

“Alok Industries Limited Q1 FY’13 Results Conference Call”

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MANAGEMENT: MR. SUNIL KHANDELWAL – CFO, ALOK INDUSTRIES LTD.

**MODERATOR: MR. VISHAL RAMPURIA – ASSOCIATE DIRECTOR, CRISIL
EQUITY RESEARCH**



- Moderator:** Ladies and gentlemen good day and welcome to the Q1 FY 2013 earnings conference call of Alok Industries Limited hosted by Crisil Equity Research. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call please signal an operator by pressing * followed by 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand over the conference to Mr. Vishal Rampuria, Associate Director, Equity Research at Crisil Research. Thank you and over to you Mr. Vishal.
- Vishal Rampuria:** Thanks Shyma. Good afternoon everyone. On behalf of Crisil Equity Research I welcome you to the Q1 FY 2013 results conference call of Alok Industries. It is a pleasure to have with us today Mr. Sunil Khandelwal, CFO of Alok Industries. During the course of this call we will discuss the main factors that drove the operational and financial performance of the quarter and provide insight on the overall business scenario, which will be followed by the Q&A session. I would now like to hand over the call to Mr. Sunil Khandelwal. Over to you sir.
- Sunil Khandelwal:** Thank you Vishal, good afternoon everybody. Thanks for joining our Q1 con call organized by Crisil. This quarter was really good for us. Our sales grew by almost 48% to 2423 Crores and exports also grew by about 34% to 837 Crores. Operating EBITDA was really good at 759 Crores and the PAT, after considering the exceptional items of 172 Crores marked-to-market, was 30.07 Crores. These are the main highlights of this Q1 results. With this I will like to keep the floor open for the Q&A session.
- Moderator:** Thank you very much. We shall now begin the question and answer session. We have the first question from Paras Bothra of Ashika Stock Broking; please go ahead.
- Paras Bothra:** My question is with regards to the debt position of the company. Can I know the debt position of the company at present, and secondly, what all things management is doing to bring down the debt and recently there was talk that real estate division is going to be sold out, so are there any possibilities with regard to the real estate as well, these are all the things which I wanted to know?
- Sunil Khandelwal:** Sure, you have hit the nail at the right place. It is our top priority to reduce the debt. Our debt as on June 30, 2012 is about 12900 Crores. Of course we are working on it. We feel that from the operations free cash flow we will start repaying this loan from 2014 onwards; and, for this year, we are working on selling our non core assets that is primarily our real estate, which we expect to give us around 2500 Crores close to that kind of realization over a period of two years of which we are targeting about 1500 Crores in this financial year and we have made good progress in that close to 600 Crores worth of transactions has been finalized till date and we have received good number of advance against that, so we are on track. Debt reduction is our top priority.
- Paras Bothra:** Second question was with regards to the forex, there was a marked-to-market of 172 Crores I suppose, and so can you please explain what exactly led to that marked-to-market of 172 Crores?
- Sunil Khandelwal:** In fact this is related to foreign currency transactions and majorly on account of forwards, restatement of foreign currency loan which are for working capital and, about one-and-a-half years back we have done some coupon only swaps where we have converted part of the rupee loan notionally in to foreign currency loan. We are paying the interest notionally in dollar and getting fixed rupee to save about 1.5% interest cost, so largely it is on account of that. If I have to break up in

forward it is equally divided in to forwards and this thing, so 173 you can actually be divided in to forwards coupon only swaps and restatement of loans.

Moderator: We have the next question from Sudhir Bheda of Right Time Consultancy; please go ahead.

Sudhir Bheda: Sir, margin has grown up very fantastically for this quarter and share of polyester has come down I think from 39% last year to 34%, so going forward if polyester sales is going to increase from 38 to 40% of the total sale, then this kind of margin can be maintained or margin will be little bit lower in the rest of the year?

Sunil Khandelwal: The thing is our polyester sale has not gone down. In the first quarter yes, it is looking 36% of overall sales but last year if you look at for the whole of March 2012 it was 34%, so 34% has moved to 36%. What has happened is that the margin improvement is on account of couple of things - rupee depreciation has helped us, so the volume increase and value increase in exports, in fact the increase in exports is about 34% of which more than 20% is due to value increase, so that has of course helped us in increasing our sales and the margins; second, the input cost; the raw material costs have gone down compared to what you are seeing in the last year, so that has also helped us. So depending upon where the rupee moves, where the raw material cost moves and how much the polyester division contributes to the overall sales, the margin would vary from time to time. Of course I would not say that, yes, this kind of a margin can be maintained, no but yes this year order book is very good, prices, we see selling prices are also we are getting good, so let us see it should be good, margin should be good.

