"Indo Count Industries Limited Q2 & H1 FY19 Earnings Conference Call"

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MANAGEMENT: **MR. K. K . LALPURIA – EXECUTIVE DIRECTOR, INDO COUNT INDUSTRIES LIMITED**
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Moderator: Ladies and Gentlemen, good day and welcome to the Indo Count Industries Limited Q2 and H1 FY19 earnings conference call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. K.K. Lalpuria, Executive Director of Indo Count Industries Limited. Thank you and over to you sir!

K.K. Lalpuria: Good Afternoon and a very warm welcome to everyone. A happy Dhanteras to all of you. Along with me, I have Mr. K. Muralidharan – our new CFO and SGA, our Investor Relations Advisor. I hope everyone has got a chance to go through the presentation by now.

Q2 and H1 FY19 has been a mixed period for us. Our major markets USA and EU are showing strength which is visible in our sales volume numbers whereas the revenue and profitability has seen some impact.

Let me start with the sales volume. Our sales volume for Q2 FY19 stood at 15.8 million meters translating in a growth of 9% on YOY basis. For H1 FY19 we clocked sales volume of 30.2 million meters translating in a growth of 15% on YOY basis. From Q1 FY19 to Q2 FY19 we have witnessed a 10% growth in sales volume. Our business is growing, giving us confidence to meet our volume guidance of 58 to 60 million meters for FY19. This growth has been across markets and with the improving trends in both USA and EU.

While we witnessed volume growth, our revenue and profitability performance was impacted. The revenue was impacted due to the following reasons:

Lower government incentives: You may recall that our industry witnessed a slew of withdrawal of incentives for the textile sector in 2017. There was a drop in duty drawback rates in addition to RoSL.

Lower Forex realization: We witnessed huge volatility in foreign exchange in H1. Being an exporter we hedge the currency however most of our hedges happened at the start of financial year when the USD-INR was around 64 levels compared to previous year when the USD-INR rate was higher. This resulted in lower realization on top line by about 2.4%.

Product mix: We witnessed a change in product mix in H1 FY19 which also impacted our top line to some extent.

Cumulatively these three affected our revenue performance; excluding these factors, we would have grown at double-digit on the revenue front translating in a higher growth on EBITDA front as well. Given the high volatility in currency, for which our H2 hedges are at Rs. 68, along with increased raw material prices due to higher levels of cotton prices, we believe H2 performance will be on similar lines. We however remain confident on the growth prospects of the industry and Indo Count as well.

Our domestic business continues to perform well and strengthen our brand profile. As on 30th September 2018, our aspirational brand ‘Boutique living’ is present across multi-brand outlets and large format stores. The brand expanded its footprint to 96 cities and is now present across 23 Indian states.

In 2017 we had destocking which impacted our performance. In 2018 destocking receded but we were hit by lower government incentives and a sharp rise in the raw material and currency volatility. We expect 2019 to stabilize and improve the trends for the industry as well as at Indo Count.

At Indo Count our strength lies in being a focus player in the global home textile market having long-term relationship with global marquee brands. Coupled with our approach of integrated bedding solution, we remain confident to achieve greater recognition in the global home textile market. We are making continuous efforts to strengthen our design and product development capabilities to offer innovative solutions to the retailers’ private level. To deepen our innovative product offerings, we have recently collaborated with Leeds University of the UK for structured research which will help us better our service offerings in the marketplace.

With this I would now like to discuss the financial performance of H1 FY19.

Revenues: H1 FY19 revenues stood at Rs. 943 crores as against Rs. 925 crores in H1 FY18 registering a growth of 2% on YOY basis.

EBITDA: H1 FY19 EBITDA stood at Rs. 114 crores as against Rs. 136 crores in H1 FY18 with margins at 12.1% for six months. The revenue and EBITDA were impacted due to the reasons already discussed in my speech earlier.

Profit after tax: H1 FY19 PAT stood at Rs. 51 crores as against Rs. 68 crores in H1 FY18 with a margin at 5.4% for six months.

We recorded an EPS of Rs. 2.56 for H1 FY19.

Our gross debt stood at Rs. 350 crores as on 30th of September, 2018 versus Rs. 371 crores as on 31st March 2018. Accordingly, our net debt to equity as at 30th September, 2018 was 0.37x.

CAPEX for H1 FY19 was Rs. 30 crores and we expect to spend an additional Rs. 35 to 40 crores in H2 FY19. This includes routine capital expenditure as well.

That's all from my side. I will now leave the floor open for question and answers.

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Vikram S from PhillipCapital. Please go ahead.

