export demand remained strong throughout the quarter. All our US customers reported strong growth in quarter ending May or June and have upped their guidance for the rest of the year. If you see their commentaries, they are quite positive as well. European brands and retailers have also started coming out with positive commentaries around the outlook. So, our export businesses continue to remain strong and that's a really positive driver for us. Further, our businesses have made strong progress on efficiency gains and cost management which has helped blunt some of the impact of the input cost increases. In order to offset the impact, we have also secured price increases in most segments we operate in.

Finally, as a result of debt reduction which we have achieved during the last year, the interest outgo has been lower for us. As a result of all these factors which I just described, we delivered a relatively strong performance in the Q1 of this year compared to the Q1 of last year which of course is a very impacted quarter. In some sense, it is not a usual comparison. But just to share the numbers, the overall revenue stood at Rs. 1439 crores which was 140% higher than 599 crores in June of last year. Overall EBITDA margin stood at 7.2% positive as against negative 4.8% last year in this quarter. Helped with a lower borrowing cost, we achieved breakeven at the PBT level this quarter. During the quarter, the company booked RoSCTL income of 13 crores for the Q4 of the previous year. Similarly, it paid about 14 crores as a one-time reward for the employees who had been with us and there were lot of impact and hardships.

The RoDTEP rates for fabrics have not been announced and hence we did not book any income on this account. Textiles revenue stood at Rs. 1176 crores for the quarter which was 170% higher than last year. Fabric monthly volumes reflect the bounce back which we are seeing especially in June. Just to give you some numbers, denim dispatched 6 million meters each in April and May and 8 million meters in June. Last year of Q4 if you see, we did about 6.7 million meters per month in each of the months of Q4 on an average. Compared to that, we did 6, 6, and 8. On the woven side, the monthly dispatches stood at 8.3 million, 5.4 million, and 9.3 million meters. Again, our average last year in the Q4 was 9.3 million meters. So, what we are saying is we are seeing a revert in the volumes which we saw earlier by June.

Export demand stayed robust throughout the quarter, specifically for denim which exported almost 15 million meters during the quarter after a gap of 3 year. So, this was a very good performance on denim exports side especially.

Garment volumes stood at 6.8 million pieces for the quarter which was 83% higher than the last year's Q1 number of 3.7 million pieces. Apart from the volume recovery, the price elevations remained quite healthy at Rs. 202 per meter for denim and 159 per meter for woven respectively. Input cost pressures continued as cotton prices continued to go sky-high. Just as a reference, Shankar6 is almost trading at Rs. 56,000 per candy upwards on ex-gin level.

As mentioned, other input costs like dyes, chemicals, packing materials and all, also remained quite high. What helped us is a fairly tight operating discipline which gave us some EBITDA margin of 8.9% for textiles as compared to 7.9% in the last year of Q1.

Our advanced materials business continues to be robust. It delivered top line of Rs. 193 crores which was higher by 81% of Rs. 106 crores last year, and the EBITDA margin in this business was Rs. 13 crores. So, this business continues to do very well for us. It has not been impacted by any of the consumer market challenges which we have seen in the other businesses.

During this quarter, our net borrowings increased from Rs. 1950 crores at the end of March to Rs. 2141 crores which was in line with our guidance. We believe it's a temporary increase caused by higher levels of gross working capital and this was caused like I explained earlier because of the slowdown in April and May. That has resulted in higher inventory as explained earlier.

Looking ahead, in Q2, we expect domestic demand to pick up as markets reopen and apparel brands – the domestic brands – resume ordering. Export demand should continue to be strong across most markets. In fact, Europe which was a slightly more guarded is trying to kind of up the buying. On the supply side, reopening of garmenting factories should help us increase the volumes. If normalcy returns and continues, we expect denim and woven volumes to reach 24 million meters and 30 million meters and garment volumes to reach 9 million pieces.

On the policy front, RoSCTL for garments has been announced but for fabrics, it is still awaited. Due to continued increase in input costs, the margins will get impacted in percentage terms as well in short term in rupee terms due to lag effect in passing on the cost push. As we have mentioned during our earlier meeting, directionally we will continue to focus on deleveraging. Our debt levels which went up in Q1 will start showing a downward trend and we expect that we will come to near March FY21 levels of 1950 crores by end of quarter 2. There was typo in the review note. It was written as March 2021.

