



“Welspun India Limited Q1 FY'17 Earnings Conference Call”

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MODERATORS: **MR. AVI MEHTA – IIFL CAPITAL**

Moderator: Good Day, ladies and gentlemen. Welcome to the Welspun India Q1 FY'17 Results Conference Call, hosted by IIFL Capital. As a reminder all participants' lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call please signal the operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Avi Mehta from IIFL Capital. Thank you and over to you Sir!

Avi Mehta: Thank you, Lizann. Hi good evening everyone, on behalf of IIFL, I would like to welcome all of you to the 1Q FY 2017 Conference Call for Welspun India. From the Company we have with us the key senior management including Mr. Rajesh Mandawewala – Managing Director; Mr. Altaf Jiwani – Director (Finance) and CFO; and Mr. Akhil Jindal – Group CFO & Head Strategy. I would now like to hand over the call to the management for their opening comments. Over to you Sir!

Management: Thank you, Avi. Good evening ladies and gentlemen. On behalf of the company we would like to welcome you all to the Con-call for the first quarter for the current financial year. In this quarter we have actually crossed the major milestone of Rs. 200 crores of quarterly profit. We have had revenue of Rs. 1,592 crores which is 14.3% growth over the corresponding quarter last year on the consolidated basis. Majority of this growth has come on the back of volume increase so, we have had almost about 10% volume increase as well as product mix because our share of the innovative product has now increased to about 35% and the share of branded product has increased to 14%, which is on annualized basis will be almost 4% increase over the previous financial year.

In terms of operational EBITDA, we are at Rs. 422 crores vis-à-vis Rs. 367 crores of last year which is about 15.1% growth in the operating EBITDA margin. The reported EBITDA margin is 27.7% compared to 28.4% last year. Finance cost has come down substantially from Rs. 59 crores to Rs. 35 crores that is we have actually started availing of the Gujarat Textile benefit for our second plant which is in Vapi.

Depreciation of course has increased to Rs. 112 crores compared to Rs. 78.5 crores last year this is on the back of capitalization of the projects which we have been doing.

PBT is actually Rs. 294 crores which again 14.1% increase over the corresponding quarter last year. PAT post minority interest is about Rs. 202 crores vis-à-vis Rs. 183 crores which is about 10.3% increase over last year.

Now these numbers which we have actually given are actually Ind-AS complied including for the previous quarter that is Q4 FY'16 as well as the corresponding quarter in the last year which is Q1 FY'16. So if we adjust for Ind-AS between Q1 last year and Q1 this year then the growth in PAT and EPS will be actually 15% instead of 10.3% that is appearing here under

Ind-AS. The major impact for Ind-AS in our case is actually because of the reorganization of the government grants which were earlier recognized as per the government scheme which was one-eighth of every year. We have to now recognize that in terms of depreciation of the underlying assets. So last year's profit has been increased by about Rs. 35 crores compared to the Indian GAAP. The other impact has been on the tax on the stock reserve so, there was no need for recognizing the deferred tax on the stock reserve which Ind-AS you have to recognize so, that is the second impact.

Both together the impact for the full year financial year last year was about Rs. 37 crores. In terms of the balance sheet, we are actually, debt we have maintained at Rs. 2,500 crores as on 30th June, 2016 also. So, practically for last three years we have been at Rs. 2,500 crores of debt. The net current assets have gone up in this quarter marginally it is about Rs. 350 crores increasing the net current assets. But mostly it is because of the payable which we had certain payments terms from the cotton vendors which mature during this quarter. So we had to pay off, so our cost conversion cycle is about 53 days which is still better than the corresponding quarter last year which was 55 days of course this is showing an increase vis-à-vis last quarter but, it is mainly because of the payables. So our inventory has actually come down from 69 days to 64 days and debtors have come down from 36 days to 34 days. Payables have reduced from 62 days to 45 days.

Return on capital employed actually is at 25.3% this is because our net current asset has increased plus we have built cash reserve so, there is about Rs. 400 crores of liquid cash in the company. Return on equity is about 39% which is again the increase in the networth as well as increase in the working capital has impacted but these are both figures which are quite healthy as compare to the industry average.

In terms of project status, we have announced about Rs. 800 crores of investment CAPEX during this year out of that during the first quarter we have spent Rs. 140 crores (Rs. 1.4 billion), this Rs. 800 crores which we are going to spend during the current year will give us additional 20% capacity so, the existing capacity of Towel will increase 60,000 tonnes to 72,000 tons; and the capacity for Bed Sheet will increase from 72 million meters to 90 million meters; and Rugs will increase from 8 million square meters to 10 million square meters.

