"Indo Count Industries Limited
Q2 & H1 FY20 Earnings Conference Call"

November 13, 2019

MANAGEMENT: MR. K. R. LALPURIA - EXECUTIVE DIRECTOR & CHIEF EXECUTIVE OFFICER - INDO COUNT INDUSTRIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Indo Count Industries Limited Q2 & H1 FY20 Earnings Conference Call. This conference may contain forward-looking statements about the company which are based on the beliefs, opinions and expectations of the company as in the date of this call. These statements are not the guarantees of future performance and involved risks and uncertainties that are difficult to predict. As the 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 "*" and "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. K. R. Lalpuria - Executive Director & CEO of Indo Count Industries Limited. Thank you, and over to you Sir!

K. R. Lalpuria: Good afternoon and a very warm welcome to everyone. I am happy to connect with you all once again to discuss the Q2 FY20 performance. I hope everyone must have got a chance to look at the presentation and press release by now.

Let me start with giving you some industry perspective and then move on to our strategy. Despite global challenges, retail demand in US and EU are stable. On the back of increased efforts and sustained strategies, we were able to achieve a volume growth of 4% for the first half of the financial year and 11% in Q2 FY20.

Our approach to value addition through innovative products, modern designs and functional products is helping us to strengthen our relationship with marquee global brands and we believe our approach to doing business and strong relationship with clients will help us to maintain an edge in global markets. Our focus continues towards increasing utilization levels and increasing the share of value-added business in our revenues.

I am happy to announce that our company has won two gold trophies from TEXPROCIL for the year 2018-2019 for highest export performance in bed linen, bed sheets, quilts from India and a special achievement award in the Made-Ups category for promoting Indian Home Textile Industry abroad.

With the focus on ensuring environmental sustainability, our company has joined "Walmart's Project Gigaton" to reduce greenhouse gas emissions resulting from manufacturing operations and supply chains. The company has been recognized "Giga-Guru" status for contributions made towards environmental sustainability.

The company has collaborated with CITI CDRA the apex textile body to launch “Project GAGAN” to improve sustainability in cotton farming for farmers in the state of Maharashtra. These initiatives will help farmers in increasing productivity of their farms along with the judicious use of water, pesticides and fertilizers.

The company continues collaboration with the University of LEEDS, UK to provide the technology platform to enhance innovation capabilities and to deliver new and exciting products into the home textile sector in the years to come.

Now coming to the financial performance.

Starting with the volumes - For the quarter ended September 30, 2019, we have clocked volumes of 17.6 million meters as compared to 15 million meters in Q2 FY19, a growth of 11% on a Y-o-Y basis. For H1 FY20, volumes stood at 31.5 million meters as compared to 30.2 million meters in H1 FY19. We continue to maintain our FY20 volume guidance for 63-65 million meters

Consolidated total income - For H1 FY20 consolidated total income stood at Rs.1,106 Crores against Rs.986 in H1 FY19, a growth of 12% on a Y-o-Y basis.

Consolidated total income for Q2 FY20 stood at Rs.587 Crores as against Rs.509 Crores for Q2 FY19 registering a growth of 15%.

Consolidated EBITDA - We are pleased to inform that the company has reported an EBITDA of Rs.154 Crores for the first half of the financial year as against Rs.166 Crores for year FY19.

Consolidated EBITDA for H1 FY20 registered a growth of 27% and stood at Rs.154 Crores versus Rs.121 Crores for H1 FY19, EBITDA margin was at 13.9% in H1 FY20 versus 12.3% in H1 FY19 registering a growth of 162 BPS on a Y-o-Y basis. Consolidated EBITDA for Q2FY20 registered a growth of almost 50% and stood at Rs.82 Crores versus Rs.55 Crores for Q2 FY19. EBITDA margin was at 14% in Q2 FY20 versus 10.8% in Q2 FY19 registering a growth of 323 BPS on a Y-o-Y basis.

Exceptional item of Rs.94.27 Crores - The exceptional item represents Rs.94.27 Crores provided against refund of excess export benefits of earlier years by way of MEIS claim to the extent of Rs.72.68 Crores along with interest thereon against the adjudication order passed by the Office of the Commissioner of Customs.

