Transcript

S.P Apparels 3QFY20 Post Results Conference Call

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Pavitra: Good day, ladies and gentlemen! I am Pavitra, Moderator for the conference call. Welcome to S P Apparels Q3 FY 2020 post-results conference call hosted by Batliwala and Karani Securities (I) Pvt. Ltd. At this moment, all participants are in a listen-only mode. Later we will conduct a question & answer session. At that time, if you have a question, please press STAR then 1 on your telephone key-pad. Please note that this conference is recorded. I would now like to hand over the floor to Ms. Prerna Jhunjhunwala. Thank you and over to you, ma'am.

Prerna Jhunjhunwala: Thank you, Pavitra! Good afternoon everyone! On behalf of B&K Securities, I would like to welcome you all to the 3Q FY20 post- results conference call of S P Apparels Ltd. From the company, we have with us the senior management including Mr. P. Sundar Rajan – Chairman & Managing Director, Mrs. S. Lata – Executive Director, Mr. S. Chenduran – Director, Operations, Mrs. P. V. Jeeva – CEO, Garments Division, and Mr. V. Balaji – Chief Financial Officer. I would now like to hand over the call to Mr. P. Sundar Rajan for the initial comments. Thank you, and over to you, sir.

P. Sundar Rajan: Thank you! Good afternoon everyone! Thanks for the participation in the call. This quarter has been very tough because of both revenue de-growth and PAT margins coming down on account of withdrawal of MEIS retrospectively with effect from March 2019 by the Central Government. Let's now do a review of the performance of each division. Garment Division – With regard to the customers, we are going steady with our existing customers. However, unfortunately, there has been a setback from the customers Mother Care and K-Mart, who has gone to Administration. Due to this reason, there has been a reasonable decline in our revenue for this quarter. This came suddenly and it was too short a period for us to make up from other customers. We have been able to manage this setback by increasing our exposures with new customers like (Inaudible 2.25) in addition to Prime Art. So, the sales will be restored from the Q1 of FY 2020-21. Going forward, we should be able to grow at the pace we have already indicated. One of the new customers has committed to grow the business in India considerably, and we are one of the new preferred business partners for them. They have asked for more capacity and we are expecting them to complete the audit of a few factories this month and then the production should commence soon. Another new customer has also planned for a 40% growth of kids wear business in India and has given an indication that they will increase their business with us. They have also approved one big factory for future business. The current order book is Rs. 220 crores. With regard to the capacity, our current capacity is 5100 and our capacity utilization is around 59000. Financial performance – Garment Division's adjusted revenue stood at Rs. 146 crores which de-grew by 20% on year-on-year. And the adjusted EBITDA stood at 17.4% for this quarter. The margins comparing last quarter decreased by 70 bps. The major reason for revenue coming down was due to two of our customers namely, Mother Care & K-Mart went into Administrationand order booked by them during the current quarter was not able to be delivered. The other reason is due to the government's recent decision to roll back incentives given to the textile exporters – garment exporters under MEIS schemes, we have taken a revenue loss of 4 crores during this quarter. The other MEIS which was on retrospective effect from March 2019, which we had to take a write-off of Rs. 9.7 crores which also hit our bottom-line. With regards to the retails, store-retails we have 32 COCO stores and 12 FOFO stores as of December 2019. We had 362 large format store doors as of December 2019. Financial performance of retail - total revenue for this quarter stood at 22 crores, as against the sale of 25 crores Year-on-Year. EBITDA for retail stood at 10.6% for the current year. Retail division hive off – the company's management and the board have extensively reviewed the performance of retail division and the said division's return of capital employed is relatively low. And hence, the Board of Directors have concluded to hive off the division. The decision was taken due to the requirement of continuous growth capital for retail division towards creating a larger distribution network, investment in brand awareness, investment in new brands and additional working capital requirements. Considering the amount of capital employed and capital requirement, the Board of Directors of the company at their meeting held on 23rd of January 2020, decided to sell, transfer its retail division as a going concern, on a slump sale basis to M/s. S P Retail Brands Ltd. The buyer has an interest in acquiring the business of the company subject to such approvals as may be required. Scheme of the settlement of this hiving off – The amount of capital employed in retail till December 2019 is 84 crores including an intangible value of 3 crores. The total consideration of the deal will be Rs. 81 crores. The total consideration will be settled by S P Retail Brands Ltd. partly by cash and a portion by way of compulsorily convertible preference share in S P Retail Brand Ltd. The cash portion will be Rs. 56 crores and off-the-cash settlement portion will be Rs. 31 crores which will be paid immediately and 25 crores by deferred payment with interest of 8%. Equity holding in that company has been planned to share any upside valuation in the future of S P Retail Brands Ltd. Let's go to S P UK business operations. S P UK financial performance - The revenue of S P UK for the quarter ended was; GBP 1.4 million, which against last quarter performance was GBP 1.2 million revenue, and margins are 3.4%. This division is promising and will grow at a better rate. The future outlook of the S P UK operations – The business model continues to grow steadily. And the retailers are looking to increase the sourcing through full-service vendors i.e. importers in order to source efficiently by (inaudible 8.21) proper mix-up, direct sourcing and landed deliveries. We continue to increase the customer base globally and planning to mitigate currency risk by sourcing from various countries. Thank you! Now CFO will brief you on the financial performance of each division. Thank you!

