



“Welspun India Limited  
Q2 FY2019 Conference Call”

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**Moderator:** Good day ladies and gentlemen and a very warm welcome to the Welspun India Limited Q2 FY2019 Conference Call, hosted by IIFL Capital Limited. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “\*” and then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Avi Mehta from IIFL Capital Limited. Thank you and over to you Sir!

**Avi Mehta:** Thank you Ali. Good evening everyone. On behalf of IIFL, I would like to welcome all of you to the 2Q FY2019 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) & CFO and Mr. Akhil Jindal, Director, Group Finance & Strategy. I would now like to hand over the call to the management for their comments. Over to you Sir!

**Altaf Jiwani:** Thank you Avi. Good evening ladies and gentlemen. Welcome to this concall for Q2 for Welspun India. This is after a while we have actually returned to a double digit growth trajectory so we have achieved a turnover of Rs.1798 Crores, which is about 10.3% growth over the corresponding quarter last year. Profit after tax we have achieved 18.8% growth over last year, which is about Rs.115 Crores. EBITDA is flat it is about Rs.307 Crores compared to Rs.306 Crores last year. Of course the margin has been lower it is at 17.1% compared to 18.8%. The reason for this is actually our exchange rate impact; while the entire cost structure has got aligned to the new exchange rate whereas the impact of that is not reflected on the topline. In the current quarter, we actually realized 68.25 Rs. to the dollar whereas the daily average spot was about 70.18, so that is about 2.8% gap vis-à-vis the spot rate. We have certain hedges we have been following this policy consistently and as these hedges get exhausted or utilized we will see the impact of current exchange rate also getting reflected on the topline.

As far as the borrowing is concerned, we had actually started reporting Welspun flooring debt separately from this quarter, so there is Rs.85 Crores of borrowings, which we have availed for our flooring business. In terms of long-term debt, it is down by Rs.136 Crores, but the short-term debt has gone up on the back of higher working capital. Net-net we are actually better from the core business, which is generating adequate cash flow. We have been able to reduce the borrowing at Rs.79 Crores. The net impact on the net debt looks muted because of the additional borrowing for the flooring business.

In terms of return on equity, we have improved from 15.4% to 18.5% and return on capital employed has improved from 11.3% to 13.2%. If we exclude the flooring business then there is about another 20 basis points increase in the return on capital employed. The total capex during the year in the first half has been Rs.321 Crores, which includes Welspun flooring capex of

Rs.192 Crores, total we have invested about Rs.212 Crores in this project so far. The SPACES business we have actually seen during the current quarter a growth of almost 20%. Last year we had Diwali, which was three weeks ahead and we had a lot of sale during September, so if we knock off the September Diwali sale for last year then comparable growth is about 20% in Q2. We have received the TEXPROCIL Award for overall export as well as the highest export for towel as well as bed sheet.

The other expenses had gone up substantially during the Q2. This is the reflection of the energy cost so we had substantial energy cost affecting the freight cost, the power and fuel cost. There have been higher legal fees, job work charges, stores and spares and also we have made provision for IL&FS, we have an investment of about Rs.10 Crores in IL&FS, we have provided Rs.2.7 Crores for that, so these are the reasons why the other expenses have gone up substantially during this quarter. With this, I am requesting Mr. Mandawewala to give his views on the performance.

**Rajesh Mandawewala:** Good afternoon ladies and gentlemen. I am aware that all of you must be concerned about the sharp reduction in the margins on EBITDA, as Altaf very rightly alluded, so our hedging policy has been holding us in good stand for the last four to five years. Unfortunately, this is the time when the payback time has come, so about 2.5% to 2.8% of margin actually was lost on account of the hedging rate, so if we were not in a hedged position we would have realized 70.2 against which we are at 68.25, so that translates to about 2.8%. Besides there are one off expense just like Altaf mentioned so about Rs.3 Crores provision for IL&FS investment. Legal fees we saw this we have provided for about Rs.10 Crores to Rs.11 Crores in this quarter and this is on account of the class action suit that we have in the US and so this is coming to the business end now where the activity is intensifying, so consequently the charge and this is also likely to continue for the next couple of quarters and there is one more thing, which is let us say we lost some cotton in a small fire in one of the godowns that we had so this net of insurance this we have actually had to take a hit of about Rs.4 Crores to Rs.5 Crores and which is again a one off thing so all put together I think those one off kind of expenses reduced our margins by about 1.1%, so if we add all this up the business is still let us say they have generated in excess of 20% EBITDA say between 20 and 21 and in absolute numbers in excess of Rs.350 Crores on this Rs.1800 Crores kind of revenue, so the underlying business this remains intact. In fact, as Altaf very rightly said, so the business has grown quite handsomely and this 10% plus growth in the current quarter is after adjusting the drawback rates, which actually came down, so year-on-year it also impacted to some extent, so the 10.8% growth is actually net of that and we believe that the growth trajectory will continue over the rest of the year and going forward as well for the future years, so this is close to double digit growth, this should be possible. So as we have seen also on the hedging side so let me also clarify that we have another \$170 million to \$180 million of hedge at about Rs.67 to Rs.68 for the balance part of the year. For the Q3 and Q4 of the current year, we are likely to realize around 69 or thereabouts, but the next year hedges are good,

