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"Discussion on the impact of depreciation of Chinese Yuan on the company and on the industry"

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IIFL India Infoline Limited

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Moderator: Ladies and gentlemen good day and welcome to the Conference Call hosted by IIFL Capital. As a reminder all participants' line will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "*" 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. Thank you and over to you Sir!

Avi Mehta: Thank you Aman. Good afternoon everyone. On behalf of IIFL, I would like to welcome all of you to the conference call for Welspun India to discuss the impact of depreciation of Chinese Yuan on the company and on the industry. 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 and Strategy. I would now like to hand over the call to Rajesh Ji for his comments. Over to you Sir!

Rajesh Mandawewala: Good afternoon all of you. Before I comment on this I will get Altaf to explain to all of you, the way we see the impact of the Chinese devaluation, so Altaf kindly takeover.

Altaf Jiwani: Good afternoon everybody. Thank you Avi. Welcome to this Conference Call. We thought it is a good time for us to clear the perception, which is there in the market about the impact on our industry and our company specifically. If you see our presentation in the past, we have actually explained the structural advantage which the country enjoys vis-a-vis other two countries which is China and Pakistan. So, India, China, Pakistan together account for 84% of supplies in home textile segment. Out of these three countries, only India is surplus in cotton. We have 25% surplus cotton, so the advantage in pricing between India and China for cotton is very significant, it is in double digits. Cotton accounts for almost about 50% of the total cost of home textile business. The second biggest cost is the labor cost, where we have another 3% to 4% advantage in the labor cost. So two biggest costs actually that is raw material as well as labor, as a country it gives us an advantage of almost about 7% to 8% on overall basis. This is about the industry as a whole and the country as a whole particularly in home textile which is cotton based. Now if you come to specific initiatives which the company has taken, which we had articulated in our previous presentations, we have focussed largely on the innovative products, so today 30% of our revenue comes from the innovative products. We also have focused on the specific product design, so we have a large product development team and we have specific offering for each of the retailer. So, we have actually moved out of the commodity business, we are more into speciality business, and typical this program which we have with all the retailers, they run for about two to three years and 85% of our revenue is actually replenishment revenue which is with the existing retailer. We have created sort of entry barrier here and stickiness based on our innovative range, based on our relationship with the retailers because we offer them the 360-degree solution. We ensure that their KPIs are met, their revenues per square feet are maximized, their inventory is minimized. So with this kind of relationship and the overall solution which we are providing is creating this kind of stickiness between us and the retailers. The second thing which Welspun has worked painstakingly for last three, four years is about the sustainability. Now, with most of this global retailer sustainability has become one of the key parameters while deciding on approving the vendors. They look at what are the best practices for labor, for environment, for CSR. We are actually very proud to say that one of our retailers has sustainability council and we are sitting on that council. So these are the two major factors - the relationship, the innovation, the sustainability initiatives, which is creating the stickiness for our business, our relationship with our clients. So with these two major, one which is overall for the industry and the other one which is specifically for the company. Lastly, we have seen government coming out with kind of assessments about this Chinese devaluation which is also impacting the Rupee devaluation. So there is a relative movement also between our currency and the Chinese currency. So far as company is concerned based on the current scenario while of course we are not the experts in the currency, so it is very difficult to say which way the currency will go, whether it is just the beginning, but based on our current business model and the current initiatives which we have taken, we are confident that it will not have any significant impact on the EBITDA guidance which we have given in past that is 22%, 23% EBITDA margin for the next two to three years and the revenue growth of about mid 10s. So with this I will leave it to Mr. Mandawewala to share his thoughts on this impact of this currency.

Rajesh Mandawewala: The only thing that I wish to add here and to elaborate this Altaf's point, actually we have de-commoditized our business where we are strategic vendor to our clients. We have seen that the Chinese have actually disappeared from the table, we have not competed for any business, any program with the Chinese companies for the past couple of years. So the space in which we are currently operating, they have not actually lost complete ground there and with this 7%, 8% cost advantage that we have over them and plus a 360-degree approach that we have taken as a company, we do not see there is any threat to our business coming from this current Chinese devaluation. There is going to be spillover effect like Altaf said, competitive round of devaluation. For all it matters any uncertainty actually moves more business are way because any uncertainty in the markets, this gets our clients a little uncomfortable and they then try to gravitate the business towards the solid players in the industry. We in fact look at this whole thing as quite neutrally, so do not see this impacting our business. So with this, we will take questions. I think that will be a better way to address and discussed this. So I will leave open the house for questions.