During the quarter actually we continue to receive the awards which has become more or less like a habit so, we received awards from TARGET the Responsible Sourcing Award. We have received award on the Sustainability Efforts from Frost & Sullivan.

As I mentioned earlier our innovative products like Hygro continues to see a huge traction in the market so, we are seeing, that there are retailers who have replaced their entire wall with 'Hygro' in some of their stores. In Branded products we continue to invest in our brands which are in India like 'SPACES' as well as we have started investing in 'Christy' brand in UK. Hygro campaign has started yielding results in the US market.

So overall growth in terms of Ind-AS after considering Ind-AS impact also it is substantially higher and Q1 versus Q1 which is double-digit of course versus Q4 it is showing negative growth but we have seasonality in our business so, it is always better to compare Q1 this year versus Q1 last year figures.

And with this, we will keep the floor open for question-and-answer session, if you have.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: My first question is if you could share the capacity utilization this quarter along with the quarter growth?

Altaf Jiwani: Nihal, our capacity utilization is almost 90-95% for the major product categories which is Towel and Bed Sheet and in terms of Rugs and Carpets we are 75%-80% of our utilization.

Nihal Jham: Okay. And will be the approximate volume growth

Altaf Jiwani: Volume growth I mentioned I about 10% during the current quarter.

Nihal Jham: Sure, sir, fair enough. Sir, the next question, we have seen a recent run up in cotton prices. We obviously are not buying cotton at this moment, buying seasons starts in October. So in case these prices continue to sustain so what could be the impact on our margins?

Rajesh Mandawewala: I will take that one. So just, cotton prices have run up significantly and there are a couple of reasons for it: a) a lot of cotton got exported out of India this year more than it was anticipated. Also Chinese imports, a lot of Chinese cotton came into the market and things like that. But, all in all it looks like for the new season this that we might actually end up with the 4% to 5% lesser acreage as compared to last year but because of two successive droughts our yields last year was extremely low and consequently the crop estimate for last year was 340 lakh bales. Now, despite the lower this acreage this year expectation on crop for the next year is 350 lakh bales. So, this will be higher. So while the prices have run up significantly but if you look at this so, trades are happening today for November, December delivery. So, they are happening at about 40,000-41,000 per candy where the current quotes are at about Rs. 46,000 - Rs. 47,000. And I am referring to Shankar-6 cotton here. So all in all there is general expectations that price should come back to about Rs. 40,000 - Rs. 42,000 a candy levels which although they will come back but are still higher than this last year average prices of say about Rs. 35,000 Rs. 36,000. So as a company, we believe we should be able to maintain our margin pass on some of this cost increases to our clients or work with them alternatively to this improve growth through better product specification and things like that. So we are not alarmed so, we have adequately covered this in terms of cotton for another quarter and it is

going forward beyond that so, we are not expecting our margins to be impacted this negatively so, we are confident we will be able to maintain pass this cost increase to our clients.

Nihal Jham: Sure. Just one last question, the current interest that we are seeing we expect to be the run rate going forward also, right?

Altaf Jiwani: Yes, current interest rate will be the run rate going forward, Yes.

Moderator: Thank you. The next question is from the line of Sumant Kumar from Elara Capital. Please go ahead.

Sumant Kumar: This the 14.3% growth we have so, what is the break-up in volume, currency impact and price?

Altaf Jiwani: The price has almost remained stable. The currency impact is about 4% and volume growth is about 10%.

Sumant Kumar: Okay. Currency impact 4%, okay. So regarding US market we have seen OTEXA there will be some de-growth in the current month. So what is the scenario now in your view and outlook?

Rajesh Mandawewala: As far as our business is concerned Sumant, we do not see anything negative so, our business continues to grow. All the programs that we are shipping out to our clients continue to do well. So this by inlarge our category within that we as a company is pretty comfortable and nor are we getting any indications from our clients in terms of whether that they are struggling. We have real time information on our SKUs that we sell to our clients, how our clients are selling. So as far as we are concerned and our business is concerned, we do not see anything negative happening. We continue to maintain that for the rest of the year as well this we will grow double-digit and so, there is nothing that is concerning us as of now.

Sumant Kumar: And regarding Fashion Bedding all these Indian companies are talking about big opportunity s, I like to know your views.