Moderator: We have the next question from Mohammad Riyazuddin of Money Ore; please go ahead.

M. Riyazuddin: Sir, my question was polyester contributing around 36% of the revenue and as you mentioned just now that we have seen some tailwind due to reduction in raw material prices and currency. So since this has increased our margins now going forward. Don't you think the clients will be asking for discount on the rates because our costs have ultimately come down and polyester being more of a commodity play, such high margins might not be sustainable always?

Sunil Khandelwal: Yes, very true. Definitely on the new orders that we take, we have to consider the present spot rates, and of course, we keep some cushion because the spot today is fluctuating a lot, so we keep some margin and quote to the buyer. As far as polyester is concerned, we have to look at from two angles, one is domestic market and one is export market. Export market as on date is looking extremely good for polyester in terms of margins and that is why we are focusing ourselves to see more and more polyester product we export to get the additional margin especially in case of texturized yarn; so because we have a multi market presence, we would definitely put our capacities or the volumes more where we get good margins and also within the product segment we have a wide range of product segment like FDY that is fully drawn yarn; we have texturized yarn, we have dyed yarn that is master batch and we have catonic and our polyester staple fiber unit is just starting at the end of this month; so depending upon which product basket giving us what margin, definitely we would push our capacities towards that, so it is a very interesting product mix we have and interesting market mix that we have, so polyester also we will have margin expansion to the extent with this flexibility that we have.

M. Riyazuddin:

As far as my bit of reading goes, we are on the brink of having over capacity for polyester because lots of capacities are about to come up in India as well and China already has a huge polyester capacity and in cotton kind of textile business, India is one of the largest producers of cotton, so we have kind of upheld and because traditionally lot of labour is required and Indian labour being cheap but polyester being a very commoditized product, first of all can you brief me about the capacity across the world because I have been reading that there were over capacity in polyester, so will it hamper the margins going forward?

Sunil Khandelwal:

Just to give you an overall consumption pattern of the fiber consumption of the world, the average fiber consumption of the world per person is about 11 kg per person; India is below that, India is at 8 kg per person. The world average of that 11 kg per person is 30% cotton and balance 70% non cotton; in that non cotton, almost 90% we can safely say is polyester, so that is the ballpark. In India the fiber consumption as on date is about 50:50, so we are below the world average in terms of consumption of polyester and if you look at China whose per kg consumption of fiber per person is about 18 kg, they are already at 75 polyester and 25 cotton and little more than that, so what has happened, India traditionally was a cotton surplus country and that is our strength and 70% of what we export is also cotton. But what has happened if you look at over a period, the gap between cotton prices and the polyester prices have widened, for example cotton yarn today 40s count is available for 230 rupees a kg whereas polyester yarn will be available for 100 rupees a kg, so gap is more than 100% now what we see today is in next two three years down the line is that India's exports will continue to go up and it will be more of cotton products where we have our strength and at the same time internal domestic consumption is also growing by 8 to 9% per annum, so at the moment, the industry which is \$85 billion, 30 billion exports and 55 billion domestic market. Moving towards 100-105 billion, the cotton surplus situation of India would start deteriorating and in fact we would become neutral in terms of cotton surplus situation; so at that time, the gap between cotton and polyester prices would further widen and we would see the masses in India would also move towards blended fabric; then you will see huge demand coming up in the domestic market out of polyester fabric. So it is a story which is going to unfold over a period of next three to four years but it is surely going to happen the way we are talking about. Yes surely looking to this trend, we have lot of capacities coming up in India but as I said there would be enough room for all and I don't see over capacity, maybe temporarily in a year or so there could be a scenario where we are having over capacity, that is why it is very prudent to have a basket of both export and domestic, so even if temporarily domestic market has over capacity, we can divert our capacities over the export market which is looking good for our products. Our costing is as per international prices and if we can produce those qualities that they are looking in definitely we have a market. So Alok's strategy is that only to have 50 to 55% of exports as of now because we are seeing good margins over there and also have some meaningful presence in the domestic market. I think long term if you ask me polyester capacity and the consumption would go up in India.

M. Riyazuddin:

I am very worried about our operating. Since we are earning such high levels of operating profits, why our cash flow from operations is negative, significant amount gets stuck in the working capital as well?

Sunil Khandelwal:

You are absolutely right, that is our area of focus also and we believe from working capital lot of capital is possible to bring back. We are working on it and you will see improvement going forward.

