Transcript

Conference Call of KPR Mill Limited

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Presentation Session

Moderator: Good evening ladies and gentlemen. I am Shyamala, the moderator for this conference call. Welcome to the KPR Mill 2Q FY19 earnings conference call hosted by Batlivala & Karani Securities India Private Limited. At this moment all participants are in the listen only mode. Later we will conduct a question and answer session. At that time if you have a question please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to hand over the floor to Ms. Prerna Jhunjhunwala. Over to you ma'am.

Prerna Jhunjhunwala: Thank you Shyamala. Good evening everyone. On behalf of B&K Securities, I would like to welcome you all to Q2 FY19 results conference call of KPR Mill Limited. From the company we have with us the senior management, including Mr. P. Nataraj, Managing Director of the company, Mr. Murugappan, CFO, Mr. Kandaswamy, who is the Company Secretary of the company. I would now like to hand over the call to the management for their initial comments. Thank you and over to you sir.

P. Nataraj: A very good evening. I am Nataraj, Managing Director of KPR Mill Limited. And I welcome you all for the KPR Mill second quarter conference call for the financial year 2018-2019. With me our CFO Mr. Murugappan and Company Secretary Mr. Kandaswamy are there. The performance was better compared to the previous year. Contribution from garment segment has gone up. As the garment production has increased, the captive consumption of yarn as well as fabric has also increased. Our effective financial plans and performance enabled comfortable current ratio and fund position. Regarding cotton, the new season has started and cotton availability throughout the year was good, and it is reported to be comfortable further. With the arrival of new cotton, the market is expected to stabilize in the coming months, subject to the trade war between the two major economies. Yarn price is also stable. Garment order booking position is also very encouraging. We have orders in hand for garment for around Rs. 600 crores.

I am happy to share with you some of the developments in respect of the growth initiatives. With regard to Ethiopia, the garment project, the installation of machinery is in progress. Some of our technical personnel are deputed to Ethiopia for monitoring and installing the machineries and for setting up the factory. Recruitment of employees at Ethiopia is in progress.We have recruited and have given some initial session there and we have taken them up here to Coimbatore to give the training at our factory. This training has already started from the last month. They are all Ethiopian nationals and are expected to give training the new recruits. So, these things are going on as per schedule or even little ahead of the plan. We expect to commence the trial production by January 2019.

The next is regarding the retail business. Here also the initial work is already in progress. Recruitment of the sales team, the brand marketing team and distribution team, all are almost in completion stage. The final process is going on. Simultaneously the technical team is studying on the design, style, fabric, color, etc., All these things are going on at our factory. And we have established the product development team and merchandize team also. Another team is in the process of in-depth market analysis on the price range, customer behaviour etc. So, we want to know practically about the market, so that during the launch we can have a very strong push. And it is expected that the operation may commence during the first quarter of the financial year 2019-2020.

So, with this we hope that the above ventures shall further strengthen the performance of the company. Now, with this the floor is open for questions. Thank you.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have any questions, please press * and 1 on your telephone keypad and wait for your turn to ask the questions. If you would like to withdraw your request, you may do so by pressing * and 1 again.

We have the first question coming from Mr. Chintan from Samiksha Capital. Please go ahead with your question.

Chintan: So, can you explain the gross margin expansion we saw this quarter for the company?

Murugappan: Yarn is 20% EBITDA.

Chintan: No, sir the reason for the gross margin expansion we have witnessed this quarter. Is it related to any benefit from the inventory gain this quarter that has led to this?

Murugappan: It is basically that the yarn textile business is doing well. The yarn prices are more stable during this quarter, garment prices are also stable. Currency appreciation has also helped and because of that the margins are better than the previous years.

Chintan: Okay, got it sir. And sir, export incentives for the first half, if you can provide the figure and as well as the same period last year?

P. Nataraj: So, in percentage means compared to last year, this year there was a 2% difference.

Chintan: 2% of sales? That is likely to continue?

Murugappan: Yeah. Exports incentive compared to the previous year is not comparable, because earlier period we had a higher drawback and RoSL rate. And now in the present they are giving the rupee refund of GST. So, it is not directly comparable. But for the information, last year it was about 61 crores and current year it is about 38 crores. And since GST is refunded, it is directly reducing the cost.

Chintan: Right. We will be knocking off from the cost of goods?

Murugappan: Cost of goods, correct.

Chintan: Okay. sir, in the presentation you have mentioned internal consumption between yarn and fabric and fabric to value added. How do you see this trend further improving in terms of more internal consumption as we are setting up our forward integrated retail garmenting capacity? Where do you see this captive consumption of yarn to increase from 18%, where do you see it will go up to?

Murugappan: Sir, captive consumption of yarn is increasing, because of the increased value added products. And current quarter if you look at it, the increase is about 1400 tons. We hope that this trend will continue for this year. And based on the further expansions in Ethiopia and all, the further increase of captive consumption will improve.

Chintan: Right sir Ethiopia unit, if I look at the garmenting volume this quarter and first half, have already, we have seen around 95% of our capacity of 95 million pieces. So, if I add another 10 million coming from Ethiopia, still the growth required will fall short. Then how do you look at further expanding your capacity on the garmenting side?

Murugappan: It is the first phase of expansion what we are looking at in Ethiopia. Depending upon the outcome of the Ethiopian project, further expansions will be decided.

Chintan: And we won't be looking at expansion in India at least?

Murugappan: Depending upon the outcome of this first phase, it will be decided upon.

Chintan: Okay, sure. Thanks.

Moderator: Thank you sir. We have the next question coming from Mr. Abhijeet Dey from BNP Paribas Mutual Fund. Please go ahead with your question.