so we have hedged about \$160 million to \$170 million at an average rate of about 73.5 based on our current policies, so we continue to hedge about 50% to 55% of our annual exports one year forward, so we are continuing to sell our foreign exchange for the next year as well on a weekly basis, so we are hopeful at current rates for FY2020 our realization, which in the current year is around 68 plus should be in the 74 range so there is a fair bit of this currency tailwind that we should be able to get in the coming year, so hopefully which should help regain some of the lost margins that we have had.

Also on the business side, there is some good news to share. The US market has recovered. I think most of our customers are out of the destocking cycles, so business is normalized. I think the e-commerce versus the real world sales balance has kind of stabilized in the market place and as a company I think we have taken huge strides to set ourselves beautifully with all the market places there, so we are gaining share on the e-commerce side of the business as well, so the visibility is good for the next couple of quarters. The sales are looking good. For the coming year FY2020 also we believe we should be able to stay on guidance, so all in all from the business side only positive things to share.

On the pricing thing, there was a significant increase in our input cost on account of cotton, fuel and so on and so forth, but unfortunately we could not pass this on. Before we could do anything significant the Indian currency depreciated, which kind of neutralizes, this increase in the cost, so hopefully from a margin perspective while we are losing in the current quarter and maybe this will look a little subdued in the next couple of quarters as well, but as I said because of the better exchange hedges that we have for the next year the margins should get recovered as we go forward.

On the carpet project that we are executing so I would like to give this offer certain details on this investment that we are making in the carpet business. Firstly we expanded the scope of the project, earlier our goal was to do only this commercial flooring, as we started getting into the market place we realized the potential is actually wide outside the commercial segment as well. Hospitality is a huge market. Residential is a massive market, so the residential area and all flooring if you look at the hard flooring, wood and so on and so forth it is in the Rs.50000 Crores range, so we said we will expand our offerings, so consequently we added product categories into our project, which actually led to increase in the project cost to about Rs.1100 Crores. We believe we will get into commercial production let us say by June 2019 the construction of the project is going on well. We believe the revenue potential is 2x of the capital expenditure that we are making. I think the addressable market for the products and for the segment that we propose to cater is about anything between Rs.7000 Crores and Rs.10000 Crores. The margin profile and the return ratio should be similar to the existing business that we are in, so although the revenue will take us a few years to realize full potential and also there is international revenue potential. We are as much hopeful to start exporting products from our facility as we are excited about the

domestic markets, so in the domestic market it will be a B2C play. There will be a huge amount of marketing, this branding element that will come in, dealer distributor, our network is going to be setup, so we are already on way to actually creating a dealer distributor network and by the time we get into production we should be ready with our dealer and distribution network. There have been I think questions around why we shifted the location from Gujarat to Telangana. We believe we have a very, very huge stake in the state of Gujarat already between all the group companies and particularly Anjar, so we employ about just close to 30000 people there and all businesses are housed there, so we thought this was the best time for us to move into another location and this as we have broken ground there and are into the construction phase we are very delighted actually with the support that we get from the state government. Also not only that we have had a very handsome incentive package from the state and the treatment there is red carpet, so they are really, really supporting us with this project that we are executing there, so we are pretty happy with that decision and although going to a new location means about Rs.100 Crores to Rs.150 Crores of additional capital expenditure, but this I think all that in the future years will get mitigated to the better package that we have gotten this from Telangana Government. Also the borrowing that we will be making for this project will come at a net cost of between 2% and 3% to us. All the term loans net of the interest rebates that we get on the project, this will come at 2% and 3%. The money is not going to be very expensive and that is where the project is. As I said we are likely to start production sometime in June 2019 and out of the Rs.1100 Crores of capex we look like we will spend about Rs.800 Crores in this current year, Rs.300 Crores or thereabouts will get spillover to the next year, which is FY2020 and the current year capex guidance is in totality around Rs.900 Crores so about Rs.700 to Rs.800 Crores for the carpet projects and the rest of it for the balancing capex for our textile business. A big part of that is actually we are setting up a new boiler for our power plant, so we did not have a standby boiler, so a big part of the textile capex is not actually for capacity, but to actually take some risk out of this captive power generation, so this boiler will come into business sometime in the March quarter for 2019, so this is where our plans for the capex are. As Altaf said we are pretty excited and we are really, really getting behind our brands in the domestic market on the home textile side of the business. Apart from investing in the brand and marketing and some of you must have caught the couple of new campaigns that we have come out with for our brand spaces in the domestic market. It has actually received a phenomenal response, the business is growing at 20%+, but spaces its position actually at the higher upper end to the higher end of the market and while the home textile market in India is in excess of Rs.25000 Crores, but for us because we are positioned at the higher end so arguably the addressable market there is about Rs.1500 cores or thereabouts. We are now working to really how do we bring ourselves into the middle end of the market, so we have actually cracked that piece. In the next couple of quarters, there will be visibility around going to market with the Welspun brand on towels and sheets and which will cater to the middle end of the market and that expands our addressable market, which currently is at Rs.1500 Crores or thereabouts to about between Rs.6000 Crores and Rs.7000 Crores so hopefully in the next year we should see phenomenal growth coming from the domestic market.