Rajesh Mandawewala : Of course, it is a large opportunity so end of the day, the top of the bed is actually a bigger market then actually the Flat Sheets and things like that. So it is a large business opportunity until now China has been dominating this space so, this is close to three forth of the US imports have been supplied by China. So India is now slowly making inroads, and as companies we have not invested into this until the recent this one year to two years. So now that all of us have started looking at this category seriously, I think this our market share as a country will grow and so, I think we will certainly make better inroads on the Fashion Bedding category as a country.

Sumant Kumar: The success of Towel and Bed Sheets from India that story can be replicated for Fashion Bedding?

Rajesh Mandawewala: I doubt that, while the growth should be handsome but I do not think we can replicate the success of Towel and Sheets. The reason why I believe there is a lot of freight involved in some of the SKUs on Fashion Bedding side like Quilts and Comforters. The other thing that, as you fill these Quilts and Comforters with synthetics so, where you do not enjoy as much advantage on cost as you enjoy in Towels and Sheets. So while we still look good as compared to China in terms of cost and things like that but, I do not see India grabbing a 50% or 40% market share like we have grabbed in the Towel and Sheet side so, that will be my take on this.

Sumant Kumar: Okay. And regarding the cotton price has increased significantly more than 30% in the recent month and the Chinese currency depreciated more than 1% over India so, what we are talking about the 10% cost of products and advantage we have it has already gone. And next year there is expectation whatever the average price was there the cotton price will be higher than may be 10% to 12%. So what is your view, the cost production will be similar to China, so India is likely to lose market share?

Rajesh Mandawewala: I do not think so because a) the cost differential it is right where it is so, as we speak today when this India's cotton is running out and China's flush with cotton, yet the Chinese cotton is about 17% more expensive than India as we speak. So the cotton advantage will continue and also the labor advantage will continue. So as we see it the cost differential will continue in the future as well and we do not see them honestly, we do not see them on the table any more so, we do not see them coming back either so, we are not to perturb with what is happening on this one.

Sumant Kumar: But in the recent month we have seen the Chinese cotton price has gone up by only 8% and our cotton price has gone up more than 30%.

Rajesh Mandawewala: Correct. Despite that we are 17% cheaper. We are still 17% cheaper cotton on an apples to apples basis. So advantage is there and it will remain. See end of the day this is situation where you are at the end of the season this in terms of the cotton crop, our new crop will start arriving September so, cotton in India is running out and China is flush with cotton and despite that we are still 17% cheaper than them. So as the new season arrives this whole situation will change again prices in India will go down. So already see this November December is already quoting at Rs. 40,000 - Rs. 41,000 which is about 14%-15% lesser as compared to the current prevailing market prices. So it is a clear indication that cotton will reduce here and the differential will grow as compared to China. So the cost advantage is too deep to vanish with this current cotton price increase. So we believe this advantage will continue.

Sumant Kumar: Okay. So do you think because of the higher cotton price there will be inventory gain for the company?

Rajesh Mandawewala: No, not really because so, we value inventory at cost. So this only benefit insulation it provides us is that it does not come and hit our P&L immediately so, we have covered this almost a quarter so the impact of this cost increase does not come and hit us immediately so,

that is the insulating that you get. So, we value inventory of lesser of cost or market price so, no inventory gain is reflected here.

Sumant Kumar: Okay. Last question, how is the growth of Indian market?

Rajesh Mandawewala: Indian market growth see, this continues to be spectacular so, this we have grown in excess of 20% in this quarter as well and not only there is business growth but also the distribution this is growing significant and the growth in the future quarters will be even more pronounced so there is a lot of work that is currently being undertaken in the company by our teams. So we believe our growth rate will actually improve significantly over the next few quarters in the current year.

Moderator: Thank you. We take the next question from the line of Saurabh Jain from HSBC. Please go ahead.

Saurabh Jain: Sir, in the current quarter we posted about 14.3% increase in revenues. Now my question is as the high base starts catching up from the last quarters, is there a risk to our revenue growth like we might end up doing 8%-10% growth in next few quarters or the current run rate will continue?

Rajesh Mandawewala: Look, we have been consistently guiding that we will have double-digit revenue growth so, what you see in the current quarter is reflecting and we have been maintaining this over the last several years and we believe our business is good to grow at double-digit growth rates for the next several years. So, despite whatever the industry is continuing to see a consolidation phase and we tend to benefit when the consolidation happens, we are adding products, we are adding new channels of distribution, we are getting into new sector, over and above that we are getting into deeper penetration into markets like Europe, Middle East, far East and things. So there are enough avenues for the company to grow double-digit so, beyond this to predict this with precision is difficult but nothing has changed so we continue to remain optimistic which is why the company has actually invested in increasing the capacity. So we are investing this capital to increase our capacities almost 20% in Towel and Sheet and that is on the back of let us all this positive trend that we are seeing coming in from our customers so, we will continue to grow this the way we are growing. So do not pin me down on this it is 14% this quarter so, it should be 14% but next. But all in all we feel confident on this healthy double-digit growth so, there is nothing happening out there which this makes us to believe that we cannot achieve that.