Abhijeet Dey: Sir, good evening and congratulations on a good set of results.

Murugappan: Thank you sir.

Abhijeet Dey: Sir, usual question first. Can you just break up the yarn and fabric sales volumes as well as the revenues?

Murugappan: Yeah, I will tell you sir. Volume of yarn is 15400 tons. Volume of fabrics is 1450 tons. And yarn value Rs.189 crores.

Abhijeet Dey: No, it will be more than that sir.

Murugappan: No, Rs.357 crores. Fabric Rs. 37 crores.

Abhijeet Dey: Sir, with cotton prices seeing the downward trend and with the arrivals also increasing in the month of October, do you think coming November there could. Be a revision in the yarn prices ?

P. Nataraj: Sorry, what is your question?

Abhijeet Dey: I was asking sir, if yarn prices could move down from November, now that cotton prices have also moved somewhat lower with arrivals starting to happen?

P. Nataraj: No, actually if you see cotton prices in the last month, in the end of August and up to the middle of September and October, cotton prices are going down. And if you see the last two weeks, it is again going up, because the Chinese are planning to buy more cotton. So, far there is no policy decision, but the market sentiment is that maybe China could buy in large volumes from India, because already there is a tariff charged and the import from US is around 25% . Because of that there is a fluctuation in the cotton prices. Since the last two weeks, the cotton prices have moved up a little bit and because of that the yarn price is also stable. People are expecting that the yarn price may also go up in November, if this trend continues. But, this is also very volatile and very difficult to predict, so we have to wait and see. But anyhow, even though the season has already started; the cotton price has not fallen down much. Because, it was previously Rs.48500 level and it came down to Rs.46000. Today it is Rs.47500. So,it came Rs.2500 down and in the last two weeks Rs.1500 has gone up. So, Rs.1000 plus or minus, it is okay. It will not have much impact on the market. But, we have to wait and see. As on today the cotton price is little firm, so there is no chance of reduction in the yarn price unless the cotton price comes down. This is the position now sir.

Abhijeet Dey: Right. And the expectation is for lower cotton harvest this season compared to what we have seen last year, given the decline in acreage. So, in terms of your inventory buildup sir, are you looking to further increasing your inventory levels than what is usual for you?

P. Nataraj: No, this is the season, so now we have no need for hurrying up actually. This decision we have to take only during February-March , that is at the end of the season whether to keep stock the inventory level. Whether to keep for three months or five months or like that, And now good quality cotton is available throughout the country and even internationally also. And as on today, keeping any inventory at higher level is only increasing the carrying cost. So, this is the position. You know in India that there is no specific data available about the area or the quantity of production all . Last year also at the end of the season various associations had predicted the same way and there was a lot of news in the market. But, this year till September, people said in the beginning, in May-June like that, cotton will not be available like that. So that mills are buying in panic at higher prices. But, actually cotton was available, even old cotton is available till today. The mills, the ginners and traders are in queue to sell to the mills. And nobody is interested in buying the old cotton. So, similarly this year if you see, the cotton acreage, the monsoon is good, the cotton acreage is also high. And very, very interesting, and very positive thing is that last year there was a pink worm issue which spoiled certain areas, especially in Maharashtra and Gujarat. And till date there is no pink worm issue. Already that time is over, they can damage only during the boll position. Now since the cotton already has matured. there is no issue of this pink worm. So, that when you go into deep to analyze, this year the quality is better and area is much more. And except certain States, the other States are doing well. And so far the general situation is that definitely it will not be less than last year crop; if not higher and this is the position. And again, the same thing we have to see that now is that what is the reaction of the trade war. Because, regularly China regular imports lots of cotton from the US and this year they can't import. And they may try to import from India. But, at the same time if there is a shortage here and if the US cotton is available, then India may have to import from US. As we have to be balanced, so that we have to wait and see. Otherwise the quality is good and overall we are very confident. And other thing why the price is high is , because last year the price was below Rs.40000 during the season and now today it is around Rs.47000, the main reason is because of the MSP. The only MSP is around Rs.44000-45000. The Cotton Corporation of India owned by the Government is very keen that they want to take care of the farming community and that the price should not fall below somewhere 45-46. So, this is the position sir.

Abhijeet Dey: Okay and sir, one last thing; the other operating income has come down and that I believe would be because of lower export incentives. Am I right?

Murugappan: Correct.

Abhijeet Dey: Okay. I know it is difficult to estimate anything on that count. But, you expect a similar kind of incentive levels for the rest of the year also?

Murugappan: Yeah, for the rest of the year that would be the same.

Abhijeet Dey: Okay. And sir lastly, what would be the net debt level sir in the balance sheet?

Murugappan: Presently it is about 508 crores.

Abhijeet Dey: 508 crores, okay sir. Thank you and all the best.

Murugappan: Thank you.

Moderator: Thank you sir. We have the next question coming from Mr. Giriraj Daga from KM Visaria Family Trust. Please go ahead with your question.

Giriraj Daga: Hello team. Sir, you were mentioning about the margins segment wise, so if you can just continue with the margins?

Murugappan: Yarn and fabric is about 20%. Garment is about 23%. Sugar is about 3%. Others are about 7%. Overall is about 21%.

Giriraj Daga: Okay. My second question is related to our hedging policy. So, if you can just remind us what is the hedging policy?

Murugappan: Sir, actually on confirmation of the orders, we usually hedge in a week's time. Almost 100% is hedged.

Giriraj Daga: Okay. So, my next question is pertaining to this, like the rupee has weakened significantly in the last few months, are the customers asking you for the price cut or they are more or less okay, since the cotton prices have gone up and they are saying, okay, this is more like offset. What is our discussion around?