The complete team has been overhauled. We have great bunch of people who are running the business and the goal is by the end of FY2020 that we should be in four digits in terms of the number of outlets that we are available out of and in excess of 1000 outlets I must say and between Spaces and active outlets. Very aggressive work is happening in that area and we are pretty happy to see the progress in that area of our business.

The business will continue to grow. We are working towards making 20% of our business coming from the domestic market and we believe over the next few years that between the floorings business and between the brand spaces and Welspun for the home textile business, I think we have a good shot of getting to this number of 20% in the domestic markets, so look out for the Welspun brand just introduced to the domestic market and as I said we are pretty excited.

One last thing that I wish to address is the working capital cycle, so in totality our working capital cycle has reduced from 96 days to 84 days, but we are aware that in absolute numbers that both our inventory and receivables are slightly higher than where we want to see them. Work is happening. I think Altaf and his team are pretty much behind this. The good part is there is nothing untoward that is happening so this inventory and all receivables are good. I think it is just cyclical, so I think work is happening and hopefully in the next couple of quarters we will see better returns particularly on inventory and more than anything else. I thought it was important for us to address that part also. With that we will be very happy to take questions from you ladies and gentlemen.

**Moderator:** Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Nihal Jham from Edelweiss. Please go ahead.

**Nihal Jham:** Good afternoon. Sir my first question is on the expense side, so wanted to know that what was average cost of procuring cotton for this quarter and was our inventory is sufficient for meeting our requirements for Q2?

**Altaf Jiwani:** We were at an average hybrid cost of about Rs.49000, but this includes premium cotton. If you talk about equivalent of Shankar 6, so we were at about Rs.46000 a candy and which by and large is the current price. We have seen most of the impact of the increase in the cotton prices in the second quarter and mind you the cotton prices have started going up in the early part of the year and so this totality impact of all that put together is by and large at current cotton prices.

**Nihal Jham:** Even the current prices are more or less same as you are saying for the remaining quarters of the year our procurement cost is more or less going to be similar is what you are saying?

**Rajesh Mandawewala:** As of now it looks like it is going to be similar and mind you our raw material is only 60% so we buy a lot of yarn and fabric as well from the outside, so there is not much that we can do to hedge our position on that front, but cotton we do try and cover. By and large as I said I think the Q2 numbers are reflective of the current cotton prices, so it is not only cotton this commences ahead with the depreciation in the Indian Rupee, our fuel prices went up, all the freight rates they went up, paper prices went up, so all ingredients everything that goes into the product and all services most of them are dollar denominated, cotton is dollar denominated, fuel is dollar denominated, so they got repriced and consequently came out and they hit our P&L, but within this expenditure as I said there is Rs.18 Crores to Rs.20 Crores of expenditure, which is one time, a part of that is likely to continue over the next couple of quarters particularly the legal cost, but rest of it is a part of the business. If our fuel cost has increased or if our stores and spares have increased or if our transportation has increased or if our job working rates have increased, so they are part of business. They have been repriced based on the inflation and the depreciation in the currency.

**Nihal Jham:** Sure Sir absolutely. The second question on this hedge policy if I exclude the impact of the increase in cotton, which is different, but generally when we say hedge 60% of our exposure I am guessing that is a figure at which our net exposure is zero, so at a 60% hedge we should have not had any impact of the depreciation coming in ideally right, the benefit of the 40% spot rate negating the impact of the increase in the cost?