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

Moderator: Ladies and gentlemen, we will now begin the question & answer session. We will wait for a moment while the question queue assembles. The first question is from the line of Sudhir B from Right Time Consultancy Services. Please go ahead.

Sudhir Bheda: Good afternoon, sir, and good to see that your volume is recovering from the month of June. My question is I have just analyzed your 2-3 quarters, and it is seen that your gross margin is around 51%. So, is it fair to say that your break-even level of sales is around 1300-1400? And anything above that, 50% would go into the gross margin for us. Is it right understanding?

Jayesh K Shah: No, I think our contribution level is not…. I think one should look at not the gross margin but the contribution level, and the contribution levels are in the range of about 29% as a company. So, any incremental sale beyond the break-even sales would contribute 28% to 29% towards the profit.

Sudhir Bheda: So, what would be our break even? Is it around 1350-1400 kind of sales?

Jayesh K Shah: At what level are you looking at break even? EBITDA level?

Sudhir Bheda: PBT level.

Jayesh K Shah: As you saw this quarter, it was 1400 crores and almost broke even. That would be the level.

Sudhir Bheda: As an industry as a whole, there is a lot of buzz around the textiles? So, how do you see that, particularly in the export market? How do you see that sector performing, particularly garments and woven, in the international market in view of China factor and also opening of the economy over there?

Jayesh K Shah: As you rightly said, there are 2 reasons. One is that, of course, globally because most of the brands and retailers did not have much inventory. So, when the markets opened up, the demand for products suddenly shot up and that resulted into, in fact, shortage of products within the textile industry. That has led to a sharp increase in demand across the board. Of course, second is the China factor as you said that there are certain customers who are opting to rebalance their portfolio of purchase and that is helping to some extent India as well. So, to answer your question, yes, the export markets are looking good. One caution, of course, is that currently there is a high amount of quantitative easing all across. So, as and when it tapers off a little bit, we have to see how the markets react, particularly in the US. However, the good thing is that Europe is just about to start buying. So, that will be a positive factor and would balance out some of the reductions if at all there is one in the US market.

Sudhir Bheda: What is the sales growth you are seeing for the next 3 quarters? We did around 5200 crores….

Jayesh K Shah: We are right now in absence of…. because of the uncertainties, we are not giving yearly guidance. Also, please keep in mind that the sales is going to go up very sharply because of the inflation on prices and the cost. So, that will not be a correct way to look at the performance. I think if you look at the volume growth which is what just my colleague spoke about, I think we are looking at a reasonably high volume in Q2 both in our mainline products denim and woven and our advanced materials division continues to remain strong and continue to grow at 20% to 25%.

Moderator: The next question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: Three questions from my side. First, on the margins if I notice, it's not as if that the gross margin has gone down so significantly but our other expenses are more or less constant from Q4? So, is it right, as you said in your opening remarks, that if I bifurcate the impact of the freight cost and these other components is much higher on the margins versus say the cotton price hike. Is that a right reading first of all?

Jayesh K Shah: Two things; one is that the fixed costs because unlike in the earlier period or this time after we having reduced the fixed cost, we haven't done any cuts in the fixed cost. Even though the plants were not operating unlike in the past where we had reduced salaries and all of that, so the fixed costs are at a lower level but remaining now constant. The Q1 impact is that because when you operate plants in a suboptimal manner, there are a lot of hidden semi-variable costs which hit you and that is why it will not give you any kind of a very clear indication of what's happening on the margin front. The way we would look at it is on the days when the plant ran full like in the month of June, we were in a reasonably good shape as far as margins are concerned or EBITDAs are concerned or contributions are concerned, but April and May would give you a very very awkward all because some days the absenteeism will be 15%, some parts of machines will not work, some will work, and all of that. However, on margin front, going forward, as I was just mentioning in the earlier question, there is a very sharp cost increase which has happened in the month of April, May, and June, and we have 3-4 months of lag because we have ordered for 3-4 months at any point in time. As we keep on taking new orders, we keep on changing price for taking care of the inputs. Since the price rise is very high, the rupee margin will also take a few months because it goes back to where it was in Q4, but the percentage margin will continue to remain low if the prices remain elevated because you will see, on these volumes, around 7% to 8% increase coming out in the Q2 only on the price front because our prices are going up fairly fast in Q2. So, margins are likely to get stabilized in unit terms sometime in September if the cost push doesn't keep going up and in percentage terms will remain lower purely because the price increase is not going to give us extra rupee profits.