Murugappan: For existing orders there is no renegotiation. The prices are firm. But, for the new orders we are also giving some portion of benefit to them and we are also getting some benefit from the rupee depreciation.

Giriraj Daga: So, net-net after adjusting for the cost inflation, we are margin accretive?

Murugappan: Yeah, yeah.

Giriraj Daga: Okay. My third question is related to the investment in the retail sector. So, you said that we will commission from the first quarter of FY20. Can you give some maybe one or two or three years visibility, like what are the number of stores we are planning to open and what is the total investment we have planned so far as of now?

P. Nataraj: As it is in the very early stage and all the preliminary work is going on and first we are planning to go for MBO - multi-brand outlet. Immediately we are not planning to go for our exclusive own stores. So, the investment will be very less, only for the working capital. Otherwise we are going to for first one year we are planning to use the MBO, that is the retail stores from third party, that will we will take a location for rental basis, like that.

Giriraj Daga: Okay. Just third question, do you plan to go regional specific or maybe PAN India basis on the first go?

P. Nataraj: Regional basis.

Giriraj Daga: Regional basis, okay. My last question is, is there any foreign currency debt in the overall debt? And if it is, how much is the number?

Murugappan: Yeah, we have about 7 million dollars foreign currency debt in the books.

Giriraj Daga: Okay. Thanks a lot and all the best.

Murugappan: Thank you.

Moderator: Thank you sir. We have the next question coming from Mr. Siddharth Rajpurohit from JHP Securities. Please go ahead with your question.

Siddharth Rajpurohit: Good evening sir. Sir, thank you for the insight in terms of cotton and the impact of US and China. Sir, I wanted to understand how the demand factor will get impacted and is it helping us in terms of trade?

P. Nataraj: Can you come again?

Siddharth Rajpurohit: Sir, in terms of demand for our products, based on the current trade war between US and China, how is it helping us sir?

P. Nataraj: Yeah, the main thing is whatever the import between these trade war countries, they are charging from 10% to 25% level duty, both import into China from US or vice versa. So, normally the price of the product will go to 10% to 25% and it depends on products. Specifically we cannot point out that this particular product is this much or so, like that, that is we have to wait and see.

Because of that, already there is a very, very tough competition. So, in that situation, Indian garment, textile export or garment export has mainly two regions, one is Europe and another is America. And American market is very huge. And in that market, if you say that there is 10% to 25% increase in the price, while China is having almost 30%-32% of the market share, where India is having around 5%. So then definitely the Chinese exports will come down and even if it comes down 5%,then it is possible that the Indian market will double. But, we cannot expect that everything comes India, as there are also Bangladesh, Pakistan, and other countries . Even if some of the portion comes to us like, 1% or 2%; we can say 20%-25% is an additional growth. So, if this situation continues, it will be a great opportunity for Indian textiles.

Siddharth Rajpurohit: So sir, does it make India competitive or very competitive in terms of China?

P. Nataraj: We hope we will become competitive.

Siddharth Rajpurohit: Okay, too competitive we are now okay, but that level we have reached up till this duty and all.

P. Nataraj: Yeah, we hope so.

Siddharth Rajpurohit: Okay sir. And in terms of garments, Bangladesh is increasingly taking over the global market . So, how is this competition panning out globally sir, in terms of garments?

P. Nataraj: So mainly, this one reason is called FTA that is the Free Trade Agreement. Bangladesh is having this Free Trade Agreement with the major countries, that is what Indian industry is struggling to get and we are continuously knocking the door of the Government. And the Government is also negotiating for almost last two-three years with the other countries, but it is still not through because of some other reasons, as it is not only for textiles but they have to compromise with other duty reduction and other areas for those countries if they want to export to India. So, because of that it is held up. And the duty structure is from 10% to 18% for Europe and for certain products it will go up to 28%, . It is totally free to Bangladesh. So, that is the reason. Cost wise and price wise they have better advantage so, that is the reason they are able to export to Europe and US in more volumes.

Even, with the difference of 10% to 18% in duty structure, India is still able to compete with those countries, because of the India's inherent strength of the availability of raw material cotton. In case of Bangladesh 100% they have to depend on outside countries. And India is the only country where we have surplus cotton. And with our technical team and technology we have a very strong foot on textiles. With all these we are able to compete with these countries. And once this kind of duty problem is sorted out and the trade war has happened, there will be a big boom for India.

Siddharth Rajpurohit: Okay. Okay, sir. Great. Sir, in terms of the cotton prices which are going up how comfortably it has been passed on in the domestic market?

Murugappan: Presently the yarn prices are equivalent to the cotton prices whatever is ruling now. Small difference of about thousand, two thousand rupees between the cotton prices will not impact much.

Siddharth Rajpurohit: Okay. Fine, sir. Thank you. Thank you very much, sir, and all the best.

Murugappan: Thank you.

Moderator: Thank you, sir. We have the next question coming from Trupti Agarwal from White Oak Capital. Please go ahead with your question.

Trupti Agarwal: Hello? Yeah. Sir, thank you for this opportunity. I have a couple of questions. In terms of the revenue breakup if I am not mistaken you said that the revenue from the yarn was about 357 crores for this quarter, right?

Murugappan: Correct, correct.

Trupti Agarwal: And 37 crores for fabric?

Murugappan: Correct.

Trupti Agarwal: So the garmenting division was close to 315 crores, is that right, because the total revenue was 709 crores for this quarter?

Murugappan: Yeah, the garment revenue is about 292 crores and the balance is other income. Hello?