Vikram S: Just wanted to understand the cost push in terms of employee cost and other expenditure, so how should we see the trend going forward? And when we say that performance in H2 will be in similar line means are we talking about YOY number or this quarter's number?

K. K. Lalpuria: First of all on the expense side, the power cost in Maharashtra state increased on a per unit basis that's why there is an increase in the power cost. The labor cost has also increased and somewhat the job work expenses also increased because input cost of the supplier also went up with GST and other embedded cost as well which is not refunded or provided with credit.. So the cost went up on the expense side. Now on a YOY basis we are unable to provide you immediately a full guidance for 2019 because of a couple of factors. On raw material cost the cotton season has just started and we were expecting the prices to neutralize at the MSP level which is around Rs. 43,000 to 44,000 but we have seen price levels at Rs.46,000 .. As we expect the arrivals to be faster , we expect the prices to mellow down but so far we do not know China may become a big buyer which would increase the demand from their side. On top of this,there is a 2% reduction in acreage. We need to see the impact of international cotton prices as well. On the Forex side we are witnessing high volatility so we need to ascertain that in the time to come to assess how much will be the impact going forward. So we will be able to give you a full year guidance later.

Vikram S: One more clarity we need is on cash flow hedge and other comprehensive loss is what we have reported is around Rs.91 crs. So can you just explain that and is it everything mark to market or how is that one should interpret?

K. K. Lalpuria: Can we provide the detail off-line Vikram because we do not have much of this detail ready.

Vikram S: Normally if you look at our financial reporting there is other operating income which is always positive but this quarter we have negative so I just want to know how much overall incentive we have received in this quarter and any other changes happening in other operating income?

K. K. Lalpuria: The other operating income was part of our business income. Now because of the lower realization of Forex rate there is no gain on the Forex side and hence the income got wiped off. And the correct number as I mentioned earlier on the Forex side we will provide you later.

Moderator: The next question is from the line of Nitin Agarwal from JM financial. Please go ahead.

Nitin Agarwal: Just wanted to know the status on Phase 2 CAPEX, so how much of the CAPEX has been invested and what's the timeline over next 2-3 years because this was supposed to come up by FY21 if you could just give us a brief on that.

K.K.Lalpuria: As I informed earlier, in Phase 2 we were automizing both spinning and to some extent the stitching unit which is underway ,and for the larger CAPEX on the weaving side, we are still waiting for the Maharashtra government to notify their policies . But so far they haven't notified what is the capital subsidy and the other aspect of the policy like reduction in power rate etc. so we are waiting for that to happen. And being a mega project we intend to get some special benefit as well which we are in negotiation with them. So as and when that comes we will be able to inform you but we believe that the CAPEX will take 18 to 24 months from the time we begin.

Nitin Agarwal: This quarter can you tell me what was the Forex loss due to the hedging?

K.K.Lalpuria: As I mentioned earlier, in H1FY19 the Forex loss was to the extent of 2.4% of the revenue and our realization is at Rs. 68 instead of 69.63 in H1 FY18. Now because the rupee was strengthening in the beginning of the year, everybody took a hedging position almost to 9 to 10 months back and then suddenly the currency reversed from 63.50 and went up to 73.50 which was quite unexpected for everybody in the industry. For H2 also the hedge rate will be around 68 because we are almost 90% covered so this is the position. But in the future year we expect that the range should improve by almost 5% to 7%.

Nitin Agarwal: So we have not entered into hedges for FY20 yet?

K.K.Lalpuria: To some extent , because we have a revolving 12 months hedging policy, so to some extent in the first quarter and second quarter we are positioned. But we believe that in the entire year we should improve our hedge rate by almost 5% to 7% looking at the range bound rupee dollar around 72 to 74.

Moderator: The next question is from the line of Praveen Sharma, who is an individual investor. Please go ahead.

Praveen Sharma: Just wanted to know since we can't hedge individual inventory of cotton which is around 4 to 6 months why do we hedge our revenues when we can't hedge our cost? Is there any way because our revenues are depressed and our cost increased like what is happening in the current quarter, so can you throw some light on that, is there a way we can hedge the quarter? Second thing as you said that we have already started hedging around Rs. 74 for the next financial year. So keeping that in mind and the current cotton cost, what kind of margin impact it will have?