Saurabh Jain: Okay. Sir, I understand that there is a lot of cyclical in the business also. But last many quarters we have not seen a QoQ dip in the revenue. Any particular reason why it was dip this quarter or it is only one off thing?

Rajesh Mandawewala: No, there is nothing like that. Generally, I could say it is a one-off thing we had a fabulous this quarter four last year. Generally, the first quarter is slow, so I would not say that it is a rule but

generally the first quarter is generally slow, I would suggest do not read anything with this one quarter results we have a fabulous order book currently, volumes are doing very-very well even right now. So do not read too much into the growth numbers that you have seen on quarter-on-quarter so, you will see things as they unfold in the future that this business is good to grow.

Saurabh Jain: Okay. And you also you were mentioning about your new channels to be hospitality and health care. So, just can you explain us like how big can the market be and I mean how fast we can grow in these two segments?

Rajesh Mandawewala: Let us say that between hospitality and healthcare only the US market is about a 1.5 billion and this is about only the product categories that we talk about Towels and Sheets and we are currently at about 25 million - 30 million in that space. So, it is a large space, we are staying away from the commodity side of that space so, it is just like our other retail business so, we are trying to build our business on the basis of innovation, differentiation, end of the day, the better attributes of products for the final end user. So we believe our business will continue to grow significantly as it has been growing although the base is small but the growth is good so, we believe the business will continue to grow. Honestly, on the healthcare side, we are still at research stage so, we do not see much revenues in the current year, we will start seeing revenues coming in from the next year so, right now this is business development time but hospitality business is already starting to see traction, so there we have started growing a lot of door opening has happened we have a lot of excited customers on that side, so the hospitality I think this will see very handsome growth in the current year as well as going forward.

Saurabh Jain: And who is dominating the space currently?

Rajesh Mandawewala: There are a couple of local companies, the largest players are actually local companies bulk of product is actually imported but the supply chain is currently dominated by a couple of local companies there.

Saurabh Jain: So this should not be the case they must be supplying at a very high cost and India could have taken advantage long back into the space.

Rajesh Mandawewala: See, end of the day it depends on so, if you are a commodity player whether it is the local company or you there will be a little margin left on the table but let us if you differentiate then you know it really does not matter so the margins come and we have had certain couple of placements already on the hospitality side but the margins actually as good if not better than what we do with retail.

Moderator: Thank you. We will take the next question is from the line of Sreejan Sinha from GAM. Please go ahead.

Srijan Sinha: My question is with respect to Duty Drawback scheme, I guess we draw some benefits under this scheme. So first pardon my ignorance on the topic so, if you could briefly explain to me how does this work? And the second part of the question is GST were to implemented from 1st April, 2017 is there a likelihood that the DDB scheme will be drawn? And if yes, what could be the consequent impact on our margins, especially because we are targeting a far bigger proportion of our revenues from Indian sales.

Rajesh Mandawewala: So first of all a drawback is nothing but the refund of the taxes that you pay.. So, our general belief is that with the introduction of GST all in all this from the incentive standpoint... So we believe that with the introduction of GST an immediate impact of about 1.5% on the margin could actually happen but there is also a logical assumption that you make then is that as the currency depreciate so, over a period of time you could actually go out and regain this apart of that margin loss. So to answer your question, duty drawback if GST gets introduced this could instantly negatively impact margins by about 1.5%.

Srijan Sinha: Okay. And how regain margin.

Rajesh Mandawewala: Altaf, you wanted to add.

Altaf Jiwani: Yes, just wanted to add in the domestic market so, your second part of the question because the moment GST comes it comes a great leveler for a large company like us who have to compete against the unorganized sector. It is going to be a huge benefit for organized sector when GST comes.

Srijan Sinha: Okay, great. And my second question was with respect to the product mix, did we see any change in the product mix in this quarter on a Y-o-Y basis I mean what was the delta in the innovative as well as branded product?

Altaf Jiwani: Nothing significant Srijan, so this innovative side we did about 35% and the brands represent at about 14% of our overall revenue so, there is nothing significant worth mentioning on this.