Moderator: Sir, Trupti ma'am's line got dropped out. So, shall we move on to the next question?

Murugappan: Please.

Moderator: The next question is coming from Resham Jain from DSP Mutual Funds. Please go ahead with your question.

Resham Jain: Yeah. Good evening, sir.

Murugappan: Good evening, good evening.

Resham Jain: Sir, I have three questions. So first is we have seen rupee depreciating against USD while Bangladeshi taka has not seen that kind of depreciation in the last one-two months. So have we seen any competitiveness coming down in terms of passing on or to take the customers not asking for price hike, anything if you can highlight on that part.

P. Nataraj: Yeah. We are able to see that in a lot of orders – that's why, you know, we are very comfortable in order booking, a lot of orders have started coming into India, but still it is a very, very early stage. We have to wait and see some more time, so just a month or like that because in the garment business; buyers also adjust for a month they totally sit here or there, but we are able to see a very positive trend.

So the buyers are, you know, some buyers are doing business in India as well as in Bangladesh they are just, you know, like, previously suppose 40% of the orders were placed in India and 60% in Bangladesh and because now the situation is a little different, they want to place more orders in India and because of the currency - rupee's depreciation. For example, if we book a garment at $3, for example, now we are able to, the same price, in Indian price if you calculate the cost, we can get that at $2.90 or something. So instead of $3, $2.90 means 10 cents lower and even for five cents only different buyers move from one country to another country and we are giving 10 cent advantage for the customers. So because of that even if we maintain the same percentage of margin we can get more orders. And another thing, as our CFO told already, we booked the order three months delivery we cover the currency, we book the currency and when the price is at a depreciating level we get some percentage, extra premium for the dollar, for the booking, So here and there when you calculate there are some indirect benefits also there, not only directly with the pricing but other areas also. So these are all some benefits which adding together is getting advantage finally per garment or per piece we take.

Resham Jain: Okay. Okay. Sir, my second question is with respect to the yarn margin. So overall from 1Q to 2Q what we have seen is that yarn prices have gone up while cotton prices have remained more or less stable, so ideally your EBITDA overall should be much better in quarter two compared to quarter one because cotton being same and yarn prices being slightly better. So is there any, like, one-off cost or something like that in this quarter that is why we are seeing EBITDA being flat Q on Q basis?

Murugappan: Yeah. If you look at first quarter EBITDA on yarn and fabric is about 18%, it has grown to 20% during this quarter. So there's clearly 2% increase in the EBITDA margin from the first quarter to second quarter. This is basically – the inventories we already bought and have in stock. Because of that we were able to get it, otherwise the margin level with the current cotton prices are more or less the same. Only whatever inventory we had during this period we are able to get.

Resham Jain: Then other division margins are lower, is it like that? Because 1Q to 2Q if everything else is same and if yarn margin has improved then the overall EBITDA should have been better in Q2, isn't it?

Murugappan: Overall EBITDA is about 21% compared to about 18% in the first quarter. Basically sugar margin is less because we were carrying about 35,000 tons of sugar at cost. During the quarter we got only 10,000 ton release order from the government, balance stock we are carrying at cost because of that sugar margins are lower. We were not able to sell that stock during this quarter.

Resham Jain: Okay. Okay. And, sir, finally on the yarn demand, as you mentioned in your opening remarks also that there is a sentimental thing in the market that China may buy more and more cotton, but as we have seen historically in FY14-15 where China has bought a lot of cotton yarn from India and that's when instead of buying cotton they bought cotton yarn which benefited the Indian spinning mills. I just wanted to have your thoughts on the same.

P. Nataraj: You are very right. So during that time they bought a lot of cotton as you rightly said three-four years before only they started buying more yarn from India and now Indian export is almost 40% to China. Suppose if we see, even three months back, that is in April-May-June, huge export of cotton yarn happened was made to China , but in the last two months they have slowed down the purchase. So it is very difficult to understand their policy, I don't know how they make cartel or something, if they buy everybody buys, and stock, If you see the last two months their import is very less, so Indian mills are expecting when they are going to start buying. So this is one thing, but what I told depends on the trade war. If suppose they are not able to import from US then they will import the cotton from India or even they may take a decision instead of importing the cotton they may start importing the cotton yarn itself. These things we have to wait and see. I think we could not predict even from the past. That is the situation, but beyond everything whether they buy or import or not. Also as we see the Indian domestic market is growing very strongly so that it is even taking the share of the export. Whenever exports slows down the domestic market is doing very well, so Indian industry is doing well and especially the yarn market is doing well. If we see in the three months August, September, October, export has come down but still the yarn market is doing well because of the domestic market.

Resham Jain: Okay. Thank you very much, sir, and all the best.

P. Nataraj: Thank you, sir.

Moderator: Thank you, sir. We have the follow-up question coming from Trupti Agarwal from White Oak Capital. Please go ahead with your question, ma'am.

Trupti Agarwal: Yeah. Hello. Sorry, sir, I got dropped. So I just wanted to know a couple of things. One is what is the garment revenue, sorry, you were giving me that number for the quarter.

Murugappan: 292 crores.

Trupti Agarwal: Sir, what I want to understand is that in the textile business, textile division, sequentially there is a drop in revenue by almost 10%. What is the reason for the same?

Murugappan: Are you comparing the first quarter and the second quarter?

Trupti Agarwal: Yeah.

Murugappan: The second quarter we are carrying a little more stock in yarn. Our yarn stock has increased by about 2000 tons and we have consumed about 1400 tons for our own captive consumption but it is in process. The exports will happen during the next quarter garment side also we are having about two million garment stock extra. Compared to eight million garments in the first quarter now we are carrying 10 million garments.