V. Balaji: Good afternoon,everybody! Q3 performance – S P Apparels reported a revenue of Rs. 181 crores for this current quarter as against Rs. 118 crores of revenue in Q3FY19. Garment division showed revenue of 145 crores, as against revenue of Rs. 182 crores. Retail division clocked revenue of Rs. 22 crores as against Rs. 25 crores revenue the same time last year. And S P UK revenue was at Rs. 13.4 crores as against Rs. 11 crores of last year. Our adjusted EBITDA margin stood at 17.4% for the current quarter as against 18.1% on a YoY basis. The retail division EBITDA margin stood at 10.6% against 3.3% YoY. S P UK margin stood at 3.4% as against 7.1% YoY. 9MFY20revenue stood at Rs. 661 crores as against Rs. 595 crores, which is a 9% growth on a YoY basis. Garment division revenue stood at Rs. 557 crores as against Rs. 495 crores, which is 12.5% growth on a Year-on-Year basis for 9 months. Retail division revenue stood at Rs. 65 crores as against Rs. 61 crores which is 6.3% growth on a 9 months basis. Garment division EBITDA for 9MFY20 stood at 15.6% as against 18.1% for 9MFY19. Retail division EBITDA margin for 9MFY20 stood at 6% as against 5.8%for 9MFY19. S P UK 9MFY20 EBITDA margin stood at 3.8% as against 7.2% last year. The Performance of each division has already been explained by the Chairman. I would like to give you details on the gross debt. As on this date,, the gross debt is Rs. 164 crores and the net debt is Rs. 147 crores. The current working capital is Rs. 250 crores i.e. including stock, receivables minus my payables. The net working capital is 250 crores. (Inaudible 11.35) March 2019, our net working capital was 273 crores. I will just brief you on the retail division hive-off. The retail hive-off will have a significant improvement in the ROCE of the Garment division. The ROE will improve and the working capital cycle will come down drastically.There is no pledge of shares by the promoters for the retail division hive-off. Rest other data is available in the presentation. We can go to the questions & answers.

Pavitra:Thank you, sir! Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone key-pad and wait for your turn to ask the question. If you would like to withdraw your request, you may do so by pressing * and 1 again. I repeat, ladies and gentlemen, if you have a question, please press * and 1 on your telephone key-pad. We have the first question from Riddheesh Gandhi from Discovery Capital. Please go ahead.

Riddhesh Gandhi:Hi, sir! Can you give us an indication of the level of confidence you have of bringing back and replacing orders from your two clients gone into bankruptcy? And effectively speaking also, if the overall profitability of those new orders will be in line with what the old orders were?

P. Sundar Rajan: Yes. Exactly. The new customers means… I mean recent customers. We are already working with them. Just recently started, I think we are doing for the two seasons. So, they are in growth mode. Just started two seasons. So, they are waiting for the performance of us for them to increase the business. So, overall, it will not have any impact on margins by adding new businesses to new customers. There will not be an impact on the margins.

Riddhesh Gandhi: Got it. And how long in … and effectively because you have already been with them for a couple of seasons, and each of your facilities are audited, you expect this ramp-up to happen reasonably quickly?

P. Sundar Rajan: Exactly, they have been doing as I told you for 2 seasons. Just they are working with 1 factory for each customer. Just for trial for both of us. And now everything you know, has been mutually satisfied. So, they have approved more than… another one or two factories and they are getting ready for this. So, it will ramp up quickly from let's say before end of Q1. The production will start from… additional quantity may be in May – June.

Riddhesh Gandhi: Got it. And how long before it becomes completely normalized? Or by April-May, we can expect all of the demand which we had lost to be again on similar lines?

P. Sundar Rajan: Yeah. They have decided to increase the business. So, straight away, the business will start coming.

Riddhesh Gandhi: Ok. But what I am asking is, we would have lost customers who are about 7 to 8% of revenues. We would expect to get all of that back by April – May? Or that might take slightly long?

P. Sundar Rajan: I think they will start placing the orders during the month of April. For production May & June and shipments in July – August.

Riddhesh Gandhi: Got it. So, then, we should be at that point filled up the idle capacity that we have.