- M. Riyazuddin:** Any significant specific steps you are taking?
- Sunil Khandelwal:** Obviously we have now out of our major expansion drive, of course, there would be capex happening but the major capex that we have been trying so now we are focused on operations and in our fabric we have identified that we are producing more than 300 qualities as of now and because of which we have to keep an entire chain for all qualities. We are rationalizing those qualities and see that how we can reduce it to 100 major qualities based on the contribution that they give to the company on that direction, so like that there are a lot many ways we can improve on and definitely there is good room to improve.
- Moderator:** We have the next question from Nirav Shah of Adroit; please go ahead.
- Nirav Shah:** Sir in spite of everybody saying we are positive we have good margins, why the stock is not performing?
- Sunil Khandelwal:** That is a question that is difficult for me to answer but I will just tell you sir that there are three issues I have been referring to. Of course there are three legacies that we are fighting. One is country legacy, if you are an overseas investor; industrial legacy - there is a general mindset that this industry is not doing well, it is not a profitable industry, it is not giving returns, industry legacy which is true but that is again a matter of legacy; you will soon see that the organized players in this industry, this industry has 85% small and fragmented players and 15 to 20% only organized players. As the organized players' proportion increases you will see that the outlook of the industry also changes in the mind of the people. Thirdly, of course company legacy. Traditionally, Alok has been in the capex mode for a long time, last nine years or eight years, we have put in capex of 11000 Crores. Secondly, during the same period, there was no free cash flow, so we borrowed a lot to fund it; in the same period, we also ventured to non related, non core businesses of real estate and some retail businesses which is again diverted with no positive cash flow we have done that, so again borrowed for that and so market has not taken that in the right way.
- Nirav Shah:** That you have sold recently, last quarter.
- Sunil Khandelwal:** We have been trying to sell the real estate; I think the market is waiting for the actual action to happen. We are working on it. The real estate portfolio which is quite large it is going to take time, so once the market clearly starts seeing those signals from the company - that yes they are focused on their core operations, they have started generating free cash flow, the company is focused on ROC; let me tell you we are focused on ROC and in the next four years consciously we would double our asset turnover and we will try to double our ROC. That is our strategy. If we are able to succeed in that you will see a different company altogether - which we are working on it, so what price it is quoting today is because of certain reasons, we might have let down maybe people in terms of our strategy, in terms of our certain steps, may be leverage is one of the major concern, if we do not know free cash flow maybe the second reason, may be the poor ROC and asset turnover could be other concerns; so we are now trying to address all these concerns one by one, and looking at the size of the company and the balance sheet size it would take time to show those kind of results. I would clearly need two to three years modestly or maybe in a long term what we want to implement may take even five, six years also but once that we have taken that path and we are moving towards that, maybe at some point of time market would start seeing that and probably will give us value but

yes what we are today maybe we have not met their expectation that market was looking at and we will try and change this legacy.

Nirav Shah: Last week I suddenly came to know that the promoter has pledged the share, what is the reason behind that?

Sunil Khandelwal: Promoters have come from a background where they don't have a surplus income or cash flow; so whenever they are required to pump money in the company to increase their stake, they are doing it through outside borrowing and they are pledging their shares to raise that borrowing in their personal books; so that is the reason the pledge has gone up.

Moderator: The next question is from Dhvani Modi of ICICI Direct; please go ahead.

Dhvani Modi: Firstly, if I look at the capacity expansion details that you have given in the investor update we see that the POI segment is going to have some decline in the capacity, is this because you are looking at internally utilizing that capacity and producing higher value added product or is there is a gap in my understanding on that front?

Sunil Khandelwal: You have got it absolutely right. Alok as a strategy is looking at polyester division on a finished product side, we would be more on to DTY, more of FDY, more of PSF and others than in to chips or POY; so that is why increasingly we will be creating more finished product capacity and reducing our POY and chips products.

Dhvani Modi: Sir I wanted an update on the H&A front in terms of how is the performance, how it is performing domestically and your plans on that front?

Sunil Khandelwal: H&A is our domestic retail venture and they are doing, I would say, monthly sale of about 5 Crores and annual about 60 to 65 Crores in topline. In terms of profitability, we are still not profitable. We are losing about 2 to 3 Crores per month in terms of outflow there and we have internally decided that in the first step we are closing about 45 non-profitable stores that will happen by September and then see the performance of the division. If it continues to be profitable and within their own means, like if they manage out of their own cash flow we would continue that business, else we would close it.

Dhvani Modi: What is the current count of stores; approximately what space we are talking?