**Rajesh Mandawewala:** There is some lag of couple of quarters it takes for it to be neutralized. For example in this quarter, you will appreciate the impact of the currency is almost instant on commodity, so the commodities get repriced the next day, but see the hedge is an hedge, because we realise 68.25 against let us say an average of 70.1 hedge and going forward this will get mitigated, so if you look at FY2015 onwards, so FY2015, FY2016, FY2017, FY2018 is actually all these hedges they actually helped us maintain a decent level of margin, so it is time to pay back I guess. Consequently we are down 2.5% to 3% in this quarter on account of the currency.

**Nihal Jham:** Just one last question from my side that as you mentioned that you are looking at hedges of say in excess of 73 for the coming year, now do we expect to take the entire gain or you expect some portion of that to be passed on in the pricing for next year and finally what would be your margin guidance then?

**Rajesh Mandawewala:** There is no question of passing on anything. In fact, we were in price increase discussions with our client because of the steep increase in the cost of cotton, so I think that gets now neutralized so that goes out of the window. There is no question of increase, but there is no question of reduction of prices as well. We do not see that; there are no discussions happening and we have no intent of reducing our prices and there is no need as well. I think the prices will remain flat

and just hopefully this with a better exchange rate we should see the margins creep back up to normal levels in the next year.

**Nihal Jham:** Sir if I understand right, we are expecting the entire gain from 68 to 74 is something that will reflect in our numbers?

**Rajesh Mandawewala:** Net of a couple of points on account of costs Nihal. The cost will continue to rise based on inflation and so on and so forth, so this net of that this as I said this we believe the current cost structure in the Q2 is reflective of the current exchange rates, so if nothing changes barring a couple of points of inflation and the uncertainty around cotton prices it should get back to the margins.

**Nihal Jham:** Sure Sir any expectation of what the margins could be like for the coming part of the year and in 2020 because we have a guidance of 19% to 20% currently?

**Rajesh Mandawewala:** Unfortunately this year because of the currency impact I think this will be a little lower on the margins as compared to where we have guided, but we should be better with this 19% to 20% guidance when we talk about FY2020.

**Nihal Jham:** Thank you so much. I will get back in the queue.

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

**Sumant Kumar:** What is the outlook for Europe and rest of world home textile market, as you mentioned US market has already recovered and we are seeing early stocking, so how is the growth in the other geographies?

**Rajesh Mandawewala:** Every single geography we are growing. If you look at the first half, when I look at the first half number actually our slowest growth has happened in the US. Europe, India, rest of the world, so India is 20%, rest of the world is about 13% to 14% and US in fact has grown in the 4% to 5% range, so all in all every market for us has grown. We feel very comfortable with the way our business is headed. The concern this as I said is if you do not like your margins to go down, but we just got hit with this currency rate, but otherwise if you really see the growth in the topline is actually in excess of the 10% to 11% that we have reflected in this quarter simply because you see the drawback rates have reduced and on apple-to-apple basis as compared to last year. The growth is actually in the 13% to 14% range it is not 11% it is in the 13% to 14% range, so the business is comfortable. It is comfortable in all parts of the world actually.

**Sumant Kumar:** Europe also we are growing at 13% to 14%?

- Rajesh Mandawewala:** Absolutely.
- Sumant Kumar:** The rest of all same growth?
- Rajesh Mandawewala:** Absolutely. India is growing at 20% for us, so on a levelized basis we are growing at 20% within India as well.
- Sumant Kumar:** We made a provision of Rs.10 Crores to Rs. 11 Crores for class action, so can you expect similar run rate for provision for a couple of quarters?
- Rajesh Mandawewala:** Yes. Also now we are in the business end of that legal thing. So the next couple of quarters, at least how you should look at, we are expecting similar kind of rates come to the P&L, so hopefully by that time we are able to find some kind of solution or let us say there is some kind of verdict, but for the next couple of quarters it appears that this will continue with this cost.
- Sumant Kumar:** Other cost will be in the higher range for the couple of quarters?
- Rajesh Mandawewala:** Right.
- Sumant Kumar:** Because of forex loss and all the provisions?
- Rajesh Mandawewala:** Absolutely right.
- Sumant Kumar:** And the EBITDA margin, you are guiding 19%, 20% for FY2020 and 2019?
- Rajesh Mandawewala:** I am saying that it should be better than that if cotton does not change from here significantly, but in the current year we will be a little lesser for obvious reasons that I just mentioned. So I do not think we will be able to make 19% in the current year, so first half year at 18.7%, if we are able to be around 18%, so that would be a more realistic number for the back half of the year.
- Sumant Kumar:** What is the outlook of cotton, your view on that?
- Rajesh Mandawewala:** So our view is that cotton should trade at around Rs.46000, Rs.47000 where it is currently, so there is no dearth of cotton. The crop in India is as good as it was last year, so this 375 lakh bales, this is the beginning of the season. Normally, we see that price is under pressure at least until the end of January and these arrivals are high, so there is no reason for us to believe that this cotton will significantly change from here. Having said that the MSP has put a floor to the cotton prices at about Rs.44000, so cotton is not going to go down below Rs.44000, so currently it is trading at Rs.46000, Rs.46500, so the downside is very little and this on the upside is at least in the next two, three months, our expectation is cotton should stay at current levels and by which time we expect to cover 70%, 80% of our cotton.