Moderator: Thank you very much. We will now begin the question and answer session. We will now begin the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on the touchtone telephone. If you wish to remove yourself from the question queue you may press "*" and "2". Participants are requested to use handsets while asking a question. Ladies and gentlemen we will wait for a moment while the question queue assembles. The first question is from the line of Dhaval Shah from Siddhesh Capital. Please go ahead.

Dhaval Shah: I have two questions. If the rate, USD/CNY the rate goes to around 6.8 which was seen in 2010, then how would it impact us?

Rajesh Mandawewala: We believe that any movement that happens with the Chinese currency, up to 10% will not lead to any movement in market share.

Dhaval Shah: 10% from today's rate or the previous rate?

Rajesh Mandawewala: From a relative perspective. We were 63/50, they were 6.2, so from there if the relative depreciation between Indian currency and Chinese currency anything between 7% and 10%, up to 10% this will not lead to any erosion on market shares, that is our belief. Because from a competitive cost perspective we are anything between 7% and 10% better than China and so up to this delta it should not impact our business.

Dhaval Shah: You are saying that 10% depreciation for China and our Indian currency staying at 63.

Rajesh Mandawewala: Correct. You have to look at it relatively. If they depreciate and we depreciate also, then the position does not change, in fact both countries relative position actually improves as compared to the other competing country. So, relative difference up to 10%, it is our belief is that we will not lose market share up to that point, because we have cost advantage plus there is no company we believe in China which is offering the kind of solution that we offer to the client. So they have a long way to go before let us say they can even remotely compete with our business.

Dhaval Shah: From 2010, Indian guys have started benefitting and getting the orders from China which were diverted to China. So after 2010, Chinese guys have vacated this space, so they are not in the business for at least the last four, five years…

Rajesh Mandawewala: At least last two to two-and-a-half years, they have completely disappeared, so as I said we have not competent with a Chinese company in the last two to two-and-a-half years.

Dhaval Shah: Which is the other country competition to us apart from our domestic names?

Rajesh Mandawewala: India, Pakistan and China is 85% of the global supplies, particularly in towels and sheets, so that is the universe.

Dhaval Shah: Okay. Secondly even the wage cost in terms of dollar has also benefitted us vis-a-vis China as mentioned in presentation. The main reason is that Chinese government has increased their wage cost every year. Now if they take a call to our reduction in the rate at which they are increasing the wage rate or start giving some export incentive in power. Do you think such possibility is possible?

Rajesh Mandawewala: Export incentives are already there, whatever little they do they are already doing it. I do not see there is any new export incentive coming because the moment they do that the key markets are Europe and US and they will immediately apply an anti-dumping or anti-safeguard, both the European and US markets are just waiting for them to do something like this. So that is very unlikely that there might be substantial incentives. So point here and there is the different thing, but we do not see any substantial, but if it comes immediately the consuming markets will move to safeguard.

Dhaval Shah: Okay. Going ahead, are you expecting increase in their domestic cultivation of cotton, currently if there importing cotton then the depreciating currency will make it expensive compared to us. How is their stance on the cotton side in terms of their annual requirement for export and what is the domestic cultivation?

Rajesh Mandawewala: There is very little motivation for farmers to grow more cotton as compared to last year. The simple reason being the alternative crops actually are more remunerative. Their per capita income has been growing, so consumption of food and supplies always increases and so there is no motivation to grow more cotton. In fact the current ICAC projections actually are eluding to a reduction in crop rather than an increase.

Dhaval Shah: Fine. Lastly on the demand side not related to the currency, with the data in US is also improving up along with Europe, are you seeing any increase in the kind of projections the clients give us for procurement, any changes in the past two, three years have you seen?

Rajesh Mandawewala: It is not anything which is noticeable, so we did not see demand going down when things were not good and nor are we seeing anything meaningful in terms of seeing a spike. This is a gradual process. So as the economy of our customer countries improve, they go up higher on the value curve. For example, if the average retail of a towel is let us say 6 dollars. Over a couple of years, the 6 average will move up to 6.5 to 7, so that means the same move to a better product as the economy improves. So that is a very gradual process and it takes time to actually translate into it and stuff like that, so it works very gradually.

Moderator: Thank you. In order to ensure that the management is able to address questions from all participants, please restrict their questions to one per participants. Thank you. Our next question is from the line of Anand Krishnan from Insignia Finance. Please go ahead.

Anand Krishnan: What will be the major reason because of which you would have actually gained market share from your Chinese competitor not in the last two years you actually said before that, so what will be the major reason because of which you actually gained market share from them?