Nihal Jham: Just on the unit terms but we have managed to keep our contribution per unit constant to factor in for all the inflation that is currently happening?

Jayesh K Shah: No, not in one. It is just at the gross level you are seeing possibly, but I think if you look at the contribution levels, we were lower in Q1.

Nihal Jham: Moving on to the next part, as I notice that the woven segment has seen obviously quite a strong improvement, especially on the export side whereas garmenting which naturally has a much higher proportion of exports, maybe, was not able to see that improvement?

Jayesh K Shah: Nihal, in Q1?

Nihal Jham: Yes, in Q1 only I was saying.

Jayesh K Shah: Out of 90 days of Q1, 45 days the factories in Bengaluru were shut actually. This time what happened was that Karnataka were most of our garment factories are situated had allowed most industries to function but singled out garment industry because the number of people who work in a small factory is very high and they didn't want that chance. So, they had specifically prohibited garment factories to operate for almost 45 days.

Nihal Jham: Last question from my side is, – you have given this disclosure, but just to have a better sense in the future – what proportion of our revenues are eligible for RoSCTL and what proportion of the revenues are eligible for RoDTEP?

Vinay: Of our total sales, our exports are close to 54% and it is equally divided between garments and fabrics.

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

Sagar Parekh: First, did I hear it right? You said 7% to 8% is the price increase in Q2 due to the input price going up. Is that the right way for across products?

Jayesh K Shah: Yes, it is.

Sagar Parekh: That is over Q1 FY22, right?

Jayesh K Shah: Absolutely it will not be like on 30th June to 1st July, Sagar. I am just giving you an indication like for example, we are taking a 4% to 5% increase in certain products starting 15th of August, some price increase has happened. I am saying at the exit, you may see that number. You may not see it on 1st July as a number.

Sagar Parekh: So, this contribution level overall of about 26.8% for quarter 1, as you said that despite the price increases, the percentage might remain lower. So, this 26% to 27% would be a sustainable number going forward?

Jayesh K Shah: Yes, it should be. If the prices remain elevated but remain steady, this percentage is 4, but till the prices keep rising, we will continue to have that lag effect for a few months.

Sagar Parekh: But if the prices cool off, then? This contribution level then keeps going up?

Jayesh K Shah: In fact, in percentage terms if prices were to come down, our percentage margin should ideally improve because you are calculating in percentages. If my cost goes up by Rs. 10 a unit and if I increase the price by Rs. 10, the percentages will drop.

Sagar Parekh: Secondly, on this Ethiopia – last year we saw losses continuing in FY21 also. In quarter 1, how has Ethiopia been?

Jayesh K Shah: Ethiopia has been marginally profitable though they were also affected but it has turned profitable since H2 of last year.

Sagar Parekh: So, Q1 would be still profitable at EBITDA level or PBT level?

Jayesh K Shah: No, it is not at a PBT level. It was profitable at EBITDA level. Some of the profits are also getting booked in our Dubai company because of the way the trading arrangements are. But purely from an MIS perspective if I were to look at it, Ethiopia operation is profitable.

Sagar Parekh: Has that also got impacted during the quarter due to some local level lockdowns over there?

Jayesh K Shah: Yes, it was across the board. The Q1 challenges are also in the form of availability of containers across. So, even in India and in other parts, we were not able to ship goods in time. that was another challenge that we faced. Also, the Bangladesh border was a big challenge because goods were not moving because of several restrictions. I think all of that has eased out in June and July. So, it should be okay now.

Sagar Parekh: So, how should we look at it – Ethiopia plus Dubai if I have to take it for FY22?

Jayesh K Shah: We don't give division or district-wise number.

Sagar Parekh: The reason why I am asking is because last 2-3 years we have been showing a reasonable amount of losses from that business. If that turns profitable, that can significantly add to our consolidated EBITDA.

Jayesh K Shah: Overall, we are looking at total business and not unit because there are a lot of units within the company which are doing not so well and doing extremely well. Even within denim or in woven, there are certain products which don't do well, Sagar. So, I think the way to look at it will be the whole business and not a particular division or a line of a product and overall garment is shaping up and thanks to RoSCTL, it should continue to do well as we increase our throughput and take it back to the normalcy in terms of capacity utilization.