P. Sundar Rajan: Exactly, like, as I told you, it was too short time for us to make it up from the business of Mother Care and K – Mart which we lost. Because, their way of working…

Riddhesh Gandhi: We have enough clients looking to increase…

P. Sundar Rajan: Yes exactly. But they need some time because they closed their order placing well ahead. So, suddenly if we go back to them, they will say to wait for the next season to come. Because we have completed all the orders placed. Mother Care, although they have gone for administration, immediately they have, within a week's time, started another company Mother Care Global. Actually, the Mother Care business model… like they were basedin the UK, their UK business was de-growing but their international business was very strong. They have been very strong even now. So, they did not want to lose the opportunity. So, what they did is, they started another company called Mother Care Global and wherein they are going to start placing the orders against LC terms. Safely, against LC terms for international business. And we have very good hopes for those businesse to grow because they are our business partners for many years and our products are very much liked by their international business partners. So, that will be another additional business. They will also take some of the stuffthat we produce for Mother Care UK. That will also be gradually taken by them.

Riddhesh Gandhi: Got it. And the last question was with regards to your new facility. You know, you had teething issues. You know, initially for a couple of quarters, so I guess it is always the case,as you are ramping up your new capacity. Is that now behind us or, is it still?

P. Sundar Rajan: One second… Can you say the name, please?

Ritesh Gandhi: No, in your new facility which you have started, right? Effectively speaking as I recall, there were initially a few teething issues a few quarters back where we had to air-ship a few products. And effectively, as they were new employees, productivity was overall lower, which is why EBITDA was lower than expected in terms of new facility a couple of quarters ago. I just wanted to understand whether now there is a normalizing?

P. Sundar Rajan: Yes, exactly. You are right. So, the last quarter, for the drop in the margin, one of the main reasons was due to lack of the workforce, where we could not manage for an order already booked. Now everything is back on track. I think in this quarter, hardly we had any air freight, in Q3 and Q4 is going to be zero air-freight. So, that's all back on track now.

Ritesh Gandhi: So, effectively speaking without much incremental Capex because all of that is already through, as our new customers, as our existing customers already ramped up the products, we expect a reasonable degree of growth that we can see going into FY 21.

P. Sundar Rajan: Yes, definitely.

Ritesh Gandhi: Ok. Thanks.

P. Sundar Rajan: Thank you!

Pavitra: Thank you, sir! We have the next question from Vikas Jain from Equirus Securities. Please go ahead.

Vikas Jain: Hi sir. Thanks for the opportunity. Sir, my first question as you said, new customers they will be ramping up their orders. That will start flowing from probably 2Q, so for Q4FY20 and Q1FY21, you are indicating that it will continue to remain subdued. Is that understanding correct?

V. Balaji: So, Vikas, in terms of Q4FY20 and Q1FY21, we expect revenues to be close to the previous year's. Comparing the previous year, we feel that there should be some 10% reduction, not 20%, what we are looking at here.

Vikas Jain: Right, sir. Correct. And sir, just one question about one customer, there is K-Mart. I had read in an earlier article that K-Mart was facing issues say, a long period of time. So, means, was it not the case that we knew that the customer is facing issues and just wanted your understanding about this.

P. Sundar Rajan: See, we have this agreement of this, the payment against the documents and some on LC. So, we are protected anyway. So, that was not the case now. Suddenly there was a drop because they filed the bankruptcy. So, what we were affected is only the order in-flow and not on the proceeds of what we have booked. Now they are taking against the payments. What the orders they had placed, now they are taking them against the payments.

Vikas Jain: Right. And sir, when you mentioned the reasons for the decline, you said that some of the orders were not able to deliver. So, any reason for that?

P. Sundar Rajan: Yeah, this is what we are exactly saying, see, when we were producing against their orders, Mother Care and K-Mart, and suddenly both of them had filed for administration, so naturally they are not taking the orders that they had booked. We are not shipping them either. So, we are just holding those stocks. Now they are clearing everything against the payment on LC terms. That is also one of the reasons why the orders are pushed to subsequent quarters. So, we are holding the stocks of Mother Care and K-Mart. But gradually they are taking them.

Vikas Jain: Right. And sir, about you said we had backed up by the LCs and all, so I hope that there won't be any hit in terms of receivables from these 2 customers, right?

V. Balaji: In terms of receivables with the Mother care business, we are facing some 200,000 dollars of outstanding, which I guess we should be in a position to know the outcome once the Administrator takes control of all the stocks in the business. I think we are stuck with these 200,000 dollars which is close to 1.5 crores of receivables.

Vikas Jain: Right. So, there is fair visibility that it should be recovered. Or what is your understandingof that?

V. Balaji: Yeah, the Administrators are saying that they will be in a position to come back to us only when they have complete controlof all the data. So, we are yet to hear from the liquidators.

P. Sundar Rajan: So, $200,000 is at risk.

V. Balaji: We are yet to know what is the status of these $200,000 receivables which is due only in the month of February.

Vikas Jain: Correct. Correct. And sir, just talking about the retail division. The capital employed in this was close to around Rs. 84 crores out of which Rs. 3 crores were the intangibles. So, these Rs. 81 crores include our stores, our inventory, everything? Means you mentioned that there were 22 COCO stores.