Trupti Agarwal: Sure. So in this quarter we sold around 10 million garments is it, Q2?

Murugappan: Q2 we sold about 21 million garments.

Trupti Agarwal: Sure. Sir, I also wanted to know in the employee cost, if I see sequentially as well as year-on-year there is a sharp increase in that particular number. Is there any specific reason for that?

Murugappan: There are two reasons. One is that we have increased our capacity during last year. Full manpower has come into play during this year. We have recruited about four thousand employees for this new unit. And the second is the minimum wage has increased during this period.

Trupti Agarwal: For Tamil Nadu, is it?

Murugappan: For Tamil Nadu, yeah.

Trupti Agarwal: So, how many employees do we have as on 30th September, total employees in the company, can you just tell me that number?

Murugappan: It is about 21,000 people.

Trupti Agarwal: About 21,000, and how many of them would be for the garmenting division?

Murugappan: It is about 12,000 people.

Trupti Agarwal: 12,000. Okay. And, sir, I also just want to know one last thing. Is there any metric as to, you know, how many employees per million garments that we generally recruit?

Murugappan: It is not based on the production; it is based on the capacity. Each machine we will have two employees.

Trupti Agarwal: Each machine two employees? Okay.

Murugappan: Yeah, yeah, yeah.

Trupti Agarwal: Sir, I was basically just trying to understand that when we put 10 million capacity in Ethiopia then how many employees would we have in that facility roughly?

Murugappan: Roughly 1000 people.

Trupti Agarwal: 1000 people. Okay, sir. Thank you, thank you. That's all from my side.

Moderator: Thank you, ma'am. We have the next question coming from Karan Desai from L&T Mutual Fund. Please go ahead with your question, sir.

Karan Desai: Hi, sir, good evening.

Murugappan: Good evening, sir.

Karan Desai: Sir, I actually missed the sugar part. Can you just highlight a bit about what exactly happened in the sugar business.

Murugappan: Yeah, sir. Actually we are carrying about 35,000 tons of sugar as of 01/07/2018. We are carrying the stock at cost. During the period we got only 10,000 tons of release order from the government. Balance 25,000 tons we are carrying the stock at cost and because of that we are having a loss during this quarter.

Karan Desai: Okay. And is it likely that in the next quarter that we will get the release order?

Murugappan: Sir, actually they gave about 6000 tons of release order for October but we have to wait and see. Depending upon the demand the government is giving the release order.

Karan Desai: Okay. So it is safe to assume that majority of the expense side you have already incurred and that is why this big loss?

Murugappan: Yeah, yeah, all previous expenditure we are recognizing as and when it happens, we are not carrying the previous expenditure to the crushing season.

Karan Desai: Okay. And what's your outlook for next year?

Murugappan: It is looking good, sir.

Karan Desai: Okay. Sir, the other question I had on garmenting, how is the order book looking and the latest facility which we started last year how is it ramping up?

Murugappan: Sir, the order book is about 600 crores now. The new facility is almost running at full capacity.

Karan Desai: And efficiency?

Murugappan: Efficiency, we have achieved about 75% now.

Karan Desai: Okay. And, sir, what's the progress on Ethiopia?

P. Nataraj: Ethiopia, as earlier we informed at the beginning of the call, we have already started installation of machineries. We have deputed our technical people to oversee the installations and completing it in time. Recruitment of Ethiopian employees has started. We are also giving training for supervisory staff at our unit in Coimbatore. We are expecting commercial production during January of 2019. We hope everything will go well; we will start the commercial production in the fourth quarter of current financial year.

Karan Desai: Okay. Perfect, sir. Thank you so much.

P. Nataraj: Thank you.

Moderator: Thank you, sir. We have the next question coming from Arjun Sengar from Reliance Mutual Fund. Please go ahead with your question.

Arjun Sengar: Yes, good evening sir.

Murugappan: Good evening.

Arjun Sengar: Sir, my first question is regarding your garmenting segment. So, yes, you are doing an expansion in Ethiopia, I just wanted to ask that given the incentives that some of the states are giving like, Gujarat, Tamil Nadu wherein they are giving a 50% wage subsidy for a period of time, so how does that subsidy – isn't that incentive strong enough for us to pursue expansion in Indian locations also versus Ethiopia?

P. Nataraj: Sir, main thing is that in Ethiopia is duty free. As already explained in detail…

Arjun Sengar: Yeah, yeah, I am aware of that, I am aware of that.

P. Nataraj: Yeah, yeah, so that's why. The duty it ranges from the – from 10% to 18% to Europe and it goes up to 28% to US. So this is a big difference and another thing, see, the labour cost in Ethiopia is very cheap and the government is giving certain concessions like power cost and other facilities also, so these are all the things. So mainly here, even in India, so the government is giving facilities to setting up the facility, the investment cost is the same, we have to – pardon?

Arjun Sengar: Sorry, please go ahead, sir.

P. Nataraj: Here in India some of the states are offering certain concessions . There are two major reasons here, one is for getting the incentive it takes a long time and another thing is setting from one state to another state and the non availability of labour in that particular state . That is the most difficult situation. We have met other people also and what the problem they are facing which we have also seen, Because of that it is very difficult, because are investing huge money and not able to utilise the capacity, and as we have seen in some of the factories even after two years they are not able to run , at even 50% capacity. So that kind of a situation is prevailing.

Arjun Sengar: This is mainly because of labour issue, unavailability of labour that is the major problem?

