"Arvind Limited Q2 FY-21 Post Results Conference Call"

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MANAGEMENT: **MR. JAYESH SHAH – GROUP CFO AND EXECUTIVE DIRECTOR, ARVIND LIMITED**
MR. SAMIR AGRAWAL – CHIEF STRATEGY OFFICER, ARVIND LIMITED

Moderator: Ladies and gentlemen good day and welcome to the Conference Call for analyst and investor for post results discussion of Quarter 2 Financial Year 2020-21 Arvind Limited. As a reminder all participant 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 touchtone phone. I now hand the conference over to Mr. Samir Agrawal. Thank you and over to you sir.

Samir Agrawal: Thank you. Very good afternoon to all of you and thank you for joining this Q2 earnings call for FY21 for Arvind Limited. Joining me today is Mr. Jayesh Shah, our Group CFO and the Executive Director.

Talking about this quarter, overall the momentum continued along the theme of the volume recovery which we had indicated in our last quarterly call with all of you couple of months back. So if I have to just summarize the key themes, there are three themes which I would like to highlight before I dive into specific numbers. First is clearly the sequential volume growth, so the momentum which we saw in the end of Q1 has continued to Q2 and this growth obviously is led by export segment, again something which we had indicated earlier. Secondly the domestic market recovery also is there, it's slower but definitely it's on. And thirdly the return to the near usual EBITDA margin levels. So the results which we have shared with you and they will talk about in a minute will kind of underpin and highlight these three things.

In terms of specific second quarter results, the overall revenues stood at Rs. 1305 crores which was in terms of comparison to the last year's run rate, it was 67% of the Q2 of last year which was 1932 crores. If you compare this with the first quarter, we had done about 32% of the previous year so we had done 599 crores which was 32% of what we had done in the Q1 of last year. EBITDA for the Q2 stood at Rs. 122 crores, so we turned positive on that parameters this quarter compared to the last quarter and this was in terms of margin it translated to 9.3% of revenues and as a comparison we were at 10% in the Q2 last year. So we are pretty close to how we were doing last year in the Q2 on margins.

In the textile segment the total monthly volume for July have recovered to 80% of previous year in case of Denim and 59% in case of Woven. Especially the export volumes in Denim has bounced back to pre-COVID levels since June and for the quarter they have exceeded the FY20 levels. Domestic market has recovered to 54% for Denim and 60% for Woven in terms of fabric volumes. So we are seeing a strong demand in the value segment which is reflected in the price realization also in the woven segment in the data we have shared with you. Garmenting volumes in Q2 have recovered to 66% of the previous year Q2 and will likely inch back slowly over next few months towards the full capacity. Textile margins in Q2 were a healthy 11.6% as compared to 10.8% in the Q2 of FY20.

Talking about our Advanced Material business; this continues to be robust and it delivered Q2 revenues of Rs. 186 crores which was marginally higher than the revenue of 183 crores in Q2 of

FY20. In this business the EBITDA margins expanded by about 100 basis points and are nearly at 15% for this quarter.

We continue to see strong market demand and solid order book position for our AMD products. We had shared about our cost rationalization measures, as a recap, these have already yielded about 15% to 20% of structural cost savings which have contributed to this healthy EBITDA margins which we have shared and we expect this to sustain over time.

Working capital discipline continues to remain strong. Our net borrowings which stood at Rs. 2371 crores as of March 31st, 2020 at the end of last financial year, if you remember these had increased to about 2700 crores in end of June and these have come down to below March level, so these are at 2291 crores. So once again to recap the numbers this Boring used to be 2371 crores in March 31st and has come down to 2291 as of September 30th, 2020. We expect to further reduce the borrowings over the next two quarters.

In terms of the Q3 we expect the sequential growth of around 10% in terms of the revenues over Q2 as the volumes continue to recover specially in the Woven segment. We expect the EBITDA margin in textile it used to be around 12.5% and in AMD to about 14%. So that concludes my opening remarks and I invite you to ask questions that you may have which we will answer. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Nihal Jham from Edelweiss.

Nihal Jham: First on garmenting, if I have to check our performance in terms of recovery which is around 66%, it's just a tad lower if I compare it to some of the peers. So I just wanted your comments on that and second and more importantly there has been a lot of talk and discussion and I think even in our last call we mentioned about potentially a lot of orders from China we are having discussions with clients. So I just wanted an update on that about how the industry scenario is going ahead? I will ask my other questions after this.