- Sumant Kumar:** So assuming 2% decline in cotton sowing this time and there is a drought in Gujarat, Marathwada and Vidarbha is also facing problems and some part of Rayalaseema there is a drought, so assuming all these factors do you think the production of cotton will be lower this time?
- Rajesh Mandawewala:** Last year, we were around 365 to 370 lakh bales or 3.7 Crores bales, so it appears that we are going to be around that level only. The projections are reflecting that from the trade associations, so they are reflecting, even last year there was damage to crop in some parts of the country, so the expectation is for the crop to be where it was last year.
- Sumant Kumar:** Thank you so much.
- Moderator:** Thank you. The next question is from the line of the Bhavin Chheda from Enam Holdings. Please go ahead.
- Bhavin Chheda:** Good afternoon Sir. How much was the innovative product sales as a percentage of overall sales and how they have grown in first half?
- Altaf Jiwani:** Bhavin, we do not give quarterly numbers, but last year 37% of total revenue was from innovative sales, which has been growing every year. So year before that we were at 36%, last five years we have been consistently growing the share of innovative sales.
- Rajesh Mandawewala:** So we are better than that, so we guide this once in a year, but we are better than what we did last year I think that should answer your question Bhavin.
- Bhavin Chheda:** Right and second question if you can help us with the geographical mix of sales either in quarter or first half, how much is now non-U.S. side of the business picking up and how much percentage that is?
- Altaf Jiwani:** So we are around two-thirds, one-thirds, which is where historically it has been, in fact U.S. is slightly lesser than two-thirds in the first half, so we are at about 63%, 64% in the U.S. and the rest of it is coming from the rest of the world.
- Bhavin Chheda:** And that part of the business is also growing in double digits?
- Rajesh Mandawewala:** Absolutely. In fact, the other parts, other business is actually growing faster.
- Bhavin Chheda:** It looks like the U.S. restocking is helping the major home textile players if we see the results, which are declared and you must be already having an indication of next seasonal since it is a seasonal business, so volume growth it looks like it is in double digit, but U.S. normally grows at

3%, 4%, which means that we are still increasing the market share and who is losing market share to India then?

**Rajesh Mandawewala:** There are two reasons. So A is this we are certainly gaining market share, as a company we are certainly gaining market share, so there is no question that we are gaining that and we have been gaining that in the past and we will continue to gain. The other thing is this is the newer products, so there is not every product that we are in is matured, so for example towel is in a matured phase, sheets is in an almost matured phase, but our flooring business is growing. Our fashion bedding business is growing, our utility bedding business is growing and we are actually very pretty excited with those categories. So there is category growth as well, and then our hospitality businesses, we are pretty pleased with the way our hospitality business is growing as well, so now in fact we have decided to take it global and we were until now focused in the U.S. market on hospitality, we want to make this a worldwide initiative, so we are pretty happy, so these are things, which also help you gain more market shares.

**Bhavin Chheda:** Thank you.

**Moderator:** Thank you. The next question is from the line of Sagar Parekh from Deep Financial Consultants. Please go ahead.

**Sagar Parekh:** Thank you for taking my question Sir. Just following up on Bhavin's question on the market share in U.S., so given the fact that this entire trade war is happening between China and U.S. and China still holds a significant part of the market share of U.S. for U.S.-based retailers, do you still believe that we can still take China's market share given the fact that there is a lack of clarity, so are you seeing the retailers coming to us and if yes then FY2020 can be a big year for U.S.-based sales?

**Rajesh Mandawewala:** So there is no question, first thing is the tariffs have not impacted the textile items, so the textiles have been left out of the tariffs. There is no direct impact of the tariffs on our product category. Having said that, there is very general nervousness in the market, so these customers are very, very concerned with what is going to happen tomorrow with their sourcing out of China, which will open up opportunities I think that it will open up more opportunity on the fashion and utility bedding side of the business than let us say on the other products because on the other products honestly the China has consistently lost part of a market share to us and it has been consistently happening, so I think the big opportunity is the way that we see it is actually from utility and the fashion bedding area.

**Sagar Parekh:** Let us say that the U.S., you mentioned that H1 growth was about 4% to 5% for us, right, so with increasing share in fashion and utility then can we expect double digit growth next year in U.S., let us say that the third round of tariff includes the textile part of the business?