K.K.Lalpuria: First of all I will answer you on the cotton side. Usually if you look at the cotton season, it starts only in November and it peaks in February and March. Now most of the cotton which is bought in the first half is in the end of the season where both the quality differs and the rates are high due to the availability of cotton bieng lower . Nobody takes up a position during that time because the availability is not there. So we cannot take a position and what everybody expects that from November onwards when the cotton crop arrives then the prices would be down. So taking that into consideration we have not been able to hedge enough cotton in the first half because we were expecting the new crop to come in with better quality. Currently,the MSP works out to around Rs.43,000-44,000. Now, last year the average cotton cost was around Rs. 43,000 Candy and we expected once the MSP was declared which was 28% higher we thought that the MSP would be in the similar range so we did not go and book as we expected the prices to be in the same range like last year of Rs.43,000-44,000. But unfortunately the prices of cotton in the beginning went up to Rs.49,000 and then when the crops arrival started it came down to Rs.46,100 which is the current price. So that's the reason we could not take up a position.

Now going forward there are three factors which we need to consider. One is the yield factor and the 2% less acerage, secondly the Chinese buying which will impact because if there is more export then there are chances that the prices would tend to move up and third the international prices of the cotton which have a direct impact on the Indian prices as well. If that moves up the Indian prices also will move up. So we have to wait and see how this pans out and only then we will be able to take up a correct position.

Now your second question was on the exchange rate, as I mentioned earlier we are hedged at around Rs. 68 this year. I mentioned that we would improveit by 5% to 7%.. Markets are concerned with the volatility and its impact on Forex rates on account of state and central election results and then we need to see how also the other international global factors such as trade war between US and China.. So all these factors we need to consider before arriving at a conclusion and that's why I mentioned that we will not be able to provide you a current guidance immediately. We will give you that guidance as and when we get some direction on these factors.

Praveen Sharma: On this mega project I think once we will get approvals for the weaving unit expansion the power cost will reduce for our current unit also, am I right in my understanding?

K.K.Lalpuria: Yes and no, because the mega project is always discussed in an exclusivity because it generates more employment, so we are in discussion with the state. And the state has already declared a policy but then it needs to notify it in the gazzete post which we can take into consideration those benefits. So we are waiting for that. We are in discussion with the state. We have also identified the land for the weaving project but what has happened unfortunately is the rate per unit of power in last one year has gone up by almost Re. 1 in our state. So by giving Rs. 2 per unit subsidy this one rupee has been subsumed. So will they increase it further that is a question for which we need to find an answer. We have to wait and see what Govt. Notifies in the public policy and then only we can check if there would be reduction in the power cost for the existing unit as well as the new unit.

Moderator: The next question is from the line of Pankaj Jain from Mahaveer Investments. Please go ahead.

Pankaj Jain: I wanted to know that the growth on H1 basis has been very strong, so is it fair to assume that you will be able to beat your own guidance of 60 million meters?

K.K.Lalpuria: Yes we have already mentioned that the volumes are to our expected levels so we should be able to clock 58 to 60 million meters as per the guidance given on the volume side.

Pankaj Jain: Can you put some light on the recent collaboration with the Leeds University?

K.K.Lalpuria: Now in the consumer market there is a 360 degrees approach we need to consider and that requires a lot of input from different developments around the globe to satisfy the consumers. We have been a very good company on the innovative and product development side. But we we should do more in order to provide the differentiation to our customers both from a product and service standpoint. So we collaborated with Leeds University which is around 150 years old and has got a heritage in both research and development and this will provide us a platform for structured research just like any other global player. And because the products which are demanded by the consumers today require some sort of functionality and as a company too we are focusing on the sleep and comfort side where we need to authenticate this research so that's why we have done this collaboration and we are quite hopeful that with this collaboration we will be able to produce goods as per the expectation of the market and try to improve the market share of our retailer

Moderator: The next question is from the line of Rohan Shah from Harsh Capital. Please go ahead.

Rohan Shah: I had a couple of questions regarding the financials of the company. The first question is related to the debt of the company so what debt should we expect in FY19 or FY20, can you give some guidance?

K.K.Lalpuria: Our debt is at Rs.350 crores. We are going into smaller long-term debt because currently we don't have CAPEX of a larger scale. But the short-term debt we are trying to reduce through our internal accruals. So that will be the pattern of the debt in the future apart from what we require for working capital. If the volume goes up definitely the working capital requirement will go up and it also depends on how we take a position on the cotton side.

Rohan Shah: Can you give a rough number or something

K.K.Lalpuria: It will be hard to give but on a similar line as you have seen that our gross debt is always on a decreasing trend because as I mentioned as a company we always believed that we should set off some of our debt through our internal accruals, so that will be the pattern.

Moderator: The next question is from the line of Ankit G from Systematix Shares. Please go ahead.

Ankit G: My question with respect to realizations where in an opening comment you said product mix has changed due to which overall revenue also impacted. So does it mean that we have witnessed a good competition on our product line and our product basket and we have gone in competing with the lower products if you can help in understand this?