Consolidated PAT for the quarter stood at Rs.11 Crores as against Rs.26 Crores for Q2 FY19. Consolidated PAT for H1 FY20 stood at Rs.45 Crores as against Rs.55 Crores for H1 FY19. However, PAT figures are not comparable due to the exceptional item pertaining to the refund of excess export benefits of earlier years.

PAT of H1 FY20 also considers the tax credit on current tax on said refund and reduced deferred tax due to the company opting for reduced corporate tax as per the recent direct tax ordinance.

Net debt - The net debt position of the company as of September 30, 2019 stands at Rs.398 Crores. The net debt to equity ratio is at 0.4x.

Capex - For H1 FY20 the capex spend was Rs.10 Crores for the full year. We expect the maintenance capex spend to be in the range of Rs.25 to Rs.30 Crores as guided earlier.

That is all from my side. I now leave the floor open for the questions and answers.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We have a first question from the line of Lokesh Manik from Vallum Capital. Please go ahead.

Lokesh Manik: Good afternoon Sir. Thank you for the opportunity. Sir just a clarification from my side, the extraordinary item which is reported is this a cash expense or would this be accruals just to take the detail?

K. R. Lalpuria: So, we have paid from our cash accruals only.

Lokesh Manik: Okay so this is not the cash flow as it would pertain in the cash flow statement?

K. R. Lalpuria: It is a cash outflow, but it is paid out of the internal cash accruals, we have not taken any debt for the payout.

Lokesh Manik: Understood. That is, it from my side Sir. Thank you so much.

Moderator: Thank you Sir. We have a next question from the line of HR Gala from Finvest Advisors. Please go ahead.

HR Gala: Hello Mr. Lalpuria. Congratulations for a really good performance before the exceptional items. Sir just a couple of things, you said that the environment on the retail side is quite stable in both US and Europe, but do you see that the current economic conditions, which are prevailing in these countries, could sustain the type of growth that we anticipate?

K. R. Lalpuria: I believe this could sustain because India is a largest cotton producer, we have an established spinning industry, textile is a traditional industry backed up by skilled labour. We have performed well over the period of last two decades in Home textiles particularly we have gained a good market share in both the US and the European market. In the European market there is competition especially in the lower end of the market because of the duty differences between India, Pakistan and Bangladesh and steep depreciation of Pakistani rupee but we feel that India is well positioned as a country to export cotton textiles provided we have a lending support from the government. We do have and I hope we will do better in the years to come. Of course, there are some challenges as far as the trade barriers are concerned but we are well positioned and the market is stable.

HR Gala: Sir what is the current position as far as the export incentives are concerned? How is the export incentive total under say MEIS, RoSCTL, duty drawback, etc., that we are currently getting?

K. R. Lalpuria: The refund of duty has been recently extended for both central levies and state levies and earlier the drawbacks also were provided on the refund of custom duties and the MEIS to the extent of 4%.Now due to the WTO guidelines, India will have to give up the MEIS in the near future and India has also lost the case against the US to appeal, with respect to export subsidy schemes in vogue. As there is no new update for us, we are waiting for the government to announce compensatory programs which we believe should come post December, so we will be able to guide you much better post December on this incentive front. But there is no new update as such so far, it is continuing in the same manner as it continued in the beginning of the year.

HR Gala: So, duty drawback totally we have 2%?

K. R. Lalpuria: Yes around 2.5%.

HR Gala: 4% is MEIS?

K. R. Lalpuria: Yes.

HR Gala: And how much is RoSCTL?

K. R. Lalpuria: RoSCTL, totally 8.2%.

HR Gala: So all put together is about 14%, right?

K. R. Lalpuria: Yes.

HR Gala: Okay. So that is the amount which we accrue in our books and show in other operating revenue. Am I right Sir?

K. R. Lalpuria: For different products, there are caps in the RoSCTL, and for different items, the incentive structure works differently, so the average is around 12.5%.

HR Gala: All put together.

K. R. Lalpuria: Yes, because MEIS scrips have been selling at a discount this year, and accordingly, there is a discounted rate in the book.