**Rajesh Mandawewala:** I guess what this we feel comfortable with our business growing around the double-digit mark in totality. Sometimes, some markets will perform better than the other, so all in all, in totality we believe that our business is good for a double-digit kind of a growth here.

**Sagar Parekh:** That is volume driven, right and the currency benefit will be over and above that?

**Rajesh Mandawewala:** Yes.

**Sagar Parekh:** Great Sir. Thank you so much. That is it.

**Moderator:** Thank you. The next question is from the line of Basant Patil from Mentor Capital. Please go ahead.

**Basant Patil:** Good afternoon Sir. Thanks for giving an opportunity. I just wanted to understand clearly on the hedging loss actually, can you share what is the loss we have incurred in this quarter particularly from the hedging?

**Rajesh Mandawewala:** So about, net-net say about Rs.37 Crores, Rs.38 Crores on a net-net basis. So as we realized let us say the spot rates, our P&L could have looked about say about Rs.35 Crores, Rs.37 Crores better.

**Basant Patil:** So you will see the pain to continue for the next two quarters also?

**Altaf Jiwani:** Yes.

**Basant Patil:** I could not understand, we have not reset the rates actually, why this actually just can you explain more in why we are getting?

**Rajesh Mandawewala:** The hedges were less than Rs.66, so there was a point when the currency actually came down to Rs.63 and we sell our exchange every week, so there was a long period when the currency was actually languishing at about Rs.63 and with 4% kind of premium we were selling exchange at Rs.65, Rs.66, so unfortunately this is the period where let us say it is coming and hitting us the most.

**Basant Patil:** So we could not able to reset that actually. We do not have an option to go for the reset immediately?

**Rajesh Mandawewala:** We do not want to see. I will tell you this. It has held us in good set over the last four, five years. Over a period of time, it will average out, yes, but we prefer the jolt instead of one year zero and the next year hero that if we can spread it over four, five years it is always in everybody's best interest here.

- Basant Patil:** Coming to this new project carpet what we are putting up, so at the 100% capacity utilization we are anticipating 2x kind of the revenues?
- Rajesh Mandawewala:** Yes, we should be able to get that.
- Basant Patil:** So by FY2021 only we can see the revenue visibility from this project, is that correct?
- Rajesh Mandawewala:** Yes, in fact even in FY2020 there will be some revenues, which will start trickling in and over a three-to five-year period I think that we will be able to realize the potential of the project.
- Basant Patil:** Another three to five years, you can able to see the 100%, above 80%, 90% kind of utilization?
- Rajesh Mandawewala:** Right.
- Basant Patil:** Can you share what kind of the margins you are anticipating in that?
- Rajesh Mandawewala:** The return ratios will be similar to our current business. The early stages for obvious reasons when the utilization is less the margins will not be reflective, but on a steady state basis the margins should reflect what you see currently and the return ratio should also be commensurate with what our current business is doing.
- Basant Patil:** Apart from this capex, carpet project, any future major capex going ahead for the next two to three years?
- Rajesh Mandawewala:** No, we do not expect, honestly on the textile side even in the current year the investment is not much as I said, we are just investing in a boiler, which is costing us about Rs.100 odd Crores and that is to our power supply, but otherwise this business is good to grow double digit for the next couple of years and not much capex needs to go, so with Rs.100 Crores, Rs.150 Crores kind of capex we can continue to grow our business over the next two, three years.
- Basant Patil:** Just coming back to the hedging, so only in next year itself we are able to see this trend to reverse happening, what we are facing this year in terms of loss?
- Rajesh Mandawewala:** Clearly half the hedges that we hold today is for the next year and the next year hedges are at 73.50, and this is let us say the current spot price at least we will stop losing money.
- Basant Patil:** Fine. Thank you Sir.
- Moderator:** Thank you. The next question is from the line of Sachin Kasera from Lucky Investment Managers. Please go ahead.