Sunil Khandelwal: See as of now we have about 190 EBO, that is Exclusive Brand Outlets, and we have about an equal number of shop-in-shops. What we have realized that shop-in-shop business is breaking even, it is profitable also; because we just share some portion of our sales, but because of the rental and other issues, it is not turning out to be profitable, so you wanted to know this space that we occupy, on an average you can take 800 square feet for I would say 290 stores, so it is about 2,30,000 square feet roughly we are operating.

Dhvani Modi: The plan is that even after this rationalization etc., if you still think that it is not viable you will probably gradually look at exiting this business, right?

Sunil Khandelwal: Absolutely right. The thing is the focus now is on ROC, so any asset which is not generating the return we would not like to continue that business.

- Dhvani Modi:** What is the quantum of foreign debt, out of the total debt that we have on books?
- Sunil Khandelwal:** On a standalone level, I think term loan would be about 1000 Crores and working capital would be another 1000 Crores, so 2000 Crores.
- Dhvani Modi:** Cash level as on June?
- Sunil Khandelwal:** It is about 270 Crores.
- Moderator:** Thank you. We have the next question from Bhavin Chheda of Enam Holdings. Please go ahead.
- Bhavin Chheda:** What is the current quarter inventory?
- Sunil Khandelwal:** Current quarter inventory close to about four months.
- Bhavin Chheda:** How has been the trend in Shankar 6 prices off late, are they going up, steady down, I think you have given the chart where it shows June prices were around 32,500 what should it be in August?
- Sunil Khandelwal:** Now of course it has moved, it is now close to 38000 to 40000 levels in fact, so it has gone up to some extent now.
- Bhavin Chheda:** Other thing, the debt number you gave is the standalone right, 10,900?
- Sunil Khandelwal:** Absolutely right Sir.
- Bhavin Chheda:** It includes all short-term working capital?
- Sunil Khandelwal:** All borrowings.
- Bhavin Chheda:** Forex figure Sir, just a confusion what you have explained 173 Crores breakup, going forward will there be any forex MTMs or this is through?
- Sunil Khandelwal:** Sir I will tell you, at 56 level now it is provided for; now it depends where the rupee goes down from here; suppose it further depreciates to 57 to 58 level accordingly the MTM would move in line with that.
- Bhavin Chheda:** What is the gross quantum on which it is provided?
- Sunil Khandelwal:** It is on different, different product like about 1700 Crores worth of rupee loan we have done a coupon only swaps then on some forward we have sold, so it is different, different, it is primarily of three transactions Sir, one is rupee loan, (a) restatement of rupee loan, (b) it is on the forwards that we have sold and (c) it is on the coupon only swaps. Majorly it is because of the forwards and the swaps, more on forward.
- Bhavin Chheda:** In terms of net exposure, we are dollar positive right?
- Sunil Khandelwal:** Obviously because our exports are much larger.
- Bhavin Chheda:** Other thing, on the real estate portfolio, you have sold real estate at about 600 Crores, right? And till date advances received have been?

- Sunil Khandelwal:** We have received about 150 Crores worth of advances and now we are closing the transactions, we are completing the agreements, etc. I think we expect to receive major chunk very shortly.
- Moderator:** Thank you. Before we take the next question, the management would like to make a small announcement now.
- Sunil Khandelwal:** In fact I would like to tell all the participants that Alok is well understood by looking at its plants. So it is our open invitation to all that whosoever would like to come to our plant we would organize the visit, they can inform Crisil or they can inform us, we have given our mail ID and you can contact me or my colleague Thirupathi so that we can organize it. We just need about two to three days advance notice, we do not need very advance notice also, but there will be two advantages for the visitor, (a) they would understand both integrated polyester business in textile as well as integrated cotton business and also a better understanding of the industry and the company. So it is a request for all of you to make it, it will just be morning-evening in a day we can complete the whole visit both Silvassa and Vapi so that was the invitation that we wanted to give, that was the request here, you can go ahead with the con-call.
- Moderator:** We have the next question from Prashant Kuti of Emkay. Please go ahead.
- Prashant Kuti:** Sir as far as the margins are concerned we said a large part of it is basically led by rupee depreciation, could we probably know what is the steady state margin for the business because we are seeing the polyester business as we just said that it increased from 34% for FY12 to 36% and if I assume the polyester business have lesser EBITDA margins as compared to the cotton segment, so if you could probably say what would probably to be steady state EBITDA margins going forward?
- Sunil Khandelwal:** As I said, it is a mix of both; it is mix of cotton and polyester; so it depends upon the mix that it would go, see as of now we are getting our margin on the cotton indicated about 38 to 40% integrated model, and on the polyester side we are getting anywhere between 15 to 17%. So that is the range that we are working on; now depending upon lot many things where the margins will move within the segment and then the blended margin of both, so I cannot tell you what will be the steady margin going forward, but yes I think for the current year, I do not see substantial up or down may be 1 or 2% here and there it is okay, but I do not see much traction to this.
- Prashant Kuti:** At what rates are forward covered?
- Sunil Khandelwal:** We are neutral at 52.
- Moderator:** Thank you. We will take the next question from Mr. Rampuria.
- Vishal Rampuria:** Sir I have two questions, one is regarding the forex loss and second is about retail chain in UK. Out of this 173 Crores, how much is realized and how much is notional?
- Sunil Khandelwal:** These are all notional Sir. Whatever is realized is already provided in the P&L, the exceptional items are ones which are only provided, this is non-cash item Sir.
- Vishal Rampuria:** By what period if let us say rupees stay at 56 levels for next two quarters then the complete loss will be realized?