Jayesh Shah: So your first question was regarding the garment, so government activity as you saw has been picking up. There are within the garments we have previous product groups, so wherein we look at the mix of product group, it is 100% utilized. In fact we are converting some of the Woven products; it's also to make knit products. As far as Denim is concerned, it is again going close to the 100% but the woven fabric which is shirting fabric; it is still at a much lower level. So that is the reason why you see overall percentage may be lower. However some of the segments are reporting very close to 100% utilization. Quarter 3 you will see a further significant boost to the garment capacity utilization and we are hoping that if things don't deteriorate from where we are today, we should be going back to normal levels of government capacity utilization in the coming two quarters. That's about this. Second is that as you saw over exports are rising very fast and we are not only looking at existing customers who have been placing orders with us now to the extent of what they used to place, even sometimes more but also we are letting customers who are new and we are also enrolling them and we bought for doing new product development and for garment pricing and everything is happening. So to answer your question in short, yes the demand for products in export market is fairly robust as of today.

Nihal Jham: And just pointedly have we seen any customer or new customer who has shifted some of the business that they were sourcing from China to us or its still with us?

Jayesh Shah: So we have got enquiries from several of the customers who are new for us and we have got orders from a few.

Nihal Jham: My second question on this was that I think we have taken 19 crores exceptional items related to…..

Jayesh Shah: So it is of the provisions required by the audit committee and auditors, so diminution in value of one of our associate companies, we have a joint venture with one of the big customers in Ethiopia for manufacturing products for that customer. We have invested some capital in it. Due to pandemic that plant is shut for some time and that required us to kind of make a provision. It's not a loss so that we have reported but we have made a provision in the diminution in the value in that event.

Nihal Jham: Just last question on the net-debt side, as we see I think we are running ahead of what we were looking at the start of the year in terms of paying down 400 crores. I just wanted to check again that is our target for pay-down on a YOY basis still the same or we are expecting considering how the business is…..

Jayesh Shah: As we have made earlier made remarks and we have spoken about our overall guidance to paid down debt over a period of time and that got a little bit halted in Quarter 1 but we are on a back to normal debt reduction program with the no capital expenditure that we see of any significant number between this year and the next year because we had invested in the earlier 2 years. We are seeing a quarter-on-quarter reduction index. As we have stated in our note which we have circulated that we see at least 100 crores reduction in Quarter 3 as well and we are not commenting on Quarter 4 because as you know the world is not the same and there has been increased level of cases in Europe and US and all, so difficult to talk about Quarter 4. But directionally the answer is that every quarter you will see that reduction happening.

Moderator: The next question is from the line of Maulik Patel from Equirus Securities.

Maulik Patel: What kind of recovery you expect in the domestic market? I understand that last two quarters were relatively better for the exports and you also mentioned in the earlier comments that the cases are going up in Europe, so the recovery might not be as good as one probably could have seen in one month back trend. But how are the things panning out in domestic market?

Jayesh Shah: I think domestic we are seeing the brands placing orders now for spring-summer '21 which it was a complete halt from various large brand houses. But there has been as you would have noticed all the customers of ours as they are reporting their numbers and as you see from the commentary that they are making that every month they are also growing by 8% to 10% compared to the previous month and since they are not bought for one season full which is autumn-winter season. Our understanding is that the inventory levels are coming down and they would be starting to buy and they have started placing small orders already. So you will see a reasonably high level of recovery in sales or rather I would say large part of sales recovery that you will see in Q3 will be on account of domestic sales.

Maulik Patel: What has been more profitable for you? I think export has always been the more profitable business for us.

Jayesh Shah: No, so like it is a product specific profitability. So some of our sales that we do to the premium branded apparel companies in India is very profitable because the kinds of service and differentiation we provide to them. That is missing as of today as you know because they are not buying. Similarly the retail that we do in India which is the own store as well as through other store is also very profitable and high side differentiated products. Exports as it's a mix, some of the customers whom buy very differentiated are profitable but we also supply to many retail chains which is our large volumes but at a reasonable price. So it's not that export is more profitable.

Maulik Patel: The cost initiatives I think I asked this question the last time also. We have almost 30% drop in the employee cost and still 35% drop in expenditure; if you look at for the first half almost 35% drop in employee cost and close to 40%-45% drop in other OPEX. So what part is sustainable now, compared to what you have seen in the previous quarter and with business…?

Jayesh Shah: So my colleague made a statement in the opening remarks that he made is that some of this which is we believe that about 15% of the FY20 cost, if you look that in fixed cost of FY20 and compare with this 15% of that cost is we believe is structural changes and that should stay with us as we go to the next year.

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

Prerna Jhunjhunwala: Just wanted to understand on this debt reduction only that since you have been focusing a lot on debt over the last 1 year; what is your target to achieve in terms of either debt to equity, debt to EBITDA or net debt position? Where you will be comfortable and then you will look at a growth part or keeping up further balance between expansion and maintaining the debt levels?