HR Gala: Yes. Okay. I understand. Now Sir another question is how much foreign exchange gain or loss is sitting our other income in H1, which has increased from Rs.16.38 Crores to Rs.30.22 Crores?

K. R. Lalpuria: The forex is around Rs.26 Crores in H1 overall.

HR Gala: Against how much it was in H1 of FY19?

K. R. Lalpuria: It was around Rs.11 Crores.

HR Gala: Another question as you said that you have adopted the new tax rate as announced by the government, so basically because of this 94 Crores provision, the amount of tax liability comes negative, so now what will be the effective tax rate if we have to ignore that effect on the exceptional item, how much it would be in our case?

K. R. Lalpuria: 25.17%.

HR Gala: Okay. On the normal profit what should we consider?

K. R. Lalpuria: 25.17%

HR Gala: And then you will not be getting any benefit of the earlier years MAT liability etc., deferred tax assets and all that. How will that work out?

K. R. Lalpuria: We do not have carry forward MAT credit or DTA in our books. As such, our new tax rate will remain at 25.17%

HR Gala: The last question is our debt has also increased, you said that we have paid this Rs.94 Crores out of internal accruals, but if you see our total borrowings has increased in September 30, 2019. So basically, what are the reasons because our inventory, etc., has not grown up that much?

K. R. Lalpuria: No. The inventory has also gone up because of the volume of the business increase and second thing is that to some extent there are some government receivables, which are still to be received.

HR Gala: One is the inventory, and your other current assets have substantially increased from Rs.124 Crores to Rs.207 Crores, so that is on account of some things to be received from the government?

K. R. Lalpuria: Yes, please.

HR Gala: So overall how do you see the current year in terms of profitability that we have achieved of about 13.9% at EBITDA level, could we sustain throughout the year?

K. R. Lalpuria: See we have given a guidance of 12% to 14% earlier. So, we maintain that guidance on the EBITDA level and we are cautious about many things like the government policies, the overseas trade impact, the government subsidies, foreign exchange volatility and the other trade impacts happening around us; so there are some moving averages but we are keeping our fingers crossed. We are concentrating on our business and on our customers and our customer centric approach, we feel, will always help us to gain more grounds and market share in the overseas market.

HR Gala: Correct Sir. So, the last question any thinking on the new project to be started?

K. R. Lalpuria: Nothing on board as of now.

HR Gala: Okay Sir. Thank you very much. Wish you all the best.

Moderator: Thank you Sir. We have a next question from the line of Lokesh Manik from Vallum Capital Advisors. Please go ahead.

Lokesh Manik: Thank you again Sir. Just a couple of queries mainly on the strategy side, as I understand we have been facing problem with exporting to European countries and the reason is the duty structure and it has been going on since a lot of time. Have we considered setting up a plant in Bangladesh instead to tap the opportunities there?

K. R. Lalpuria: No. Not yet. Because we have adequate capacity where we have invested in India and we have a fairly large capacity to cater to our customers at the moment and we have not thought about going into in any other country, and Bangladesh is also a country where the Companies work on labour arbitrage and also on the benefits of duty in the importing countries like Europe and UK. So once the duty structure is rationalized, we get a level playing field. I think we will be competitive similar to them and once the country moves from the status of developing nation to a developed nation, the labour arbitration also will go away so it will be on similar lines to India and lastly you see Bangladesh does not have any raw material of its own. It imports raw material. So, I think that is a big disadvantage to Bangladesh.

Lokesh Manik: So, is there an import duty in Bangladesh if people in Bangladesh are importing from India for cotton?

K. R. Lalpuria: Of course, there is a small duty component. I do not know the exact number, but there is a duty component.

Lokesh Manik: So, they would be importing from China then?

K. R. Lalpuria: I do not know. But I would love to know that.

Lokesh Manik: Sir the second query was on the products that we are supplying to the retail as Wal-Mart of the world. We are mainly dealing in thread counts of 300 plus. So, is there an opportunity to enter below these thread counts?