Srijan Sinha: Okay. And my third question sir, with respect to volume growth, we have been saying that we can easily grow our volumes in the double-digit. But since our capacity utilization is already in high 90's how do we plan to increase our volumes? Are we planning to sweat our existing capacity or are we planning to prepone our CAPEX kind of stuff?

Rajesh Mandawewala: Good question, so this is something I wanted to address anyways. So this capacity expansion project that we were undertaking since the last three years is now almost coming to an end. In the current year there was about Rs. 250 crores - Rs. 300 crores CAPEX left from the capital expenditure project that we were implementing to take our capacities to 60,000 tonnes of Towels; 72 million meters of Sheets and consequent increase in the yarn capacities also fabric capacities. So we are also over and above that we are investing another Rs. 300 crores in the current year to further take the capacity up from 60,000 tonnes of Towels to 72,000 tonnes and

from 72 million meters of Sheeting to 90 million meters of Sheeting so, this is in line with the growth in business that we see and end of the day these are all Brownfield expansions so, every quarter something will be available to us. As we need capacity there will be capacity for us available through this expansion projects that we are doing. So about Rs. 600 crores - Rs. 650 crores of this capital expenditure in the current year to actually take our capacities to Rs. 72 tonnes of Towels; 90 million meters of sheets and 10 million square meters of Rugs and Carpets. And over and above that we have earmarked another Rs. 150 crores on the carpet side which is something that is at a research and development but just to abundantly cautious so, we have actually allocated about Rs. 150 crores of capital expenditure for that. So with this Rs. 800 crores of guidance that we have given out on capital expenditure at the beginning of the current year this is where we expect to get to.

Moderator: Thank you. We will take the next question from the line of Sahil Doshi from Birla Mutual Fund. Please go ahead.

Sahil Doshi: Sir, just one question, one related to the gross debt number which has put out in your presentation has increased from the March quarter itself. So we were also planning to reduce our debt over a period of time. So could we assume this is with relation to the CAPEX and could this be the peak number which we are looking at?

Altaf Jiwani: Are you referring to gross or net?

Sahil Doshi: Gross debt number which has increased from Rs. 2,500 odd crores to Rs. (+3,000).

Rajesh Mandawewala: Yes, so I would encourage you to look at the net debt number because see, our cash position as of end of June is actually Rs. (+500) crores which was about Rs. 140 crores at the end of March. So cash has also significantly grown so, we have also drawn some term loans for obvious reasons against the capital expenditure and two is this also there is some timing effect actually working capital debt was significantly low we manage to get some cotton long-term credit towards the end of the year which we are currently paying out. So all in all we continue to maintain our guidance that this year we will actually reduce net debt so, there is no question of increasing debt. We will definitely reduce net debt significantly.

Sahil Doshi: Sure. Sir, another question was related to a previous question where you have mentioned about focusing more on Comforters and other value-added products as Quilts, etc. So can you just articulate your plans in that area meaning how much would today of your top-line be a contribution from those products besides how much of the capacity would be utilized and how do you really plan to ramp up?

Rajesh Mandawewala: So you actually leverage on the Sheeting capacity that you have already installed and over and above there are Quilting equipment that we have so, it is a not a CAPEX intensive it is more business development than anything else. Currently we are in the \$10 million - \$15 million so, it is a very small business for us. So there is a long-long way to go this as far the Fashion

Bedding business is concerned so, it is significantly large categories to get to triple digit in terms of top-line over the next few years this should not be difficult.

Sahil Doshi: Sure. And just a last question I will take sir, is addition to the duty drawback benefit of 1.5% which could hurt us, is MEIS withdrawal is also being questioned, the 2% kind of number which we receive today.

Rajesh Mandawewala: So right now gentleman what is being discussed is nothing getting taken off but adding of incentive. So the government has seized they are looking at the textile industry as a big employment that is generating potential and you guys must have read about this. New Textile Policy that they just announced for apparel where they have actually gone out and increase the drawback rates by 5% and there is also discussion happening for the home textile categories as well. So there is nothing on the cards of taking away any incentives. Our view is that we would not be surprise of some additional incentives actually come in so we do not see anything getting taken off. So expect the GST impact so when GST comes as the transitioning happens this 1% -1.5% could get impacted but there is nothing beyond that if at all something happens it will actually be on the positive side.

Moderator: Thank you. We will take the next question from the line of Sebastian Taylor from Pioneer. Please go ahead.

Sebastian Taylor: Could you just go into a bit more detail on the European side of your business where do you manage to negotiate or still in the process of negotiating better access to the EU market and could you also talk a little bit more talk about your progress in Japan if any? That will be the first question. The second would be are you still taking share from other Indian competitors in the US markets currently? And the third question would be a bit more on the mix in the US market and if you could just give a bit more granularity about what the dynamics are in the US markets for you currently?