Jayesh Shah: I think we would want to look at least a 1000 crores reduction from where we are now. So our next 18 to 24 months and we have an internal plan to work on it. Timing of it came can become

24 or 24 may become 30 based on how pandemic plays out but we are very clear that we want to go, reduce debt by another at least a 1000 crores over next some period of time.

Prerna Jhunjhunwala: So that is net debt or gross debt that you are targeting at?

Jayesh Shah: It is not very different because we have only 50 crores difference between gross and net. So it's not very different.

Prerna Jhunjhunwala: As you mentioned in the previous comments that you are looking at garment's capacity from Indian getting into full utilizations very soon due to increased traction visible from the China shift to India or increased enquiries. Are you looking forward to some CAPEX in any of the segments where we as a company can benefit?

Jayesh Shah: As of now, Prerna we have enough headway in terms of available capacity in-house and outsourced. For us to continue to grow beyond, if I were to say, do we have headroom to grow by say 10% of what '19-20 sales? The answer is yes and we should aim to reach their before we do any significant CAPEX. So for the financial year December next year we are not proposing any significant CAPEX.

Prerna Jhunjhunwala: My last question is on profitability. We have seen improvement in EBITDA margins in this quarter as well. When do you think, what factors could lead us to reach our previous levels of 15%-16% EBITDA margin? Is there any game plan on drawing more for achieving that because if you have achieved a good improvement in EBITDA margin but that's not percolating down to the PAT level?

Jayesh Shah: So since we were on a CAPEX cycle and we were on a, as a result the both interest was high and the depreciation rate or depreciation amount is higher for a few years keep the PBT level at a depressed level compared to what it improvements you see in EBITDA. However as I said we are looking at cutting the debt down over next few years. That will help us to reduce interest cost. As far as EBITDA margins are concerned, they are one of the components of EBITDA margin for us is the new initiatives that we took in garments which has not still given up any kind of profits because we started them in last year and then we got derailed and the entire efficiency cost that we wanted to rise as cotton little bit of taken a backseat. However as we begin again ramping it up we believe that EBITDA margin should keep improving over next few quarters. It is also a function of cotton; it is also a function of currency and all so I would not want to put a number to EBITDA margin but two factors (a) optimum utilization of capacities and (b) our structural changes in fixed cost should help us to improve our margin.

Prerna Jhunjhunwala: Last one question on the demand scenario. So we have seen Denim being under oversupply situation over the last few years. Could you give some idea on what kind of, are there any unorganized players coming out of, going out of business, is there equilibrium coming in, in this space and do we see domestic Denim market improving on and on which fronts?

Jayesh Shah: Denim there has always been a situation where many of the capacities which were there were under utilized for a long period of time and that situation as of today, what has happened is some of the plants have shut and as a result the capacity there remained or actual output has remained over at the same levels as they were earlier but to say that there has been a change in structural change in demand supply in India. It is too premature to say, as you see today one of the challenges in India for many of the players had been on the credits in the market and that situation has not undergone a change. So there are players who may want to or maybe selling but the working capital cycles are looking very bad for some of the players. Market conditions have not improved to that extent for us to see comfortable. So our emphasis and focus has been to do more exports and I think you will see on our increased proportion going towards export in coming period from our side.

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

Resham Jain: We have seen a very good improvement in margins despite a very low utilization. So just wanted to understand is it that Denim has seen a significant recovery and as of March our cotton inventory we were little light and also rupee depreciated post that. So is Denim one of the key reasons why the margins are slightly on a better side?

Jayesh Shah: To answer your question in a few parts; one is that yes the cotton for H1 has been soft as you know and currency had a positive impact on the margin. However all the segments that we are in Indian fabrics not only Denim have reportedly sent margins across the board and one of the reasons of course is the input cost but the other reason is also the fixed cost because we are also operating at a much lower fixed cost in comparison to what we were doing last year. So it's a combination of input factors as well as the cost which is a fixed cost which is helping us to improve margin. The other factor is that last year at least a last year; if not the earlier years we were incurring a lot of preoperative cost on our plans, some of the new which is now we are no longer in that negative zone in any of our big businesses that we are in so that is also helping to improve the average return on sales.

Resham Jain: Another just long-term history when we look at the textile margins like few years back, we used to do like 14%-15% margins consistently and over the last 3-4 years we have further done integration in terms of our garmenting business. So if you can just help us understand what might have led to this margin coming down to this extent and also do you think that a lot of these changes which you have done, we can go back to that 13%-14% margin any time soon?