V. Balaji: Yes, all put together. Including the investment that we have made in the Crocodile Products Pvt. Ltd., a subsidiary company where we hold 70%, all put together we see Rs. 84 crores of capital employed.

Vikas Jain: Right. Just the last question. Just like promoters have also done in the past, that promoters have infused capital in the form of preferential shares, so why this time the same route was not… means the question was about requiring capital in the retail business, right?

V. Balaji: Correct.

Vikas Jain: So, what is your thought process behind this? why was it completely sold-off?

V. Balaji: Vikas, we have already said that there was a growth plan that was presented by the retail division to the Board in the month of August where they wanted a couple of more brands that needs to be in their portfolio for bringing more competitiveness in the products. And they wanted to invest more into working capital, more into opening up stores. Sothe requirement was on the higher side. Since new brands needed to be clubbed with the retail brand, the Board decided that more investment of money into the retail branch will put the capital allocation into a question. Because retail division requiring more capitaland decisions going forward where the requirement of the working capital is also on the higher side, considering the amount of capital employed and the return on the capital employed and the risk ratio, reward ratios did not favor more investment into retail division. So that is why the hive off happened.

P. Sundar Rajan: Sorry... they cannot just continue with one brand retail. Needs to have more than one brand. So, that is one of the reasons. So, if they want to scale up their business, then they need more than one brand. If that is the case, they need additional working capital and continuous growth capital. So, then the Board decided not to sign the core business, so let them do it on their own. So, we can hive it off.

Vikas Jain: Correct. And sir, just last question. When will be the financial numbers ex of retail? When will we start reporting that? I mean when we expect the transaction to complete?

V. Balaji: So, we have to get the shareholders' approval. I think the ballots will be posted on Monday. So, we are expecting the voting process to be completed before the 31st of March. And I expect the transaction should happen before 31st March.

Vikas Jain: Correct. Thank you, sir! Thank you for answering the questions.

Pavitra: Thank you, sir! We have the next question from Vivek Ganguly from Nine Rivers Capital. Please go ahead.

Vivek Ganguly: Good morning, sir! I have a couple of questions. One is on the hive-off that is happening. Post the conversion of the CPPS what would be the company's holding in the new retail business?

V. Balaji: Post CPPS? Currently, we are not in a position to value the retail brands – S P retail brands. So, what the Board decided is that the current moment we will have Compulsory Convertible Preferential Shares in the retail brands and whenever there is a fund-raising process that happens in the retail division, then at that point in time there will be a valuation that will happen. And we will definitely look at the time of converting equity at that point in time. So, that is how we have done it. Now, currently, there will be only preference shares. We will not hold any equity there.

Vivek Ganguly: You have valued it at Rs. 81 crores, of that Rs. 56 crores you will be receiving in tranches. What is the tranche in which you are going to receive? Secondly, the remaining 25 odd crores is that remains to be received. So, there must be a timeline or something, you know, otherwise the equity investors in S P Apparels we are left out out in the dark as to how this whole thing will happen. Secondly, if you look at most of the companies that are into the retail business and have a brand in place, while they might not be making too much of a profit, there is significant equity value that is attached to it. And historically sales has happened in 2 to 3X range. So, I was wondering how this came about to be, you know, the valuation of 21 odd crores? And also, it is being sold to S P Retail Ltd. So, who is owner of this company and was it actually shopped out and other options explored? We would like to understand.

V. Balaji: So, in terms of valuation, what you get on a retail company, we have taken valuation from a category A merchant banker Centrum and based upon that valuation, we have come to a conclusion of Rs. 81 crores of consideration. And on the second point, the split between Rs. 81 crores is that Rs. 56 crores is cash and Rs. 25 crores is compulsory convertible preference share. Of these Rs. 56 crores, Rs. 31 crores will be paid immediately and Rs. 25 crores will be a deferred payment of 3 years, which will be paid over a period of 3 years at an interest rate of 8%. In terms of your question, S P Retail Brands is held by the promoter group company only.

Vivek Ganguly: No. No. When I said Retail brand were the merchant bankers given the option to look out for any other structure where you could have

V. Balaji: Yes, yes.

Vivek Ganguly: brought in a company

V. Balaji: Yes, we had looked at many options. We have engaged a couple of people on this. We are a licensee brand owner. And even though it is a perpetual brand, so the buyer is investing 100 or 150 crores money into the retail, would like to look at it in terms of so many other things where, the person whom we have appointed advised us that it could go into a special purpose vehicle and where there can be a possibility of raising funds there. That is how it has been. The transaction has come to close now.