P. Nataraj: Availability of labour and we have to migrate the labour from one state to another state, so in that case they are skilled and after some time they want to go back, even in the middle, once they get trained. Also nowadays it is becoming a culture from what we heard in those states that three months they are given intense training and after three months they as a group they want to go out, to negotiate with another factory that we are all trained people, if he is setting up units in those place and gives more money then we will come and work. You know unhealthy practice is becoming more and more. So these are all some issues.

Arjun Sengar: Sir, my second question is on the retail business, so will be doing all manufacturing in-house, most of it in-house?

P. Nataraj: Yeah, presently we are planning to make everything in-house.

Arjun Sengar: Sorry, I couldn't hear that, sorry.

P. Nataraj: Actually our plan is to make everything for the retail in-house only and based on the turnover and all these things so we can either expand and we can do something else such as outsourcing, but actually our main aim is to do in-house only. We can expand our manufacturing capacity also.

Arjun Sengar: Sure. And this product is as of now only inner-wear or is there anything else also in the pipeline?

P. Nataraj: We will start with inner-wear.

Arjun Sengar: And do you have any set target for the first two years or something like that in terms of sales, any rough target?

P. Nataraj: Sir, once it is finalized I will come back to you.

Arjun Sengar: Al right, sir. Thank you very much.

P. Nataraj: Thanks.

Moderator: Thank you, sir. We have the next question coming from Harshil Shah from Anvil Wealth Management. Please go ahead with your question.

Harshil Shah: Hello, sir.

P. Nataraj: Good evening.

Harshil Shah: Good evening, sir. Sir, is it safe to assume that now we can go for value addition in garmenting, sir, our realization for garment can improve from here on?

Murugappan: Yeah, we are planning for value addition. We have already installed some of the facilities. We have installed continuous printing facility; we have also installed few garment printing facilities also. We are looking at the increase in per piece realization.

Harshil Shah: Correct, sir. And, sir, what is the highest realization per piece as in currently it is averaging around 130 to 138, so what do you think it can go to, like?

Murugappan: We hope to increase it by 10-15% in one or two years' time.

Harshil Shah: 10%-15% in one or two years' time?

Murugappan: Yeah, yeah.

Harshil Shah: Okay, sir. And, sir, only thing on the inventory, sir, on the yarn inventory, sir, you said you have sold less in this quarter, right, sir?

Murugappan: Yeah, we have about 2000-ton additional stock during this quarter.

Harshil Shah: 2000 tons of yarn inventory and garments, sir?

Murugappan: Garment we have additional inventory of about two million.

Harshil Shah: Two million pieces. Okay, sir. And, sir, on the retail side, have you decided, like, how much will be the marketing spend or any budget, like, that you are willing to spend on the retail franchise?

P. Nataraj: That's why actually all these things - we have recruited all the teams, technical team, marketing team and certain market experts also, so all the discussion is going on, still we have not prepared the full budget, so once we made what is the expected sales for one, two, three years and what is the budget plan. Actually based on the sales projection only we can be able to fix the budget also; so that we will definitely let you know once it is finalized.

Harshil Shah: Sure, sir. And one last question, sir, on the growth. Like, next two years, what is your growth plan, sir?

Murugappan: Sir, we are looking at a growth plan of about 10%-15%. It will be decided in which area and other things based on the outcome of the projects already in implementation.

Harshil Shah: Sure, sir. Like, 10-15% in FY20 over FY19, can we safely assume that?

Murugappan: Correct, sir.

Harshil Shah: Sure, sir. Thank you, sir. That's if from my side.

Moderator: Thank you, sir. We have the next question coming from Naushad Chaudhary from Systematix. Please go ahead with your question.

Naushad Chaudhary: Thanks for the opportunity and congrats on a decent set of numbers, sir. The first question I have is on the working capital side. Sir, any comment on that and the reason behind the good improvement in the overall working capital cycle, especially in data days we have around 10 days improvement, any comment on that, sir?

P. Nataraj: Yeah. The market is very good and we have fixed targets of collections and other things. We have improved the monitoring system that we have in place so the working capital cycle is coming down and the interest cost also managing.

Naushad Chaudhary: Sir, you feel these numbers are stable or can we go back to our earlier data days number?

P. Nataraj: It will be maintained and the availability of working capital depending upon the new cotton season. During the season the availability will be a little higher, otherwise we are maintaining the process.

Naushad Chaudhary: Okay. A few data points, sir. If you can share….you have shared this current quarter revenue breakup of garment, yarn, fabric, can you share the same number, sir, for last year, 2QFY18, garment revenue, yarn, and fabric revenue?

Murugappan: You want last year's Q2 numbers, correct sir?

Naushad Chaudhary: Yeah,

Murugappan: Yarn is 379 crores, fabric is 27 crores, and garment is 235 crores.

Naushad Chaudhary: And volume number sir?

Murugappan: I will tell you. Yarn 18,500 tons, fabric 1200 tons, garment is 17.6 million.

Naushad Chaudhary: Okay. So, garment there was around 20% volume growth in this quarter, right?

Murugappan: Correct.

Naushad Chaudhary: Okay. And 4% realization growth. So, this realization growth was primarily due to rupee depreciation or was this because of the processing and printing capacity we have added last year?

Murugappan: Both are there, to some extent in the value addition and to certain extent in the depreciation in dollar also.

Naushad Chaudhary: Okay. What was the volume of yarn and fabric in this quarter, sir?

Murugappan: Yarn is 15,400 tons and fabric is 1450 tons, garment 21 million.

Naushad Chaudhary: You said you have added 4000 new employees in last quarter or 1HFY...

Murugappan: Half year sir.

Naushad Chaudhary: Half year. And these were primarily for garmenting division?

Murugappan: Yeah, primarily for garmenting division.