Rajesh Mandawewala: As a country, our competitive position versus China is significantly improved and so that drove market share from China to India just over a period of time, so that was one reason. As a company, the operating costs are as good as they can get, so over and above that it is the 360-degree model that we have adopted with the customers, of actually going out and doing consumer research, doing innovation, product development and come up with a product to satisfy the unfulfilled desired need of the consumer, build that innovation capability, manage the customer supply chain, help them with advertising, marketing, branding and things like that, and then keeping their inventory lean at the same time keeping them in stocks, so managing their supply chain. So all these things are kind of unique to our company. That was another strategic initiative which we have been investing for the last 8, 10 years. It is sounding a little aggressive, but I think there are not many companies out there who are able to deliver this value to the customer. The third thing is perhaps we are one of the very, very few manufacturing companies who have this wider product mix in their portfolio - towels, sheets, rugs, carpets, it kind of makes it easier for the client to work with us, so they look at as a $100, $150, $200 million potential vendor as compared to a single product company where they start looking at their pie and things like that, so these are two or three things that we have build over a period of several years to actually gain this competitive advantage and to draw our company away from the back. That is the reason why this business has been continuing to come into our company. Now this is despite the fact that the industry is growing at 1% , 1.5%, 2% over the last several years, but our business has always grown and in fact the last seven, eight year our average is about 18%, 20% growth. So, these are the reasons why the clients prefer to work with us.

Anand Krishnan: Why is it difficult for a competitor to not realize that if x, y and z company is actually giving that services to a retailer then why cannot other company also give the same services to the retailer and get competition from you?

Rajesh Mandawewala: This is about creating competence and first thing it is start from the DNA of the business. See how did we acquire this competence and what price did we pay for this. Some of you who have been following the company over the last six, seven years, you would have known that we actually exited, we licensed a few brands in America, we got into the fashion business, we opened up stores here in India, we acquired a company in Europe, we acquired Christy in UK. None of it actually worked for us and we actually wound all that down in the year 2011 and 2012, except Christy. So what we did is while it cost the company a lot of cash to get in and get out of those acquisitions in the front-end businesses that we got, so while we want them down we actually retained competence, we retained the people, we retained the skill set, and even within the whole business we actually learnt what is the consumer behavior and how do you get consumer insights and how do you run the business like an FMCG company. This was a very, very expensive exercise and it was exercise because there was a strong desire to get closer to the consumer. We do not see that happening in the industry honestly and it is not a one-day, one-year, two-year process. We have invested for 10 years to acquire this knowledge and skill that we have done, so it does not come overnight. This is like today you decide, you want to have brand, the brand is going to take 10 years. A baby needs to be in the womb for nine months, so you cannot decide this I want to have a baby today and tomorrow you deliver one. So, there is a process that any company wants to go into this will have to follow and we believe that if not more, it is a minimum five-year process, if not 10. We have actually invested 10 years to build this competence and may be Rs.500 Crores, Rs.600 Crores over this 10 years to actually build this competence.

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

Sumant Kumar: I would like to understand the impact on demand or opportunity for us when the currency appreciates more than 10%, because when the China currency appreciates by 10%, in that scenario the Chinese will become competitive. So at that time what kind of opportunity we lose?

Rajesh Mandawewala: As I said if the relative position between India and China up to 10% I do not see an impact on our business. I am saying our home textile business, and this is a business we understand very clearly. So up to 10% relative difference we do not anticipate any impact on the market share for A , the country and B, as a company this for sure that we do not see any impact. If it goes beyond 10% then let us at least say they earn the right to come on the table. For example, if they depreciated 10% and we depreciated 5%, the relative impact is 5%, so it will have no impact on the market as far as competitiveness is concerned, so up to a relative difference of 10% it will not impact. If the relative difference goes beyond 10%, then they earn the right to get on the table. By now we have got the market share, so even if they earn the right to get on the table gentlemen we will not allow them to enter our space at least as a company. It is not going to be an easy ride beyond 10%. Up to 10% we do not even consider them to be competitive enough to come and grab any market share.

Sumant Kumar: Can you tell us what kind of segment they are into in home textile, suppose in terry towel or bedsheets, are they in marked segment or premium segment?

Rajesh Mandawewala: They actually cut across the entire value chain. They are strong on polyester, cotton bedsheets. As a company, we do not compete in that space, so we are not impacted vs. China, so that is kind of lower middle end of the market. So that is where China is very dominant and so is Pakistan, and we do not operate in that area at all. That is where their strength lies. In the middle end of the market, we do not see anybody operating there, where they could do the level of stuff that we are doing here out of our company.