Vivek Ganguly: Sir so, if we believe that we cannot support this business and the business has better prospects and it is being hived off, then why do we still have to have CCPS in it? We can as well have, you know... first of all there is only 31 crores which is coming in cash. The remaining is deferred

V. Balaji: Sorry, not 31 crores, it is 56 crores.

Vivek Ganguly: Yes, immediate cash. Rs. 31 Cr is immediate cash. Right? Rs. 25 Cr, which is again not a very large number, is coming as deferred payment and then we have an uncertain upside from an equity conversion of 25 odd crores. So, if we are not certain about it, then why have the equity option still available? Why not make sure that the entire value of 80 – 81 crores is given to the company and there is a key…

V. Balaji: Today, if we need to invest more 40 – 50 crores rupees into retail division, buying out 2 more brands, I think there are concerns on the the decision to invest more money in the retail brand by the Board. So, considering all the pros and cons, and future growth that needs to be looked at, and that is how the Board has decided that it will be hived off.

Vivek Ganguly: No sir, I agree that the Board has decided to hive it off, fine. We agree with that, but our question largely is then why do we still have the

CCPS conversion option? Which is there is still an umbilical cord linking to the business. We could have a clean separation.

V. Balaji: See, why Rs. 25 crores of CCPS is that we still feel that there is a good potential for us in the retail sector whenever there is a private equity that comes, or an investment happens in the retail. Any future valuation that could give us more…

P. Sundar Rajan: What I am saying is that, when it is a stand-alone business, so it has got a great potential because you know, they will go into a multiple brands and more brands and things. So, they already have a good network and good connections and contacts and reference. So, we could, you know, when they have shown us the business… the business model was impressive. So only problem was, in the manufacturing it could not go well because two different mindsets and it is always a growth capital investment. So, manufacturing we did not want to continue that one. So, as a standalone with some private equity if they raise some money, so we could definitely still say that it is a good potential in that business, so why not see the upside of it?

Vivek Ganguly: You all said very well. I just made this point and you know, let the conversation carry on. See, if you all had still seen the potential upside, you all could have subsidiarized it and look to bring in a PE investor which you all just said you all are looking out if there is potential instead of selling to promoter entity.

V. Balaji: Mr. Ganguly,
we already have a subsidiary company and raised money there.If somebody wanted to invest money through that company, he would ask more capital equal amount of capital to be invested in that company by S P Apparels, the holding company also. Where again tomorrow I have to, wherever there is an investment that is happening, that should also go through the internal process where we need to take the Board's approval to invest more money into the subsidiary company. The second also is that the process of hiving off as a subsidiary company will take at least 2.5 years of time because of the NCLT process which needs to be considered.

P. Sundar Rajan: That's the main thing. And sales people are also a key thing here.

Vivek Ganguly: You know, overall, the way it looks that the thought process is somewhere in the middle. It is neither a decisive cut nor is it. Anyway… Thank you!

V. Balaji: Thank you!
Pavitra: Thank you, sir! We have the next question from Hardik Sodha from Crescita Investments. Please go ahead.

Vijay: Hello! Hi sir, this is Vijay here from Crescita Investment. Sir, I just wanted to get sense on K-Mart and Mother Care issue being at the highlights. And you said some of the clients will compensate on that account. So, what is the overall growth you see in the coming quarter or there can be de-growth on account of these 2 clients? And secondly, you said this client would start resume in the first quarter. So, is there clarity that has emerged on the same? And last, have we got some receivables also stuck with those guys? And if yes, then how much?

V. Balaji: So, in terms of the new customers, you are asking for the Q4 guidance and Q1 guidance? As Mr. Sundar Rajan in his opening remarks said that in Q4 we should look at a flat Year-on-Year growth, or there could be a 5-6% decrease in Q4. Going forward in Q1, we feel close to 5% increase. And then we should look at 10 to 15 % growth there onwards.

P. Sundar Rajan: From Q2 we will be back on track. We will restore the situation.

Pavitra: Sir, sorry to interrupt. It looks like the participant's line is not active. Shall I open the line for the next question?

V. Balaji: Yeah, yeah. Please.

Pavitra: Next question comes from Naushad from Systematics. Please go ahead.

Naushad: Hi! Naushad this side from Systematics. Most of the questions have been answered. Only one question I have on inventory. Sir, what is the level of inventory currently we have? And what is the average cost?

V. Balaji: So, currently, we have 227 crores of inventory. The average cost, I don't understand your question.

Naushad: In cotton and MRP.

V. Balaji: Oh! On the cotton front? Cotton inventory could be close to 30 crores. Of this 227, cotton would be 30 crores, and it is closely around 47800 in terms of Bale cost.

Naushad: 47,800. And this Rs. 30 crores would be for how many days, sir?

V. Balaji: Since we are in the season time, we are piling up in stocks and by the end of March, it should go considerably higher side. Where today my stock is closely around 110 days' stock.

Naushad: Ok.. Was there any inventory loss in this quarter ,sir?

V. Balaji: On the cotton front?

Naushad: Yeah.

V. Balaji: No, no. No inventory losses.

Naushad: Ok. The last thing on the overall growth guidance that we have been, you know, talking about. 70 million in this financial year and 10-15% growth again in FY 21. So, what is the revised guidance you would like to give for the overall financial year FY 20? And for the next 3 years?