- Sachin Kasera:** Good afternoon Sir. Just one question; the revenue for Q2 is higher by around 14% over Q1, entirely driven by volume?
- Altaf Jiwani:** Yes, So this is our volume growth, yes.
- Sachin Kasera:** So we can assume this Q2 number sort of sustainable in terms of the run rate for the remaining two quarters, at least?
- Rajesh Mandawewala:** Yes. We are hoping to do double digits in the balance part of the year, but right now honestly on the topline we have a lot of confidence, so topline is moving in the right direction and you never know something is happening, for one or two customers some orders will come and orders will increase we do not want to be bombastic, but our confidence is pretty good on the topline.
- Sachin Kasera:** Appreciate it. Second question is on the carpet. You mentioned three to five years for full ramp up, but what level of utilization should be break even and which year do you foresee that at the net level and both at the EBITDA level?
- Rajesh Mandawewala:** At 40% I think we should be able to break even and that should come in back half of the second year or the third year, latest in the third year, so that is what our expectation is.
- Sachin Kasera:** So fair to assume that in FY2020 there could be some drag on the profitability because of the carpets getting commissioned because of the fixed cost and the ramp up will obviously take some time?
- Rajesh Mandawewala:** I will tell you. Out of this capex, so one third of the capex is actually to produce this yarn for consumption a part of that yarn we are already consuming to make our rugs and the other products in our Vapi and Anjar factory. So one-third of the capex will start yielding results hopefully in a quarter or two, so as we stabilize the yarn plant it will start at least that will produce, let us say these two capacities, so that will cover hopefully just cover a reasonable part of the expenditure that we are going to incur and interest outgo is going to be limited as I said the term loans will come at an average cost of 3%. The interest outgo is going to be limited, but the depreciation is going to be sizeable, so to that extent at the PBT level there might be some impact, yes.
- Sachin Kasera:** At the EBITDA because while the one-third cost will be recovered remaining two-third will have a lot of fixed cost, so even in the EBITDA level if you think FY2020 we should break even or even the EBITDA there could be some loss in the first year of operation?
- Rajesh Mandawewala:** We will be very happy if you can break even, but we should be slightly shy of that as per our current estimates, but we are a little aware, so unless we get to the market we will not know, but this is comforting as I said, so there is a comforting fact that a third of the capex will start

yielding results, so this is not that everything is going to be off to a slow start, so at least third of the capex will be productive capex early and the balance two-third will take a little time for us to ramp up.

**Sachin Kasera:** Sure, Sir. Just one question on the margins front; you indicated that this year we should be looking more closer like 18 compared to the 18.7 that we have reported. You also mentioned that other than legal, which was going to continue for the remaining two quarters there were some other fixed costs in other expenditure, which may not be there, so are we assuming some more cost increase from cotton in H2 and that is why we are looking at the benefit of the one off being negated by higher cotton cost or is it that there has been some other expenditure also going forward?

**Rajesh Mandawewala:** What I mentioned is that this is the one-off cost, so a couple of other costs that I enumerated were one-off cost. The other costs, which have increased will continue because if power has been repriced, if coal prices have gone up, if trades have gone up, they have gone up, if job work charges have gone up they have gone up, so they have already been repriced so they are a part of our business, because of the currency and inflation those costs have gone up and they will continue to remain up and we have already priced it. The second quarter is almost reflective of the new cotton cost and the new cost on other inflation so this already factored let us say in the second quarter.

**Sachin Kasera:** So fair to assume that we do not see too much of risk to the H2 numbers from cotton, as of now we are comfortable in the quarter and as far as H2 is concerned. In the sense we have built in that cost already in our model?

**Rajesh Mandawewala:** We were at Rs.46000 right now cotton is around that, so the results take care of Rs.46000 cotton.

**Sachin Kasera:** How much will you hedge for the next six months, are we hopefully hedge for cotton as far as cotton is at least concerned?

**Rajesh Mandawewala:** No, in fact, this is just the beginning of the cotton season, so we will start covering now cotton. In fact we have started covering cotton, so this is between now and end of January our goal is to cover most of our requirement.

**Sachin Kasera:** Just on facility front assuming for whatever reason the cotton comes to Rs.48000, Rs.49000 for the season can we see more risk to the margins in H2 Sir?

**Rajesh Mandawewala:** Of course, to that extent the margins will get impacted. Currently, we are at Rs.46000, so these all margin discussions are around the 46 mark.