K.K.Lalpuria: I think the correct evaluation on the product mix will be on an annual basis because we have just now delivered for Christmas season and the Black Friday and the New Year promotions for both US and the EU market. So the correct assessment of the product mix will be only at the end of the year. However as we grow we have been saying that we will have a better exposure in the non-US market because we were at 70%-75% earlier in the US market and the balance percentage in the ROW (rest of the world market). So our intention is to grow the rest of the world market also. While traditionally the US market is a higher thread-count market and in the rest of the world the sales are traditionally the mid-thread count region. So there will be a value difference between those two that will certainly have some impact on the revenues.

Ankit G: My second question with regards to understand that since in a volume terms FY19 will look good but in FY20 do you think so that base effect will start playing out and from there the base will become higher like 60 million meters for the time being we assume and will there be a situation where growth slows down and margins move up as your current hedges will play out next year?

K.K.Lalpuria: First of all our efforts are to increase our global footprints and reach which is showing us signs of success because we have been able to penetrate some of the new markets and new customer base. And secondly we are present in fashion, utility, institutional segments which is providing the customer the necessary confidence because as a company we specialize, we don't generalize the product space. Lastly our constant innovation on the product side and service offering and with a customer centric approach, we presume that in the future this trend should continue. We are quite hopeful of that and we may even do better, if certain situations still improve.

Ankit G: Any guidance in terms of margins for next year because clearly from these two things if I conclude, first one was as the product mix or as the geography changes from US to non-US your realization will go down, probably revenue will also come down as you said. And secondly the base effect….

K.K. Lalpuria: It's not necessary. Sometimes the US does well, sometimes the EU does well, sometimes you get both. There are many things which get changed in the process. So that's the reason we have mentioned that we will be able to give you better idea on the product mix only after financial year end because we deliver a lot of value-added product for Christmas and, New Year and other promotions starting in the third and fourth quarter. So we will be able to provide you a better view on this later.

Ankit G: If you can give us a revenue breakup of US, non-US now and three years before, similarly the fashion, utility and hospitality now and three years before, how was it?

K.K.Lalpuria: On the fashion utility and institutional side we have marginally improved to 14% from what we did last year. So there is an uptick in this, all the other data I will definitely provide you off-line.

Moderator: Next we have a follow up question from Vikram S from Phillip Capital. Please go ahead.

Vikram S: we have seen an increase on the Working capital & receivable days over a period of time, how do you see that going ahead?

K.K.Lalpuria: They are coming down to some extent which we can provide you offline, the number of days..

Vikram S: In terms of dollar pricing for our products on a like-to-like basis is it there a pressure in terms of realization or it's particularly in US?

K.K.Lalpuria: No I do not think that there is a pressure on realization. Of course, in this environment there are lot of challenges but I think with the kind of product development and innovations and differentiation which we do as a company and being a healthy company I think we are quite competitive in the marketplace.

Moderator: The next question is from the line of Sumant Kumar from Motilal Oswal Securities. Please go ahead.

Sumant Kumar: My question is regarding the raw material cost, we have seen the cotton prices increased, the cotton production is also likely to be subdued at this time, so how is the gross margin going forward in the coming quarter, how is the margin pressure currently?

K.K.Lalpuria: If you compare our H1 to H1 on a YOY basis we have done fairly well on the raw material side. Now since the crop is delayed, there is low acreage, there is a mismatch between international rates and Indian rates and this cost also cannot be passed on immediately to the customers plus the Chinese buying will have an impact. So all these factors we need to keep observing and as the crop arrives in higher quantities, then we will get the real idea of how the prices will pan out during the next year. But of course looking at the overall situation, the prices won't be same as per last year. It would be a little bit more because even the MSP has been increased by almost 28% on a YOY basis by the government. So we still need to observe how this entire situation pans out and we will keep you updated on this.

Moderator: Thank you. As there are no further questions, I would like to hand the conference back to the management team for closing comments.

K.K.Lalpuria: At Indo Count we are confident of growth going forward on account of multiple levers

(i) Leveraging our capabilities with cost efficient manufacturing and strong market presence,

(ii) Enhancing our focus on the fashion, bedding, utility and institutional businesses whose share in overall revenues is steadily increasing

(iii) Strengthening our brand and service our customers with innovative designs and solutions.

I take this opportunity to thank everyone for joining the call. I hope we have been able to address all your queries. For any further information kindly get in touch with me or SGA, our Investor Relation Advisors. Wishing you once again a happy Dhanteras and a very happy Diwali and a prosperous new year. Thank you.

Moderator: Thank you very much. On behalf of Indo Count Industries Limited that concludes this conference. Thank you for joining us ladies and gentlemen, you may now disconnect your lines.