V. Balaji: So, FY 21, we are looking at guidance where the growth should be anywhere between 14-15%. If you are looking at quantities, that quantities would change considerably because of the product mix. So, we would stick to the value-wise growth guidance which we will stick to anywhere between 14-15% for FY 21.

Naushad: Ok. Apart from this Rs. 1.5 crores which is at risk from Mother Care, is there any other expenses or costs we might see because of these 2 customers going out?

V. Balaji: The receivables are close to 40-42 days. Beyond Mother Care, we have informed 200,000 dollars, we don’t foresee any other customer into any risk like that.

Naushad: Ok. And what will be the due from the K-Mart towards us?

V. Balaji: K-Mart we haveclose to around 60,000 dollars, which is paid off.

P. Sundar Rajan: And only the stocks which are shipped against it.

Naushad: Okay sir. That’s it. Thank you!

Pavitra: Thank you, sir! We have the next question from Gautam Gupta from Nine Rivers Capital. Please go ahead.

Gautam Gupta: Good afternoon, sir! It is a follow-up question on the retail transaction that you have done. On the CCPS components, you know you explained earlier that, the conversion to equity is going to be linked possibly to a future valuation event if a PE investor comes in. But, could we get some more details on it? Because today as an example, we valued it at 81 crores. The CCPS at today's valuation would give S P Apparels Ltd. a 31% stake in the business. So, in the future, the valuation could be more than Rs. 81 crores and can be less than Rs. 81 Crores. In this scenario how would you have the conversion work? Do we get at least Rs. 31 crore or better? Or how does it work?

V. Balaji: So, on the Rs. 81 crores, we are getting Rs. 56 crores by way of cash. And Rs. 25 crores will be there as preferential shares. So, what happens subsequently when there is a buyer, I mean private equity or any kind of capital coming there raised We would always take a discount to the valuation there and see that our equity portion is on the higher side. So, we cannot predict what will be the valuation that can be taken there now at this point of time.

Gautam Gupta: I understand that, sir.

V. Balaji: So, they may add more brands to their portfolio. And when they add more own brands to their portfolio, we find that the valuation will be attractive, and that is why we are keeping 25 crores when there is a price hike and enjoy that because of the 25%.

Gautam Gupta: Yes. But again, sorry to belabor this point but, the valuation for the deal today is Rs. 81 crores. The way I understand, is it possible that CCPS can convert to equity at a higher valuation? I mean, you know what I am trying to say, today if I, today S P Apparels straight equity in that venture, it would own Rs. 25 crores divided by 81 crores, 31%. Tomorrow potentially, it may own less than 31%. Is that the right way to look at that? Because you may get a very high valuation, potentially.

V. Balaji: See, we will not be in a position to comment on the future number. So, tomorrow if say Rs. 100 crores being raised in that company, the person who is coming in, into that company, bringing in Rs. 100 crores, will have some valuation process that will take place. So, I am not sure where it will be 31% or because if there is a equity which is…

Gautam Gupta: Percentage could be less because the other gentleman is bringing in cash. but could be…

V. Balaji: Not known for the current moment.

Gautam Gupta: Fair enough, sir. My hope is that Rs. 81 crores valuation is the base valuation. You know, percentages can change because other equity may come in from a promoter, an outside investor. I understand that. But my hope is that Rs. 81 crores valuation is the highest valuation, which we will get this equity.

If you look at it…

V. Balaji: It's at a premium.

Gautam Gupta: Ok. I think sir, at some point of time if you can give us more clarity on this, it will be helpful. Because ultimately it is 20% of our market cap and I still really don't understand how to read the CCPS. There is no dividend on this, right? The cumulative dividend that comes in?

V. Balaji: Dividend?

Gautam Gupta: There is no dividend attached to the CCPS, right?

V. Balaji: Yes. Yes.

Gautam Gupta: I would suggest.

V. Balaji: CCPS you are asking about?

Gautam Gupta: The CCPS, yes.

V. Balaji: CCPS is carrying a dividend of 1%.

Gautam Gupta: Ok. So, that's nominal. Sir, maybe we can do a private call on this? Off-line because it is taking a lot of time.

V. Balaji: Yes. Sure.

Gautam Gupta: Please give some clarity on this issue.

V. Balaji: Ok.

P. Sundar Rajan: Yes. Sure.

Gautam Gupta: Alright.

Pavitra: Thank you, sir! We have the next question from Ankit Gor from Systematix. Please go ahead.

Ankit Gor: Yeah, hi! Thank you! Sir, my question is with regards to overall volume, around 11 million pieces we did. And that was sales volume, right? What was the production volume?

V. Balaji: Production volume was close to 12.4 million pieces.

Ankit Gor: So, that means we were earlier kind of aware about the situation what Mother Care and K-Mart were going through. Since our run-rate for the quarter was always 16-17 million pieces.