Sumant Kumar: If currency appreciated more than 10% for China, in that case the competition will increase, in that case can we say that we may lose some margin for volume growth. Can this will be safe for us?

Rajesh Mandawewala: Again, do not look at only them, you should look at them vis-à-vis us. If they depreciate 10 and we appreciate 5, the net difference is only 5, so that is what you should be looking at. Up to 10% I do not think there will be any impact, because right now we believe their cost is about 7% to 10% higher than an average company in India. So for them to come in and impact first they have to cover lost ground, so right now they are actually 7% to 10% behind India, so up to a 10% difference they will only cover a part of that gap and not even the full gap.

Moderator: Thank you. Our next question is from the line of Pritesh Chhedda from Lucky Investments. Please go ahead.

Pritesh Chhedda: Thank you for the opportunity. Two questions. One, in the last three years China was relatively not present in the home textiles market on the international operation side. If you could tell us the change in the market shares that would have happened in the three years and if you could recap on the total bedsheet market and the market shares that you have as on date?

Rajesh Mandawewala: I am just pulling the slide out. If you look at the overall market share, India has moved from 30% to 37% over the last four, five years on the towel side, on sheets from 27% to about 47% over the last five years. If you look at China's shares they were 29 and they are down to 23 on the sheet side over the last five years. Within this overall numbers, it is very important to draw a distinction. One is cotton driven and the other is polyester, cotton and synthetic. So China is actually a little stronger on the synthetic side as compared to cotton. So they have lost more ground than what these numbers suggest on the cotton side. The reason why they are still in the 20s is because the polyester, cotton, the synthetic business is intact. One reason is because within India nobody has focussed attention in that area and it needs a different kind of setup and needs a different kind of manufacturing facility to take cost down which none of us actually have invested. All Indian companies have chosen to compete on the cotton side. So, they have actually lost a much bigger cotton share as compared to the synthetic side.

Pritesh Chhedda: Just looking at the 47% India market share for bedsheets, my guess is largely it should be cotton. It is almost half of the market and global demand in the space would grow at single digit number and we are already at about 50% market share. Do you think that if one has to grow faster then obviously the growth has to be higher than this right, growth has to be higher than the single digit market growth, do you think still that steam is left for the market share to actually grow higher than 50%?

Rajesh Mandawewala: This is a very good question. There are three ways you can continue to grow. I will talk about this as a company. A, there are new channels within the existing markets that you grow with, almost all our business with the retailers, the hospitality area is completely open. Last year, we did only 2.5% of our overall revenue on the hospitality side that is clear. It is a $2 billion market only in the US. We are now firmly entering that space, so you can grow the channels, internet is the other channel. So you can grow within that market by channels. Then you can grow by products. For example, we are a multi-product company and every two, three years we add a new product category. We believe that there is product growth available with our existing customer, so that will drive growth. Then new markets will drive growth, so at the end of the day, if America is about 32% of global consumption, there is 68% consumption happening outside America as well, which is what we are also doing, so focusing attention on Europe, Latin America, Middle East, Far East, so our business actually is growing faster in the other parts of the world as compared to what it is growing in America. So there are enough levers for the business to grow overall within America as well as in the other parts of the world where we are actually under-penetrated. As a company we believe that we are still good to grow in the middle teens.

Pritesh Chhedda: Little bit more here. When you say channel it does not get affected it in the 47% market share, number one?

Rajesh Mandawewala: It does get affected, but as a country you are not a player. For example, the hospitality industry we are not as a country, we are not a player. We are not even playing in that channel, so as a company now we have started doing that as similarly some of our competitors also have started focusing attention in that area, so that is the virgin market which is currently dominated by Pakistan, China, Turkey, Portugal and some of the local companies there in America. It is a matter of time and we are actually making very rapid growth there. We believe our business in those space could grow very, very rapidly and it is growing, though it is of a small base it is growing pretty significantly.

Pritesh Chhedda: On the geography side, can you tell us the size of the opportunity available in US, because generally we know that US is the largest economy and obviously largest consumer and the contribution they would have in a market would be very high. What kind of opportunity side possibly available non-US in other geography?

Rajesh Mandawewala: To give you overall picture this is a $45 billion market at wholesale and US is 32% of that consumption as a overall home textile category. So 68% of the consumption is actually outside America. Europe is another 30%, so it is a massive market and do not forget India, the consumption boom is just beginning here and if our economy takes off we have massive way to go and which is why we actually relaunched spaces last year with Parineeti Chopra as our brand ambassador. We have aggressive intents to grab bigger market share and our business in India is actually growing 40% to 50% on an annual basis although it is of a small base, but it is actually growing very, very rapidly. The far eastern markets with Korea, Japan we are duty-free into those markets, so huge effort we are making in those regions also to grow our market shares, so there is enough potential for us in the other geographies to grow as well as I think there is big opportunity within India itself.