Rajesh Mandawewala: Okay, so, I will take care of the first part of your question which was the Europe and the other markets. So, yes, we continue to stay focused on the European market for obvious reasons, in terms of size it is as large as the American market. So our business is continuing to grow in the European market so, this also in terms of as a percentage our growth is actually higher in Europe as compared to what it is in the US So in the current quarter our business in Europe and the rest of the world is actually grown by about 24%-25% so, the business is continuing to grow. I would say that we would have opened the doors with almost all the major retailers in Europe as we speak so, our general expectation is that as we grow in experience with these clients, our business will continue to grow and we will be able to grab a bigger piece of their market. Now this growth is happening despite the fact that we start at (-8%) to (-9%) duty disadvantage against Bangladesh and Pakistan so, despite the fact that our products attract 9% import duties into the Europe market, yet our business is growing at 20%-25% year-on-year in the European market. So this clearly is differentiation the brands and the innovation that we are offering to our clients is getting due credit in the European market. Similar things are

happening in other parts of the world. So even the rest of the world is our business although it is small but it is growing pretty significantly. Japan about I would say three-fourths of the retailers this we have opened the doors. Business developments has happened with almost anybody and everybody that we would want to work with. But by nature Japanese are very conservative so in Japan you have to take a five-year view, so we are into our third year, I think it will take us another two years to three years to build a sizeable business. Having said that, the business is growing pretty decently in that region as well. We are growing well in the Middle East. So all in all, all other regions are actually growing pretty decently for us. Coming to the US part of your question, are we gaining market share? Yes, so, if you look at FY'16 our share in the US imports actually grew from about 18% the previous year in excess of 20%. On Sheets we were about 10% which grew to about 11.3%-11.4% so, yes we continue to gain market share both from our international competitors as well as some of our Indian competitors as well. So our business is continuing to grow with our US clients as well and also this business is currently positioned so we feel that this will continue to happen in the future as well.

Sebastian Taylor: And on the mix side?

Rajesh Mandawewala: Nothing significant to report here, so our mix continues to remain where we were last year so, there is nothing significant to report there.

Sebastian Taylor: And you are guiding for CAPEX with 8 billion this year, next year are you still guiding for a CAPEX to decline significantly?

Rajesh Mandawewala: Yes, of course, as I mentioned that this large capital expenditure journey that we started three years back is now coming to an end so this year it will be over. The big part of the CAPEX will actually be behind us and going forward our aspiration is to keep our CAPEX within the depreciation that we charge to the P&L so that should be good enough for us to grow our business at double-digit and also should be able to support some routine maintenance CAPEX that we might want to incur.

Sebastian Taylor: Finally, on your ancillary project, could give us an update on any progress there please?

Rajesh Mandawewala: The first spinning unit is already in operations so they will produce about 45 tons of yarn a day for us. They are half way so the unit has just been commissioned about two months of three months back. So, 45 tons of yarns a day. There are about 11 other ancillary units that we are currently in discussions with, so although not for raw material but for other ancillary and supporting products, trims and things like that so there are another 11 units which we believe will come into production by March of 2017. So the strategy is playing out in terms of raw material which is yarn and fabric. We want to develop the model with this first spinning unit that has started so that philosophically we are actually trying to create a win-win situation. At the same time, we want to establish control on the supply chain. So we will give this first unit about three months or four months go through a learning curve and then perhaps roll it out

with a lot of other interested party. So, we have interest in this ancillary model for more yarn making units, people want to align with us and set up more yarn factories. There are people who want to set up fabric factory. So we want to first learn with this one ancillary that has come up, perfect the model and then roll it out with the other. So the over next two years - three years hopefully the rollout should happen.

Moderator: Thank you. The next question is from the line of Manish Bhandari from Vallum Capital. Please go ahead.

Manish Bhandari: I have two questions, my first question is regarding the supply side addition which is taken by your competitor so, is there a possibility of price destruction while negotiating with your customers. So what is your view on that?

Rajesh Mandawewala: Sir this is a very good question. So this we have if you look at this Towel side of our business so, we have seen an influx of capacity coming with some of our key competitors. And this over the last two years we have demonstrated that our business has grown both in terms of volume top-line pricing as well as market share, and also margins. So we believe that our business is strong enough now and I think we have gotten to a point where we believe our relationships with our clients is more strategic so it is not where this small difference in this pricing could move business from one vendor to the other. So the business is consolidating, I think our clients respect us for helping them improve their business and we stay true to our commitment. So all in all, so far we have managed to retain margins in fact grow margins over the last two years or three years and also currently we have managed to retain margins. And even going forward we believe that we should be able to retain margins so work through cost increases, competitive pressures from competitors, work through all these things. These are natural business things they are bound to happen, but we believe we can work through all these with our clients and just continue to maintain margin that we have.