Jayesh Shah: We would want to go to that margin as soon as we can. Let me explain to you that on fabrics the margins are not lower, not so significantly lower from say 15% to 10% nothing of that sort. It is that the garment business that we are doing that is definitely at a lower margins and fabrics because it's a more operating cost business and in the last few years we have been strong expansion mode so we have always had our businesses which was giving us less return than what other mature business were giving and that's a process that is going on even now with the

(Inaudible) 27.25. But other than that there is nothing like that our margins have collapsed and with the cost savings that we have done and as I said preoperative is not been there in any more. We believe that we should be looking at healthy margins in fact.

Resham Jain: So basically because of garmenting business it's optically looking lower?

Jayesh Shah: That is correct.

Resham Jain: Again If I look at the long-term history of the standalone business and you have actually lot of subsidiaries also within textile but the working capital as you have rightly highlighted, it's been quite sticky with domestic market. So you feel that within the existing working capital itself currently the overall turnover is lower but as and when you will reach a slightly higher turnover you can still reduce your overall receivable plus inventory from the current level?

Jayesh Shah: Yes. We are working towards internal plan and we have spoken about that in the past also. In fact if you look at the last financial year, we improved our working capital turns and not the though the turnover was at a higher level, we ended up with more than 5 working capital returns from historical 3.5 or something and that happened because of the improvements that we brought about in every part of our working capital cycle. And even current focus is that we are bringing down working capital as we speak. In fact if you look at H1 also the working capital turn is better than what we have seen in the past. So when we grow to the pre-COVID levels we believe that a very small incremental working capital will be required and not proportionately large working capital will be required for us to grow back to the normal levels.

Resham Jain: My last question is on the CAPEX and the related debt and cash flows. So as you mentioned the CAPEX at least for this year we have just 40 crores in first half and over the next 18 months also it should not be material, is that understanding right?

Jayesh Shah: That is correct.

Resham Jain: When you look at the normalized cash flows, actually your cash flows for the year should be like closer to 600-700 crores in a normal situation and with a minimal CAPEX over the 18-24 months these 1000 crores debt reduction plans looks quite should be sooner than later once market recovers. Is that again a right understanding?

Jayesh Shah: I sincerely wish and hope that you are right.

Moderator: The next question is from the line of Gautam Rathi from CWC Advisors.

Gautam Rathi: I have couple of questions on the Advanced Material business, if you can help us understand better. The first thing is can you give us some color on the order book what you were talking about in the opening remarks on the Advanced Material business like is there some size, if you can give out or what are the type of customers?

Jayesh Shah: Sure, do you have any more questions on AMD?

Gautam Rathi: Yes the second one I had one more which is about the filtration and the composite business of AMD, right. So how do you see that scaling up because like what is the competitive scenario in India for those businesses and because fire protection, I still understand but the other two part of the business. So how do you see that scaling up going forward in the next 3 to 5 years?

Samir Agrawal: The question is around the market unfolding for next 3-4 years on composites and industrial filtration, right?

Gautam Rathi: Right.

Samir Agrawal: Currently at least the part of the market we play in both these segments, we are largely export focused because the products which we are offering are significantly higher quality and also much better engineered. Now not to say that there is not a large enough domestic market but most of that commoditized. So as we kind of see in next 3-4 years our feeling is that so two things will happen, one is that the local consumption for some of these materials will become larger and larger. So if you know today across the gamut of construction and structural applications the metals is still a preferred material of construction but that’s changing very slowly and as your airports and train stations and industrial structures and warehouses start to absorb more composite there will be demand for that Tier I engineered kind of composite to become more and more. So there is going to be a demand creation over next 3 to 5 years but as of now we are largely export focused for the reason.

Gautam Rathi: On the order book of the whole division, if you can give any color?

Samir Agrawal: Order book is pretty robust and healthy. We maintain a good 2 to 3 months at the very least and we continue doing that.

Gautam Rathi: Is it fair to assume that large part of this 2 to 3 months would be for the human production, the fire production part or is it for like equal for each part of the business?

Samir Agrawal: Across the board, Advanced Material businesses are largely B2B businesses. A lot of what we do is serving customers and accounts which are long-standing multi-year accounts on whom we have a fairly good continuing visibility. So across the board I would say what I said applies to the entire portfolio.

Moderator: Thank you. Due to time constraint I now hand the conference over to Mr. Samir Agrawal for closing comments.

Samir Agrawal: Thank you everybody, appreciate you all taking the time and engaging us on this Q2 results. We look forward to meeting you once again in one quarter. Thank you.

Moderator: On behalf of Arvind Limited we conclude this conference. Thank you for joining us and you may now disconnect your lines.