Naushad Chaudhary: Okay, and out of 1000 employees required per year as per your plan, how many we have already recruited sir?

Murugappan: Supervisors are all recruited. On the labour side, we have recruited about 25%.

Naushad Chaudhary: Okay. One thing if I heard it correctly, our current garment order book is around Rs.600 crores, right?

Murugappan: Correct sir.

Naushad Chaudhary: And the retail division would be operational from 1QFY20?

Murugappan: Correct sir.

Naushad Chaudhary: Okay, that’s it. Thank you so much.

Moderator: Thank you sir. We have the next question coming from Supriya Madhye from East India Securities. Please go ahead with your question.

Supriya Madhye: Almost all my questions were answered. Thank you so much.

Murugappan: Thank you.

Moderator: We have the follow up question coming from Resham Jain from DSP Mutual Fund.

Resham Jain: Thank you. Sir, my question is regarding Ethiopia. So in Ethiopia, we are saying that we are going to start the commercial production somewhere in quarter 4, but do we have orders in hand for the same, and if so, then what is the period of ramp up for this 10 million pieces? You see that starting over a period of one year or so, and if you can share the customer also, are there multiple customers, or is it a single customer?

P. Nataraj: No. We plan for multiple customers only, and presently we have orders already with the existing customers, they are in fact ready to place the order, mainly the US customers. Once we set up, so we can immediately process the order, almost that is also finalized. Before setting up, we are also planning so that the fabric should be from here and processed fabric only we are going to send it there. Then if we are starting in January means, by December itself we have to confirm the order. We have to process it, and all these things are going on. And the customer is also very optimistic, mainly the customer gets duty-free garment from there to their country. So, that way we are very positive, and there are already customers. Two customers we have identified, one is already ready to place the order, and after that we are planning to have the multiple customers, not a single customer.

Resham Jain: And sir, how much time do you feel it will take to ramp up this existing million pieces capacity?

P. Nataraj: We expect it to be around six months' time.

Resham Jain: Okay, right. Thank you.

P. Nataraj: Thank you.

Moderator: Thank you sir. Ladies and gentlemen, if you have any questions, please press * and 1 on your telephone keypad. Ladies and gentlemen, if you have any questions, please press * and 1 on your telephone keypad. We have the follow-up question coming from Supriya Madhye from East India Securities. Please go ahead with your question.

Supriya Madhye: Thanks for the opportunity. I just wanted to know the capex plan for the year and any plan for the rest of the year?

Murugappan: Current year we are planning for the Ethiopian investment of about 25 crores and we are planning for a technology upgradation capital expenditure of about 50 crores in the existing plant. Ethiopia is almost spent and domestic we are on the process.

Supriya Madhye: Okay. And anything has been spent out of this plan? Do you?

Murugappan: No, current year, we do not have any other plan.

Supriya Madhye: Okay sir, thank you so much.

Moderator: Thank you ma'am. We have the next question coming from Sunil Kothari from Unique Investment Consultancy. Please go ahead with your question.

Sunil Kothari: Thank you very much. Congratulations sir. Sir, my question is regarding this sugar division. Last year we have done roughly 265 crores…..

P. Nataraj: Excuse me; we could not hear your voice, please, a little louder.

Sunil Kothari: Sir, sugar division, last year we have done 265 crores revenue and EBITDA of around 78 crores. So, should we hope that we will be able to match those numbers in current year?

P. Nataraj: Currently we are also hoping sir, we will be reaching to that level, or a little better also.

Sunil Kothari: Okay, great. So, next half should be better for sugar division.

P. Nataraj: Yeah, yeah. During this season only there will be good.

Sunil Kothari: And, sir, my next question is what is the status of the state subsidy, which we haven't received for last I think, six to nine months. Any progress on that?

P. Nataraj: We are still waiting for that. So, actually, we have not provided in the books, so we are approaching the government and because of GST, even the state government also. Till now the fees is not clear, how much is the percentage, because previously 100% was to State, now it is 50% to State, 50% to Central, and already, State officials they said that some portion of the Central government, the 2.5% also, they will give it to State. So, at what percentage they will give it, so that is not clear. So, because of that, that is still pending sir.

Sunil Kothari: Right, right. So, are we hopeful to receive?

P. Nataraj: No, definitely we will get, at least that 2.5% we will definitely get, and what the central will give, that is only we are waiting, and there is no cut-off date for the application, and because already we had paid and we only need to claim it back, and even the SIPCOT local government official told that you please wait for some time, otherwise once you apply for 2.5%. At later stage if the central government opts to give something, maybe 1% or 2%, so that once you avail, you may not get it back. So, that is the reason we are waiting sir. So, we are continuously monitoring that. So, 2.5% definitely we can get.

Sunil Kothari: And sir, we have done almost 45 million pieces of garment production during first half; so should we hope that reach roughly 90 million by this year end, current year?

Murugappan: We are hoping sir; we will reach around 90 million during the year.

Sunil Kothari: Right. So, Mr. Murugappan, we are talking about 10%, 15% growth next year, so I think, local capacity we cannot ramp up may be furthermore, so there may be some value addition, which you are saying every year, for next two years, you are talking around 10%, 15% higher realization. And remaining will come from Ethiopian capacity?

Murugappan: There are, three things. One is Ethiopian capacity, second is retail and third is future expansion plans.

Sunil Kothari: Okay. So, are we planning any future expansion in India?

Murugappan: We are just; right now we are not planning anything. We are waiting for the outcome of these two projects, based on that we will be deciding.

Sunil Kothari: Right. And sir, you said 10%-15% better realization. That means, around 15, 20 rupees better than current average realization. So, you feel it will reach maybe Rs.150, Rs.160 over a year or two, right?