Manish Bhandari: My second question is, have you deliberately chosen not to stress on the Asian market and Asia is a big size of opportunity for you, I understand your US strategy, I understand your Europe strategy, if you put a big pocket of Asia together there would be an equally good size of market which you would expand. So what is your strategy on the Asian markets?

Rajesh Mandawewala: We are quite deeply focused on the Asian market as well. As I just said, Japan is focused market for us, we are trying to make inroads now into Korea, Taiwan and so that part. We are quite focused in these markets as well. Having said that, as I said these are very conservative market so, it takes you a very long time to actually get meaningful business in these markets so Japan as I said we are into our third year already and so hopefully in the next couple of years we will see decent traction coming in. And the other markets will also follow. So every market which is meaningful we have business development happening today. There is no market that we have left untouched so, we are continuing to work on all the markets.

Manish Bhandari: Sir, one clarification, you mentioned about the ancillarisation in your response to an earlier participant on the growth rate what you would like to achieve. So if I understand correctly, you had said that we will be somewhere between 10% to 15% or 10% to 20% range for considerable period of time. Does it mean that our CAPEX cycle gets over so, all this growth of 15 percentage point assuming so would be contributed by the ancillarisation model and is your ancillarisation model gearing up for that for multi-year growth of 15%-20%, is it doable in that format?

Rajesh Mandawewala: Yes, we believe so, let me answer your question in two parts: a) what we propose to ancillarize is actually making of yarn and the fabric for Sheets. Yarn for both Towels and Sheets as well as fabric only for sheeting so, hopefully if we succeed in doing this in ancillarizing this which we believe we will so, that takes away close to two-thirds of the capital expenditure that we have historically been doing to create capacities. Our intent is to continue to invest on the value adding activities of dyeing and finishing and cutting and sowing, design development and distribution. So we will continue to invest which reduces the capital expenditure to about a third of what we have been used to investing-in in the past. So, there will be so just to give you a rough ball park number we believe that this capital expenditure should be in the depreciation range or there about. So the depreciation that we charge to the P&L so that should suffice for capital expenditure so, that is the way we are planning to run our business in the future and that should give us the double-digit growth in capacity that we need.

Moderator: Thank you. We will take the next question from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: On the ancillarisation just want to understand, our expanded capacity would be fully commissioned by end of FY'17, so would not our units also have to come up by the same time for us to meet or increase the yarn and fabric requirement?

Rajesh Mandawewala: Yes, so this it is preferable that these units come up in that time. But there is any which way so there is enough raw material available in the market so, there is enough yarn and there is enough graze fabric available in the market. Even today we source a lot of yarn and we source a lot of fabric from the market. So it does not constraint, so the pace of ancillarisation does not constraint our model from being successful. So the purpose of ancillarisation is actually to gather better control on the supply so, there is a millions of tons of yarn and there are millions of meters of fabric which is getting produced in the country. So, in other words so if the ancillarisation does not happen for six months that does not mean that our business is not going to grow. So we can continue to source and grow our business. So the purpose of ancillarisation is to actually have a better control on the supply chain. So we are trying to match the pace but as I said our growth is not conditional on ancillarisation so if there is a gap we will continue to outsource from the market. So the cotton yarn and the fabric these are all commoditized products so this we can source it from the market.