- Sachin Kasera:** I appreciate it. Last question, you mentioned that other than carpet the normal textile from next year for sometime will not require any major capex, so are we looking at increasing payout in that case because of the cash flows is robust or are we looking at a significant debt reduction that in 2020?
- Rajesh Mandawewala:** FY2019, all the cash flows that we generate for the capex and FY2020 onwards, certainly, there is a reduction of debt, I know we have been talking about it for a long time, but hopefully by starting FY2020 you will start seeing reduction of debt, so we still have some high-cost debt, high cost meaning 9%, 10% cost debt on our book, so the first thing that we would want to do is actually eliminate that debt before we actually increase the payout.
- Sachin Kasera:** Thank you so much and wish you all the best.
- Moderator:** Thank you. The next question is from the line of Avi Mehta from IIFL Capital. Please go ahead.
- Avi Mehta:** Sir, I just wanted to understand, while we have seen an uptick in the volume growth on a two-year CAGR basis has there been a clear pickup in underlying demand because the base also was there a little favourable, so how should I look at that, Sir?
- Rajesh Mandawewala:** You got it right. There is an extraordinary event, there is some market share erosion and we are regaining that market share, which is what is happening and going forward our business has consistently grown, outgrown let us say the rate of growth of the world GDP, so this we believe that our business is good enough to continue to grow, so this double digit and at least this quarter is reflective we feel good about the rest of the year and FY2020 also we hope that this growth momentum should continue.
- Avi Mehta:** While there are clearly levers, from an industry point of view for India, how has the growth rate being Sir, is that being on a two year, three year basis improving or flattish is what I was trying to understand?
- Rajesh Mandawewala:** I have reasons to believe that everybody in India, this is I think is a part of the important process that they saw last year, now that as the business is restoring to normalcy I think everybody's topline should improve.
- Avi Mehta:** I think my question was more or now some of two years if I look at only two years. I understand the base was there. We remove that base and see the base before that, so on the two year growth rate basis has there been an improvement that is what, but I will take it offline Sir. The second thing was on Alok if there is any update over there post corrections and change in the ownership, any comments that you could share on that, Sir?
- Rajesh Mandawewala:** We have no idea where the legal process.

- Avi Mehta:** Competitiveness or something like that is what I was looking for?
- Rajesh Mandawewala:** No, I know as much as you guys know.
- Avi Mehta:** Just on the flooring side, just wanted to understand, would it be fair to say that the key pickup we should see in FY2021 coming in from flooring side?
- Rajesh Mandawewala:** The first representative here I believe because as we get into the market firstly to feed the network of distribution one year will go away, so I think 2021 should be the year when business will start showing some kind of this attraction.
- Avi Mehta:** And Sir, from a per unit level, would the margin trajectory be a little most superior than our existing products, so how should I look at that, Sir?
- Rajesh Mandawewala:** By and large you see it will be in the same range.
- Avi Mehta:** That is all from my side. Thank you very much Sir.
- Moderator:** Thank you. Due to time constraints, we will take the last question from the line of Naushad Chowdhary from Systematix Shares and Stock. Please go ahead.
- Naushad Chowdhary:** Thanks for the opportunity. A couple of questions. First one, on the investment capex plan for the power thing, if I heard it correctly you said you would be spending around Rs.200 Crores to Rs.300 Crores for this boiler, right?
- Rajesh Mandawewala:** No. It is about Rs.100 Crores, between Rs.100 Crores and Rs.125 Crores, which is getting covered in the current year itself.
- Naushad Chowdhary:** And how much margin benefits are we expecting from this investment?
- Rajesh Mandawewala:** So more than the margin benefit it actually provides more security of power. I am afraid that I cannot put a number to this because it is actually an investment, which is going to mitigate the risk, but what I can tell you is that because of the low PLF that we have lost about consistently anything between Rs.8 Crores and Rs.15 Crores of margin every year because of let us say this low PLF, which is what we aim to actually say we have this boiler in our power plant.
- Naushad Chowdhary:** You expect this to be operational by March 2019 right?
- Rajesh Mandawewala:** Yes.

- Naushad Chowdhary:** Second thing on the cotton side, is there any possibility that cotton can trade below MSP in any scenario?
- Rajesh Mandawewala:** I doubt. I hope that happens, but I doubt that is going to happen. You know it is going to be more in the 46, 47 range than in the 44, so honestly we do not see cotton actually trading downwards significantly.
- Naushad Chowdhary:** Last thing on the capex for the carpet business is around Rs.1000 Crores, right?
- Altaf Jiwani:** Rs.1100 Crores.
- Naushad Chowdhary:** How are you funding that, what would be the debt portion there?
- Altaf Jiwani:** It is around Rs.800 Crores, about 70:30, 70 will be debt, which will come at average cost of 3% and the rest of it will be from accruals.
- Naushad Chowdhary:** What is helping us to get the debt at that cheaper rate, 2% to 3%?
- Altaf Jiwani:** That is the kind of package that we have negotiated with the state.
- Naushad Chowdhary:** So it is not the foreign rates INR debt, but you are getting at 2% to 3%?
- Altaf Jiwani:** Yes, absolutely it is a rupee debt.
- Naushad Chowdhary:** Thank you so much Sir.
- Moderator:** Thank you very much. I now hand the conference over to the management for their closing comments.
- Altaf Jiwani:** Thank you ladies and gentlemen for joining this call. If you have any more questions, you may please contact Harish and he will be happy to answer those questions. Thank you very much.
- Moderator:** Thank you. Ladies and gentlemen on behalf of IIFL Capital Limited that concludes this conference call for today. Thank you for joining us. You may now disconnect your lines.