V. Balaji: No, Ankit, it's not that we are aware of. See, we were supposed to ship the sales to Mother Care during the month of December. So, 26th December was our shipping date. So, they went into Administration in the month of October. So, anything which we didn't have clear POS there; because Mother Care POS have now closed. So, the production was definitely disturbed because of Mother Care which got into Administration in the month of October. And that is why the production pieces are below.

Ankit Gor: Ok. Got it now. Ok. And sir, on Capex side, now since our capacities will be little more vacant now, should expect some slowdown in Capex and what would be our new guidance on Capex in the next 2 years?

V. Balaji: No, see. There is no slowdown, actually. But for the current 2 quarters, we are finding difficulties in bringing orders in the existing clients in this period. But, going forward, we should be in a position, because Mother Care and K-Mart were hardly 7-8% of our revenue – total revenue. But I guess, the capacities as planned should come up. But as we previously said, there will be consolidation next year. For FY21 we should look at consolidation on capacity front. No major Capex.

P. Sunder Rajan: No major Capex for next year.

Ankit Gor: Ok. Ok. So, what sort of machine addition should we expect?

V. Balaji: Now we are at 5,100, so we should look at 5,500.

P. Sunder Rajan: Yeah, around 400 to 500 machines.

V. Balaji: Which we have already planned for.

P. Sunder Rajan: What we have said, before end of FY 21, there will be approximately 6,000 machines running and utilization would be say about, 80 to 85% by the end of next year.

V. Balaji: Now we are looking at 5,500 machines.

P. Sunder Rajan: From April.

Ankit Gor: Ok. And any expected risk you see from our existing gamut of customers since we have a handful of customers and they are doing well with us. You must be keeping a close track on those customers after these 2 you know, went into administration. So, any early signs you would have caught by now?

P. Sunder Rajan: Yes, we have. Yes, we are ok. We have checked the credit ratings and everything. I mean, you know our customers, you know John VI, Walmart group, H&M and Carters. They all are financially strong. We don't see any issues with this.

Ankit Gor: Ok. Got it. Thank you very much, guys.

Pavitra: Thank you, sir! We have the next question from Mr. Resham Jain from DSP Mutual Fund. Please go ahead.

Resham Jain: Yeah, sir. Just on the cash-flow side, you mentioned there is no major Capex next year, and 10 to 15% growth and around 16-17% EBITDA margin. If we do this rough math, you will be able to do roughly around Rs. 120 crores of cash generation next year. And what I could see is you guys will get Rs. 50 crores from this deal as well, if it goes through. And what is the debt you have currently is basically subsidized debt which I presume you will not pay off because you get export packing credit and top subsidy on that. So, just a question because dividend payout history since IPO has not been that great, so what is your plan in terms of this Rs. 120 odd crores of cash generation which you will have next year? Thank you! That's the only question.

V. Balaji: So, dividend payout in terms of our performance after IPO, I think the last year we have not declared dividends, before that we have been declaring the dividend. We have declared for 2 years. Last year we did not declare. But on the future cash flows that can be generated, definitely, it will be taken to the Board to see increased dividends. Increased dividend and payout to the shareholders should be looked at.

Resham Jain: Any consideration on the buy-back given next year you will be trading at 5 times?

V. Balaji: For the current moment, we are not in a position to comment on that.

Resham Jain: Ok. Thank you!

Pavitra: Thank you, sir! We have the next question from Sriram from Ksema Wealth management. Please go ahead.

Sriram: Hello!

Pavitra: Yeah, please go ahead.

Sriram: Sir, Mother Care and K-Mart contributing 8% of our topline, which are going for administration for the next one or two quarters, right?

V. Balaji: Yes.

Sriram: Yeah. Apart from this we have been signed as a preferred partner for some of the new lines, right? Can we get the name of the client? And what will be the contribution from Tesco to our top-line?

P. Sunder Rajan: They are existing customers but you know, cannot be discussed in the Con-call.
Two new customers have added in last 1 – 1.5 years and both are going good. And that's the original plan. Even I mentioned in several con-call stats that on the trial basis, on an experimental basis they have started again, that is going on. Now everything is ok. Now they are scaling up. They have already spoken to us, and they started working on you know, increasing the capacity. That's why I said they have factory audits to ensure we have enough capacity for them to place the orders. That is what is going on now.

Sriram: Ok. (Inaudible) administrative process has been settled off (inaudible) the new Administrator?

P. Sunder Rajan: Can you say it again? Your voice was not clear.

Sriram: Actually in (Inaudible) Mother Care and K-Mart (Inaudible)

P. Sunder Rajan: Your voice is breaking.

Sriram: Is it right now, sir?

P. Sunder Rajan: Yeah, please.

Sriram: (Inaudible)

V. Balaji: Sorry, your voice is breaking. We are not able to hear properly.

Sriram: Oh my God. Ok. Can you please give me some clearance on the capacity side? What is our current capacity?