Pritesh Chhedda: What would be the market share for Indian players in non-US, any guess?

Rajesh Mandawewala: It would be half of what it is in America and it is a matter of focus. Honestly, we started focusing attention about three years back, ever since our business is rapidly growing here.

Pritesh Chhedda: One last question. You pointed out the advantage that India has which is 7% to 10% in labor and cotton. Now we are fairly confused on the cotton policy in China, so if you could update us and what is the policy today? What is the risk, if that risk pans out and it is negative for us from the cotton perspective, if you could tell us those two areas?

Rajesh Mandawewala: The current cotton policy is that until last year China was procuring cotton at absolutely ridiculous rates. Now, they are subsidizing the farmers directly. Let me tell you that this net-net with the current state of affairs they will continue to remain about 10% to 15% higher as compared to India in terms of cotton prices. If you look at the economic price of growing cotton there versus economic price cost of growing cotton here, so that delta continues, so the Chinese cost of growing cotton is higher as compared to the cost of growing cotton here in India. We believe that this relatively speaking 10% to 15% delta will remain and again, they are net importers of cotton, so while there are huge stockpiles, also a big part of the stockpile is aged cotton, cotton which is around 2010, 2011, 2012, 2013 and over a period of time the cotton also degenerates. So if you look at what they have been managed to sell and they auction the cotton it is abasement. So they are trying to auction this cotton small lots at a time, but the people are not interested in buying that cotton because the quality of the cotton is uncertain and one thing is that it is a natural commodity, as the cotton becomes older it become unfit or unworthy of use. In a product for example a sheet you just cannot use old cotton because it will not have the strength, it will start peeling on a towel, it will start linting, a lot of that cotton that we are stitching on is unworthy of use at least for our product category. From that perspective, we do not see any negative coming out of that really. At the end of the day they are crop-to-use ratio is about 1.25 or 1.3. so their consumption is 25%, 30% higher than the crop. We export 25%, 30% of our crops, so we will always have that advantage, at least the lowest advantage you will have the supply chain cost, which itself is about 7%, 8%, so that advantage we will always have over China.

Pritesh Chhedda: I did not get on the first part, they are subsidizing the farmers?

Rajesh Mandawewala: Correct, the procurement price is about 45% higher, so the Chinese the cotton that they buy from the farmer is almost 45% higher than Indian prices. So the difference between the market price and the support price they give as a direct subsidy to the farmer, which means that the cotton trades there at the market prices and the farmer gets a direct subsidy from the government.

Pritesh Chhedda: What would be the risks, which is the biggest risk, there were two black stone events, one was Yuan devaluation, second one cotton policy. These are two reasons periphery to our business; one is rectified and we have given some thoughts. What is the risk in cotton policy if you have to suddenly get a shock overnight?

Rajesh Mandawewala: Let me tell you, who are the exporting countries of cotton? India today is the largest producer and exporter of cotton followed by USA. USA has no consumption of cotton and their crop is also reducing and it is an obvious thing that our cost as compared to America is much, much lower to grow cotton. So India today determines the price of cotton in the world, unlike five years back or three years back when US was the dominant force, so the center of gravity on cotton has shifted to India. So it is what happens in India that will determine cotton prices worldwide and not vice-versa, because we are the ones which have the surplus and we are the ones who are going to export. China will import, Pakistan has to import cotton, so from that perspective it is important that the cotton prices will be determined by what happens in India. So in India, this cotton at Rs.34,000 is still remunerative, so at that price and our support price is close to about Rs.33,000, Rs.34,000 from the government. The cotton prices cannot fall below this. If they fall below this, the government will step into procure the cotton which is what the government did last year. There was a period of two, three months when cotton prices went below the support price, the government CCI intervened and they procured all the cotton. So there is a floor where the cotton prices can go and the floor gets set by the support prices at which the Indian government is going to buy cotton.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was the last question and now I hand the conference over to the management for closing comments. Thank you and over to you.

Rajesh Mandawewala: It is an obvious thing that the big Chinese devaluation is a big event, so we thought it would be a good opportunity to actually engage with all of you and give our perspective on this, and I hope you find this discussion useful. With this we thank you for all the time that you gave us for this call. Thank you.

Moderator: Thank you. Ladies and gentlemen, on behalf of IIFL Capital that concludes this conference call. Thank you all for joining us and you may now disconnect your line.