- Nihal Jham:** Definitely, sir. And just on the CAPEX part I just wanted to confirm on the 8 billion, 2.5 billion is carry forward from last year 3 billion is on Towels and Sheets and Rugs and the remaining 1.5 billion is on the Carpet side, is it the right break-up?
- Rajesh Mandawewala:** Yes, broadly I would say, Yes.
- Moderator:** Thank you. We will take the next question from the line of Sameer Gupta from IIFL. Please go ahead.
- Sameer Gupta:** One question, sir on the 4Q call if I remember, the margin guidance was stated 22% to 24% and today I saw news wherein the guidance has been cut down to 22%-23% so what exactly is driving this lowering of the guidance?
- Rajesh Mandawewala:** No, let me clarify, there is no margin guidance change. So we have currently reported in excess of 26%, the reason why we guide this lesser because of the government incentives. So because of the incentive we have always been cautious to say that we will be around 23% or thereabout. We are currently reporting 26% and the reason why we are conservative as I said is tomorrow if the incentives get taken away we still feel confident that we can be around 23% mark. So there is no change in guidance despite what has happened on the cotton prices, despite whatever is happening in the market so, we believe and we are confident that we will maintain our margins.
- Sameer Gupta:** Follow-up question, what are the likely incentives which you see or are thinking that might be taken away is it like some of the state schemes?
- Rajesh Mandawewala:** Honestly, as of now there is this transition of GST which could impact margins by about 0.5%, other than that in fact, we are not expecting anything negative for the matter some more incentives can come because apparel guys recently got 5% additional drawback. So we wouldn't be surprise if some additional incentives are actually thrown at us. So we do not expect anything getting taken away right now.
- Sameer Gupta:** Sir, one last question if I may. Any state government policies or sunset clauses which are coming to end in 2017 any CAPEX done after that?
- Rajesh Mandawewala:** Nothing.
- Moderator:** Thank you. The next question is from the line of Jitesh Kumar from ICICI Securities. Please go ahead.
- Jitesh Kumar:** Sir, my question is you have mentioned the reduction in the finance cost based on the base rate cut, I believe some of our loans are also foreign currency, do you see some impact to the foreign currency rate cuts as well in the finance cost reduction?
- Rajesh Mandawewala:** Altaf, you want to take that?

- Altaf Jiwani:** Jitesh, our total borrowing 90% is actually rupee borrowing, only 10% is foreign currency and the reduction which has happened has two components one is the base rate reduction other is the Gujarat Textile policy which we have started availing for Vapi plant also.
- Jitesh Kumar:** Okay. And is this a new loan which you have mentioned the Gujarat policy?
- Altaf Jiwani:** Yes, we have started availing from this year so, it is pertaining to the CAPEX modernization plant expansion which we have done in Vapi plant in last two years
- Jitesh Kumar:** Okay. One related question sir, you had earlier mentioned about the textile package, are we seeing something for us also in the same package?
- Rajesh Mandawewala:** Jitesh, we are certainly lobbying for it, there is none other than our Chairman, BK Goenka who is right in the forefront leading this whole thing so, this is a work in process with lobbying you never know so all our associations are involved. So what we hear is positive so, let us hope for the best.
- Altaf Jiwani:** Jitesh, just to add the genesis for which the garment policy has been now issued so, we actually qualify for all the requirements criteria which are given there.
- Jitesh Kumar:** I agree sir, but somehow since the garment is very miniscule or not a big part for us so, that way my question was from home furnishing are we expecting something?
- Rajesh Mandawewala:** Yes, so there is a lot of work happening in that area. The Textile Ministry has also said it is positive so, let us hope something positive comes out.
- Moderator:** Thank you. We will take the next question from the line of Chirag Lodhia from Value Quest. Please go ahead.
- Chirag Lodhaya:** My question is on the gross margin front, in last three years the cotton prices were on a downturn and we have seen about 7%-8% kind of gross margin improvement in our business. A lot of may be because of cotton prices as well as currency and now in last three months - four months, we have seen 30%-40% increase in our cotton prices and still you mentioned, currently cotton trades are happening at 41,000 - 42,000 still they are 15% to 20% higher. Suppose if this price has sustained for next half of the year what kind of impact you will see on your gross margins?
- Rajesh Mandawewala:** That is what I said, despite the cost increases we believe we should be able to retain our margins so, we have a strategic relationships with our client. So we hope to work through all these cost increases with our clients to pass on some of the impact to price improvements or repacking of the products or a combination of the two. So we believe we should be able to retain our margins.

- Chirag Lodhaya:** So you mean to say 20% Y-o-Y increase in cotton prices you will be able to maintain the gross margin despite 20% increase in your cotton prices on a yearly basis I am taking about.
- Rajesh Mandawewala:** I do not know about the gross margin my friend. This we are talking about EBITDA margins. Our goal is to retain our EBITDA guidelines that we have been giving out to all of you.
- Moderator:** Thank you. Sir, that was the last question. I would now like to hand the conference back to the management for their closing comments.
- Altaf Jiwani:** Thank you ladies and gentlemen and if you have any more questions you may please e-mail it to our Investor Relations team Harish and Subir, and we will be happy to address those. Thank you.
- Altaf Jiwani:** Thank you. Thank you so much.
- Moderator:** Thank you members of the management team. Ladies and gentlemen, on behalf of IIFL Capital, that concludes this conference. Thank you for joining us and you may now disconnect your lines.