K. R. Lalpuria: Product mix keeps on changing as per the consumer demand and there are different types of products at different times of the year being exported from India. India is very competitive on the higher thread count product range. However, once the synthetic duties get rationalized in India, polyester will become cheaper here I think India will be able to compete with the other countries who are exporting at the lower end of the market and also there is a big gap in Pakistan about their rupee getting depreciated to a large extent, so they have suddenly become competitive again for some of the Indian products. But I think India is well positioned and has performed well and I think it should do well in the years to come.

Lokesh Manik: Okay and in the US market, are we seeing competition from these countries, Bangladesh, Pakistan and Turkey?

K. R. Lalpuria: Not yet. They are in the lower end of the market and Bangladesh, we do not feel is any player of recognition over there, because their main concentration is in the UK and EU market where they are duty free and at the lower end of the market.

Lokesh Manik: Okay. So, you are seeing that once the duty structure with respect to polyester comes into play, we will be looking at lower thread counts, but you are seeing low thread counts are entering that market?

K. R. Lalpuria: We have a complete product range and we provide end to end solution to our customers. So, whenever they demand any product, we have to supply. So, we are competitive except for duty tariff which are not competitive enough to support these exports. And also, there is some good news from the government that when they have walked out of RCEP they have declared that they will discuss FTA with Europe and UK, so there is some good news which we expect in the years to come.

Lokesh Manik: Okay and the government incentive on RoSCTL have we implemented?

K. R. Lalpuria: The notification is there of course so it is clear that it is implemented.

Lokesh Manik: And what would be the current raw material situation in India for cotton?

K. R. Lalpuria: From what we hear from the sources is that the cotton crop is good. There is an increase in acreage of up to 14%. The season has just started. So, the cotton prices are pretty low as of now. But we need to watch about the flood and rain situations, how it pans out on the crop. So, we are watching it closely about the prices on the cotton side. I think it should be stable and we should see raw material prices on an annual basis as it averages out from season to season.

Lokesh Manik: Correct. That is, it from my side Sir. Thank you.

Moderator: Thank you. We have a next question from the line of Pankaj Jain from Mahavir Investment. Please go ahead.

Pankaj Jain: Thank you for the opportunity. Sir I have two questions. The first being, Sir what would be our share of value-added fashion utility and institution?

K. R. Lalpuria: Last year it was 14%. Now it has come up to 15% level.

Pankaj Jain: Sir that would be for H1 or Q2?

K. R. Lalpuria: For H1.

Pankaj Jain: Since we have done good volume growth in Q2 FY20, what would be your volume guidance for FY20 and FY21, any sense on that?

K. R. Lalpuria: See we have already given a volume guidance of 63 to 65 million meters, which we are maintaining. As we move ahead, we will provide you with further guidance at appropriate times for the next year.

Pankaj Jain: Okay Sir. Thanks a lot.

Moderator: Thank you Sir. We have a next question from the line of Chintan Desai from Param Capital. Please go ahead.

Chintan Desai: Good afternoon Sir. Sir our other current assets have increased from Rs.124 Crores on March 31, 2019 to Rs.207 Crores. Can you give us the split as to what would be export incentives recoverable and balances with VAT?

K. R. Lalpuria: I do not have the figures readily available, but we can give you offline. But it is mainly due to as I mentioned earlier because of some of the government receivables which are held up and also GST to some extent.

Chintan Desai: Basically, the mix would be the same as it was last year, right?

K. R. Lalpuria: Yes. It would be the same but only because the funds are held up so I think once they get released, the current assets will come to the same levels.

Chintan Desai: Sure. That is, it from my side. Thank you.

Moderator: Thank you. We have a next question from the line of HR Gala from Finvest Advisors. Please go ahead.

HR Gala: Sir just wanted to know is there any change in our forex hedging strategy?

K. R. Lalpuria: No, we are still maintaining hedging policy to cover 65 to 70% of our exposure and that is moving on well and that is for 12 months forward, we see a range bound rupee so it is stable out there but we never know. We will take appropriate hedging decision as we see how we pan out in our businesses going forward.

HR Gala: Okay. Sir as far as the debt is concerned, is it on rupee borrowing or do we have any dollar borrowing also?

K. R. Lalpuria: No. We have only rupee borrowing.

HR Gala: We do not borrow from outside.