Murugappan: Yes sir, yes sir.

Sunil Kothari: Sir, my last question is to Mr. Nataraj. Sir, it seems we are becoming very competitive to China or to any other country because of this currency, or local availability of raw material and scale. So, do you feel this global market, which has been catered by China majority, we can get major share, as a KPR may not be as a country, but you will be able to fetch your major market share from some Chinese competitor? How do you feel about those competitive scenario and situation of KPR?

P. Nataraj: Yeah, it is a very apt question sir, what you have asked, and really it is, as a country, what is the percentage that gets compared to other countries, but regarding KPR, you are very right, because we are already doing with the international major brands, almost all the brands. You name the major brands, all the brands we are doing. So, then all these brands are doing in China in big volumes. So, definitely, there is more chances of getting… whatever India gets, definitely KPR will get better share than an average.

Sunil Kothari: Great, great sir. So, best wishes and congratulations for good performance. Thank you very much.

P. Nataraj: Thank you.

Moderator: Thank you sir. We have the follow-up question coming from Arjun Sengar from Reliance Mutual Fund. Please go ahead with your question.

Arjun Sengar: Good evening sir. Just one quick follow-up. So, on this 10% to 15% growth that we are talking about for the company as a whole in next year, I just wanted to understand where is that growth going to come from? One is Ethiopia, one is retail, and what is the third that you said?

Murugappan: Sir, next year, it will be Ethiopia and retail business, in the future, next two, three years, we are looking at the value added products, and the expansion depending upon the outcome of these projects.

Arjun Sengar: Sure. So, 10% to 15% growth we should see starting FY20, right?

Murugappan: Correct.

Arjun Sengar: Alright sir. Thank you. That's it from my side.

Moderator: Thank you sir. We have the next question coming from Trupti Agarwal from White Oak Capital. Please go ahead with your question.

Trupti Agarwal: Sir, thank you again for this. I actually wanted to understand from a medium term perspective, based on your internal business plans, by when do you think we would be fully using our fabric capacity? Because I see a lot of capacity in yarn, and there is, I think, only 25% to 30% that we are captively consuming. But, in terms of the fabric division, by when do you think you will fully use the fabric internally, and then will have to put capex? By which year, as per your plans, would be the capex in the fabric division?

Murugappan: Presently we have a fabric roughly about 27000 tons. We are consuming about 4000 tons now for our captive consumption. We hope it will take another three, four years for us to consume fully for our existing capacity.

Trupti Agarwal: Sure. Currently you said we are consuming only 4500 out of the total captively, is it?

Murugappan: For the quarter we are consuming about 4000 tons, per annum we are consuming about 16000 tons.

Trupti Agarwal: Sure. So, next two, three years, is when you plan, I mean, you would use the capacity. And when you would do a capacity expansion, would you be able to give me some sense of what that capex number could be?

Murugappan: As far as the fabric capacity is concerned, investment will be very less, about 10000 tons capacity we need about Rs.50 crores.

Trupti Agarwal: Okay sir. Thank you so much.

Moderator: Thank you ma'am. We have the follow-up question coming from Naushad Chaudhary from Systematix. Please go ahead with your question.

Naushad Chaudhary: Thanks for the opportunity again. One last thing on this, again, on the working capital side, sir, is it possible if you can give it separately, of your yarn, fabric, business economics, in terms of your working capital cycle, and the garment separately, how these two divisions behaves…

Murugappan: Yarn is about 30 to 45 days, garment is about three months.

Naushad Chaudhary: The entire working capital cycle? Or…

P. Nataraj: Segment-wise.

Naushad Chaudhary: So, going ahead if we increase the garment revenue share, then we can expect the substantial increase in the working capital cycle. Is it…

P. Nataraj: Correct.

Naushad Chaudhary: But at this moment we have, substantially improvement in terms of the revenue share from the garment division, from around 30% two years back to now around 38%, and still we have seen the improvements in overall working capital cycle, sir. So, can you help…?

P. Nataraj: Yarn, we have reduced the working capital cycle.

Naushad Chaudhary: Okay.

P. Nataraj: It offset the garment increased working capital requirement.

Naushad Chaudhary: But, if garment is taking three months and yarn and fabric is only 30 to 40 days, and 5%, 10% increase in the garment revenue share would have substantial impact on the working capital cycle, so, ideally it should have gone up, if I am understanding it correctly.

Murugappan: You are looking at overall working capital cycle only. This if it is fabricated it is like this only. We hope that garment also the cycle will improve in the coming season, coming three years, because of the better payment terms from the buyer.

Naushad Chaudhary: Okay sir, thank you.

Moderator: Thank you sir. There are no further questions. Now I hand over the floor to the management team for closing comments.

P. Nataraj: Yeah, thank you. With the concentration on value addition, considerable size of production capacity in all the segments, the drive from government to encourage employment opportunities, there is a lot of benefits the central government has started giving in the last couple of years, and improved export earnings, sustained support from all stakeholders are expected to propel the growth prospect of the company. So, we are confident and we hope that our major strength, I feel, in the future, will be the retail, So we are making it slow and steady in time We want to set up the base very strongly, so that's why it will take…We also know that it is taking little more time. But, the management is almost having discussion every week and all of the top management are sitting together for the whole day for the retailing, to discuss various aspects. So, we would like to come up with very strong note on this area. So, this is why the management is having this confidence. With this, I thank you all very much for attending the call. Once again, thank you.

Moderator: Thank you everyone. Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may all disconnect your lines now. Thank you and you all have a great day.

Note:

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