Sagar Parekh: On this Others segment, I understand that it's a very small part of our business, but still, every quarter it is showing losses….

Jayesh K Shah: It has businesses which are all AMC driven businesses. There is a lot of annual maintenance business we do across most of the businesses which are part of Others and those businesses were the worst in the COVID period. So, we had to kind of have zero revenue in those businesses with fixed cost remaining high. It has turned and it is not so in July onwards. So, you will not see such challenges July onwards.

Sagar Parekh: So, Others will become profitable from Q2 onwards at EBIT or EBITDA level?

Jayesh K Shah: It will be marginally profitable or marginally loss but it will not it is because of the challenge of the service sector that we are in that affects us.

Sagar Parekh: Any thoughts on the real estate monetization that we had embarked upon last year?

Jayesh K Shah: I told in the last conference call that we are likely to realize about 150 crores. We have started to get that money and we are hopeful that at least that amount will come during the year.

Sagar Parekh: On deleveraging part, how much should we expect total deleveraging for the year and what would be the CapEx number for FY22?

Jayesh K Shah: CapEx I can tell you because that's in our hand. Deleveraging will depend upon how the market and the COVID uncertainties play out. Directionally, deleveraging will happen, but CapEx number I can tell you will not exceed about 100 crores during the year.

Sagar Parekh: So, similar to last year's level. If we do about 800-850 crores of operating profit this year, then with the 150 crores additional coming in from land sale, then we can safely assume about 400 to 450 crores of deleveraging this year?

Jayesh K Shah: Numbers are with you. I wouldn't comment on EBITDA or anything, Sagar, because it is very uncertain. I would love to give a guidance but there are challenges which are absolutely beyond us for us to be able to give you a number.

Moderator: The next question is from the line of Ketaki Jain from Canara Life. Please go ahead.

Ketaki Jain: Sir, my question is with regard to the ramp-up. In the textile division, can we expect 1500 crores next quarter given the July ramp-up we have shown in the presentation**?**

Jayesh K Shah: Again, I want to highlight 1 sector. You can expect that kind of a number or even slightly higher turnover – I wouldn't call it large portion – but some portion is because we have a very high level of price increase which will affect the overall sales or rather the sales will get inflated to the extent, but in short, answer to your question, yes, it is possible for us to have that kind of turnover in this quarter if everything remains normal and there is no lockdown.

Ketaki Jain: Then, my question is with regard to our subsidiaries. Last year, we had shown in the annual report 14 crores of loss in the Westech Canada and 52 crores kind of loss in the Arvind Smart Textiles. What do you expect in these subsidiaries' performances?

Jayesh K Shah: We do not look at individual company as I just mentioned. Smart Textiles is a company which is running some of its garment plants and garment plants were one of the worst affected plants in the last year. This year, as we said that it is coming to normalcy and we are hoping that the garment per se business will turn profitable.

Ketaki Jain: Sir, any incremental cost reduction initiatives we are trying to improve our cost structure?

Jayesh K Shah: It is a continuous exercise but nothing very drastic or significant as we implemented a very large rationalization program last year, but it is always a continuous exercise.

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

Prerna Jhunjhunwala: Sir, I wanted to understand your geographical exposure of sales with respect to US, Europe, and other countries.

Jayesh K Shah: 46%, Prerna, is India. Within 54%, I would consider almost two-third of that would be US and about 20% will be Europe, and balance will be rest of the world.

Prerna Jhunjhunwala: Sir, given there is no lockdown, what kind of garment volumes now we can see for the entire year?

Jayesh K Shah: If I were to say there is no lockdown, then of course, Q2 will be a little slower to start because the ramp-up is happening in July, but August-September should get to normalcy. With that, we are expecting to reach a run rate of 12 million odd so per quarter in H2.

Prerna Jhunjhunwala: Sir, also I wanted to understand from China plus 1 perspective on this garmenting thing. How is the demand per se from….?