K. R. Lalpuria:` No.

HR Gala: Okay and what is our average cost of debt?

K. R. Lalpuria: The average cost of debt is MCLR linked and is at 8.3%. We get a subvention of around 3%. So, it should be net-net around 5.3%.

HR Gala: So, this is applicable on all the loans that we have contracted or the recent ones? And is it for working capital or term loan?

K. R. Lalpuria: The average cost of debt for both working capital and term loan is around 6%.

HR Gala: So the current liability borrowing will be basically all working capital?

K. R. Lalpuria: Yes.

HR Gala: Okay. I understood that. Sir another question is on a long-term perspective, how would you see the Indian market where we have started the retail initiative, so how do you think that the thing is going to grow in future?

K. R. Lalpuria: We are at a nascent stage on the domestic front, of course, we are taking adequate steps to improve this business. As and when we get some traction, we will definitely report. Our focus is still on the export business because the market is conducive and there are products out there and we are growing that business. In the domestic front also, we feel there is a large market but it is fragmented and as an organization we are taking appropriate steps to increase the business.

HR Gala: No. That is fine. But do you see any sizeable traction happening over next few years?

K. R. Lalpuria: Of course. It should grow at 9% to 11% looking at the change in the consumer behavior buying pattern, the middle class getting stronger and urbanization; so all this will help to grow this market, so we do see that the home textile market would grow in India and so that is the reason we launched this aspirational brand "Boutique Living". We are quite confident that in the brand space, we will do well, as there are only few brands existing in this space.

HR Gala: In our annual report for FY19, we gave the geographic breakup of revenue, there we have given, the India revenue as Rs.54 Crores. So, was it out of this retail initiative that revenue Rs.54 Crores?

K. R. Lalpuria: That is mainly from the yarn division.

HR Gala: That is yarn. Okay.

K. R. Lalpuria: Yes, because we do sell yarn in the domestic market and in exports as well, mainly of the yarn division.

HR Gala: Okay. So, there is much of retail sales included there?

K. R. Lalpuria: Somewhat we have retail sales also.

HR Gala: How much it could be roughly?

K. R. Lalpuria: I have to check the figures Mr. Gala, I will tell you offline.

HR Gala: Amongst the Indian players, how is the competition in the overseas market where we are operating?

K. R. Lalpuria: See India is well positioned as I said. We are almost at 50% of the market share in the sheet market in US. So, we have a commendable position and among all the Indian companies we all have different business models, we offer different product categories and we all have different strategies but Indian companies are very well respected because of its strong manufacturing base, because of a strong raw material base and also because India has performed well in the last two decades. India is very competitive at the moment and all the need base items are not being manufactured overseas in the developed nation so the manufacturing has shifted to the Asian countries and 85% of the exports are happening out of four Asian countries that is China, India, Pakistan and Bangladesh and of late Vietnam has also got added because of slowing down of manufacturing in China due to the pollution norms. So, I think India is well positioned in raw material, in exporting all these products to the export market and all the companies I think are doing well and they are well positioned out there.

Moderator: Thank you. We have a next question from the line of Nehal Shah from Edelweiss Financial Services. Please go ahead.

Nehal Shah: Thank you so much. Congratulations on a good set of number Sir. Sir if I compare your volume growth for this quarter of the first half, to how the industry data in terms of what it pans out, we have definitely done much better and especially considering that most of our exports are to the US geography I assume, so in that context could you highlight we have incrementally got any more orders this year compared to last year or would there have been customers, which have been added?

K. R. Lalpuria: I would say both aspects stand true as we always look out for new customers, new territories, and we also build our business with our existing customers. There is consolidation happening in every businesses and the retailers to whom we are already delivering complete end to end solutions, are looking out for other product categories to buy from us such as fashion and utility bedding apart from sheets. We are getting a good traction and we have increasing interest from the existing customer and we are also building with new customers and new territories.

Nehal Shah: Absolutely. So most of the volume growth or our revenue mix between Europe and US and ROW is more or less similar or is it changed compared to last year?

K. R. Lalpuria: No. In the US as we had mentioned earlier, we are doing around 70% plus and in Europe we are doing around 20% and 10% in the Rest of the World. So that is pretty defined well.