V. Balaji: 5,100

Sriram: Not in terms of the machine. In terms of capacity of…

V. Balaji: Pieces, I guess, pieces will not be

P. Sunder Rajan: Correct, because there are different fashion and basic products. So, that may vary from time to time. It depends on the orders what we take. So, roughly…

V. Balaji: We cannot give you capacities in terms of pieces. That is not possible.

Sriram: Ok. Fine, no problem

P. Sunder Rajan: And these are baby products, so there are many volume lines are there. So, it changes with time.

Sriram: Ok. (Inaudible) is 60%, right? For the last… for the 9 months. Going forward we have already lack of 2 clients. How do we expect that we can possible to achieve 80 to 85% capacity (Inaudible) If there any possible factors to be factored?

P. Sunder Rajan: Naturally, once we start getting the additional business through these 2 new customers, we will ramp up the capacity utilization from Q1 onwards.

Sriram: Q 1 onwards the ramp up process will...

P. Sunder Rajan: We cannot continue to do like this, yeah.

Sriram: So, what is our current liquid and non-liquid investments in our books? For the 9 months?

V. Balaji: Liquid investments? You are talking about the current assets?

Sriram: Yeah, current and non-current assets.

V. Balaji: Current assets, net working capital is Rs. 250 crores. Stock is Rs. 227 crores; receivables is Rs. 115 crores and payables is Rs. 91 crores. So, net is Rs. 250 crores.

Sriram: Ok. Can you give me the (Inaudible)

Pavitra: Sorry to interrupt Mr. Sriram, could you please use your handset to ask your question?

Sriram: Yeah, yeah.

V. Balaji: So, Mr. Sriram, I request you to drop in a mail on data which is required. Which I will definitely revert.

Sriram: Yeah, sure sir.

Pavitra: Thank you, sir! The last question of the day is a follow up question from Mr. Vikas Jain from Equirus Securities. Please go ahead.

Vikas Jain: Hi sir! Thanks for the follow up question. Sir, in the opening comments, the CMD said that one or two customers are trying to ramp up their operations in India. Sir, can you please elaborate on that?

P. Sunder Rajan: See, we have you know in the past, we were planning to increase the customer base. And dilute the market, you know, all were focused in the UK. So, we have to entertain more customers, from America, from international reference. So, this is the plan and as per the plan we had done in last 1 – 1.5 years. So, there we have taken 2 more new big customers. One from the US, one from the international presence. So, those customers are working with us for the past 2 to 3 seasons to see how the business performance is. And we also wanted to see how we get along with their requirements and deliveries. In the mean time, we wanted to increase the capacity so that we give room for entry of their additional business. That was the plan. So, that's what we had planned for and as we had planned, everything was going ok. And they were to start the business from Q 1 onwards to increase the business of these 2 customers. That's what anyway is going to happen. But because of drop-in Mother Care and K-Mart business, what we are going to do is we will increase the business from these new customers to fill the short-fall. That's the plan.

V. Balaji: His question was on the 40% in India.

P. Sunder Rajan: You said 40% in India, one customer you mean?

Vikas Jain: Yes sir, means about the ramp up of operations) in India.

P. Sunder Rajan: Yeah, one customer, they already have a plan to increase the basis and business sourcing from India from existing level to another 40%. They wanted to increase another 40% sourcing from India. So that's the plan. Anyway, so which means it makes things easier for us to fill the short-fall made due to Mother Care and K-Mart business. So, we can take extra business to fill these capacities.

Vikas Jain: And our primary competitor in gaining that 40% share would be Kitex?

P. Sunder Rajan: Which I don't know. I do not think that one is for Kitex. I don't know. But they have a limitedbabies and kids supply out of India. So, definitely we will take maximum advantage out of it.

Vikas Jain: Right, and sir just last question, Balaji sir said that our guidance for FY 21, revenue growth was 14 to 15%. Correct? Is that understanding correct? And margins for that year?

V. Balaji: Yeah, we are not sure about the incentive schemes. So, we should stick to 17-18% of margins of EBITDA.

Vikas Jain: Despite MEIS at current moment being scrapped?

V. Balaji: Yes, yes.

Vikas Jain: Right. Thank you, sir! Thank you for the opportunity.

P. Sunder Rajan: Thank you, Vikas!

Pavitra: Thank you, sir! Due to shortage of time, that would be the last question of the day. Now I handover the floor to Mr. P. Sunder Rajan for closing comments. Over to you, sir.

P. Sunder Rajan: I thank everyone for their detailed questions and you know, it shows their the level of interest what you see for the company for the future. And I would like to definitely take this opportunity to say that, we have definitely, every time 2 to 3 years' business plans. You know it is an international export business where there are so many external factors are involved including this bankruptcy and government policies and other things. So, we are always working to mitigate this kind of risk always. So, our plans are very very clear. Visibility is very very clear on the business plans and we are very confident that the level of growth what we originally indicated to you; we will maintain the same thing going forward. We do not see any kind of intricacies or any setbacks whatsoever in the coming quarters. Thank you for your time. Have a good day!

Pavitra: Thank you, sir! Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant day!

Note: 1. This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.