Jayesh K Shah: After all, we have a very limited capacity and for us to fill that capacity is not at all difficulty because garment for us is an extra added layer over our main business which is fabric business. So, if we are selling say 10 million meters of denim to 1 customer, we do 1 million of that customer in garment form and 9 million we give them in fabric form. So, for us, filling orders for garments is always possible. So, we will not be the right company to understand the garment scenario in the country honestly because for us it's a vertical integration and if we are selling lot of fabrics to a company and we take some orders when they want us to do some orders in garment form, we do it. We don't chase them for garment orders. We chase them for fabrics because that's our main business. So, we are not the right company to look at what happens to garment industry in the country. But we believe that with the China factor, India is getting a lot of orders. I think India across the board is filled with the orders for garments which we see in our orders that we get for fabrics from various garment factories. I think India is constrained by the capacity and the efficiencies that we have. Now that RoSCTL has also been brought back, I think it's a great opportunity for Indian companies to grow garments.

Prerna Jhunjhunwala: Sir, my last question is, how to look at this company from a 3 to 5 year perspective if garment is not the way going forward and you are not looking at major investments in fabric as well?

Jayesh K Shah: I think what we are looking at is…. we invested heavily in FY20 and also in FY19 and then as we were ramping up, the COVID hit us and then 18 months we have not been operating at full utilization. So, I think we have good, I would say, legroom for us to grow by 8% to 10% for the next 12-18 months without any CapEx. Beyond that, we are selectively investing. We are not doing large CapEx but we are doing selective investments. We are in product categories where we believe we will be able to maintain, lead, and maintain differentiation and pricing power. So, we are investing in athleisure fabrics. We are investing in Indigo Knits. We have gone into knitted fabrics for Indigo. That's the business where we almost reached 100% realization in Q4. We are investing in polyester based fabrics again – man-made fiber fabrics. And a very large focus is also on advanced materials. So, we would at appropriate time talk about what is our next 3 years' plan in that. In the next 3-4 months, we will possibly talk to all of you. But we have an ambitious plan for advanced materials business. After maybe a loss of 1 year or 1-1/2 years, we will reach hopefully a 1000-crore mark this year. And we want to rapidly grow at a much faster pace than what we have done in the past in this business. We have good engines for growth, but we want to maintain the discipline of a much higher asset turnover ratio than typical textile business.

Prerna Jhunjhunwala: At leisure fabrics, polyester-based fabrics, do you think they are…. What kind of asset turnover these fabrics can give you as compared to normal woven fabrics?

Jayesh K Shah: Again, we are not investing in the entire value chain. We are investing in only the last mile or some processing or some weaving equipment somewhere. So, we are looking at anything around 3 to 3-1/2 turns of assets for every incremental investment we do.

Prerna Jhunjhunwala: Margin profile and revenue share today in this Indian new businesses?

Jayesh K Shah: It's very very miniscule, not even worth talking because we have been investing and experimenting and perfecting these products for now almost.… it took longer because of COVID but almost 12 months. We are now at a level where we are confident that we can achieve our internal goals of certain margins and certain product differentiations. So, now we will ramp it up as and when the times get to normalcy and today we don't believe we should take any risk because anything can go wrong in the coming 3 to 6 months.

Prerna Jhunjhunwala: So, no further investments in garmenting for the time being?

Jayesh K Shah: For this year, no.

Moderator: Due to time constraints, we will take the last question from the line of Rishabh Jain from DSP Mutual Fund. Please go ahead.

Rishabh Jain: Sir, just 1 question on garmenting. We have expanded quite rapidly but the ramp-up we had these COVID issues and all. This quarter we did 270 crores kind of top line and you mentioned we can do 12 million pieces which is almost doubling of what we have done in Q1. With this kind of turnover of around 500 odd crores, what kind of margin garmenting business can do going forward?

Jayesh K Shah: We don't necessarily look at garmenting business and a margin of the garmenting. Of course, we have a concept of a forewall vertical margin only and we as I was telling in the context of some other question is that we look at our customer level profitability and we provide them extra service in the form of very complex small garment orders as well so long as overall customer is giving us enough business and the profitability. So, for us, independent garment margin is not the criteria to look at from internal perspective. I think that whole thing about comparing our garment margin with another company's garment margin, possibly we don't look at it that way and we would not recommend one looks at it that way. For us, it is a forewall we look at. However, if I were to completely separate and see what could be the garment margin in our context despite all the inefficiencies that we purposely let it be because we want to earn on our fabric business from a customer, it can still be in the range of 8% to 9% with the current RoSCTL rates.

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

Jayesh K Shah: Thank you all for coming over for the quarter 1 conference. I look forward to meeting you all in the month of, maybe end of October for Q2 results.

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