And of course, as we have mentioned earlier we are trying to increase our footprints into the other areas also.

Nehal Shah: In terms of our volumes that we have reported a 5% growth H1 so is it similar across our exports to US and Europe or is that Europe has seen a higher growth?

K. R. Lalpuria: Absolutely. We have maintained because similar efforts are being put into each area so we intend to grow the business apart from the US and we always look out for new territories if the equation works.

Nehal Shah: Absolutely. So just one last question in terms of the domestic market Sir, how is your domestic venture progressing and what is the kind of growth we have clocking there, any new initiatives that you are taking to further penetrate that segment?

K. R. Lalpuria: See as I mentioned earlier to Mr. Gala, we are taking appropriate steps in order to grow this business because India is of course a large market even though it is fragmented and there are challenges in distribution and branding. We as a company are still focused on the export side. Looking at the market size, we are quite optimistic that in the years to come, we will grow our business in the domestic front also. We cannot give you just a clear number of how much the growth would be at this moment of time because as a company we are strategizing how to improve our numbers Pan India by spreading our branded product into different MBOs. We are taking appropriate steps and as and when, when we have good numbers, we will come back and report.

Nehal Shah: Thank you so much Sir. I will get back into the queue Sir for further questions.

Moderator: Thank you. We have a next question from the line of Atul Kothari from Progwell Securities. Please go ahead.

Atul Kothari: Thank you Sir for the opportunity. Sir you have mentioned on sustainability initiatives in your presentation, Sir may I know as to what benefits you are seeing on account of this?

K. R. Lalpuria: Sustainability is a global concern today and everybody, every company, every country is looking towards this change as a big challenge. We are all impacted in our day-to-day life, so as a company we are committed to sustainability. Since last two to three years, we have taken adequate steps with all our customers by joining hands with them into different initiatives taken by them. With big customers like Wal-Mart and Target, we had joined hands with them in order to reduce the carbon footprints and the utilization of energy, conservation of energy then water conservation, so all these things which are turning into a scarcity and which are troubling the business dynamics. We as a company are committed to sustainability and that is why we have reported in our investor deck on what we are doing and we will keep on reporting on this area.

We have also launched a sustainable cotton initiative called "GAGAN" which is a backward integration into connecting with the farmers of our country. This was launched in Chandrapur district in Maharashtra state where we are going to secure our supply chain towards BCI cotton. We have started with BCI cotton and we will grow that to organic cotton as well in the near future. So, we will keep on reporting about our sustainable initiatives, which are very important from the company's standpoint.

Atul Kothari: Okay Sir. Sir if you can throw some light as to what is the share of our business in India?

K. R. Lalpuria: India business is at a very nascent stage, as I said earlier, I do not have the figures right now but we will report that to you offline.

Atul Kothari: Sir lastly what is your status on the mega product capex which we had panned earlier, any updates?

K. R. Lalpuria: We had already provided that update that the board has withdrawn the proposal to go ahead with the 200 Crores capex in phase 2 and we have already reported that in the last quarter itself.

Atul Kothari: Okay. It has been delayed for, now right?

K. R. Lalpuria: Yes. It has been postponed.

Atul Kothari: Okay. Thank you very much. That is all from my end.

Moderator: Thank you Sir. As there are no further questions from the participants, I would now like to hand the conference over to the management for closing comments. Sir over to you!

K. R. Lalpuria: At Indo Count, we are expanding our footprint to newer geographies and penetrating deeper within the existing ones. Our focus going forward continues towards increasing our utilization levels and increasing the share of value-added business in our revenue.

Once again, I would like to reiterate our volume guidance of 63 to 65 million meters and we are optimistic on the future performance of the company.

We believe our approach to doing business and strong relationship with customers will help us to maintain an edge in global market. With this, I would like to thank everyone for joining on the call. I hope we have been able to address all your queries. For any further information, kindly get in touch with me or Strategic Growth Advisor or our Investor Relation Advisor. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, on behalf of Indo Count Industries Limited that concludes this conference call. Thank you for joining with us and you may disconnect your lines.