- Sunil Khandelwal:** No. The coupon only swap is a period of four years and also the forward that we have done is again for a longer period about 4 years, so the realized if rupee stays at 56 you can simply divide it by 4, so about 70 odd Crores can be our realized losses per annum, 70 to 80 Crores.
- Vishal Rampuria:** Okay Sir, the four years is from 2012 or it was from year back?
- Sunil Khandelwal:** From now also it is four years. It is done in the last year, so the last one-year has gone now, it is 3.5 or so, but it is from now.
- Vishal Rampuria:** Regarding the Store 21 retail chain in UK how is the performance for six months?
- Sunil Khandelwal:** They again follow March ending and of course this quarter was not good for them, again they had a loss at the EBITDA level. They have made a loss of about 4 million pound at the EBITDA level and there again we are taking a formulative strategy to come out of that maybe next within a year's time or so, our endeavor is to come out as earlier as possible so we are working on that strategy.
- Vishal Rampuria:** Last question is related to polyester business. Sir, other industry players are facing problems in sourcing PTA because there was shutdown at all the three plants in India, Reliance, Mitsubishi and IOCL, so how is Alok Industry coping with the PTA supply and what is the situation of PTA currently?
- Sunil Khandelwal:** Of course that has been a challenge, from July onwards that had started so that challenge which is there for the industry is for us also. Everybody has reduced the throughput and we are working on the options of imports and all, so far so good - we have been able to manage it and fortunately or whatever you say because of that the margins in this period has really gone up substantially so on that side it is a good news.
- Vishal Rampuria:** The additional 1 lakh tonne of polyester by when it is expected?
- Sunil Khandelwal:** No it is a long way at least not in the near future, not till 2014 we will not even start looking at that.
- Vishal Rampuria:** What is the current capacity, 4 lakh tonnes?
- Sunil Khandelwal:** Half a million tonnes.
- Moderator:** We have the next followup question from Sudhir Bheda of Right Time Consultancy. Please go ahead.
- Sudhir Bheda:** Capex were not going for polyester from 5 to 10, but then what kind of capex you are envisaging for this year and maybe next 12 months?
- Sunil Khandelwal:** What is happening, we will be all focusing on a balancing capex now. For example, in knits, we have machine in our production house ready, so we will expand our knitting capacity from 25 tonnes to say 50 tonnes a day; similarly our spinning is creating about 60% of our weaving internal requirement, the volume of that is 40%, is very large, so we have to source it from mini-mills, more than 20 mills we are sourcing that, so again the quality of yarn in terms, because we are going from different mills, so it varies, so we are gradually increasing our spinning to match, bring it down to close to 90 to 95% of our internal consumption, so we will be looking at that similarly on the wider width side we are not getting it from the market, so we are trying to put up 200 wider width looms to match our processing capacity.

- Sudhir Bheda:** Amount wise what kind of capex are we looking for this year and next year? What will be the result of this, how much percentage turnover will go up next year?
- Sunil Khandelwal:** It is difficult to give you that how much capex will go up but our idea is to have a asset turnover of at least two, so whatever capex we will do it will have asset turnover that is what we are internally keeping a target, as far as amount is concerned of capex it is anywhere between 800 to 900 Crores, which is equivalent to our depreciation charge, we would be trying to limit our capex within that limit.
- Moderator:** Thank you. As there are no further questions from the participants I would now like to hand the floor back to Mr. Vishal for closing comments, over to you Sir.
- Vishal Rampuria:** Thank you for attending this conference call. On behalf of Crisil Equity Research I thank the management of Alok Industries for the con-call. As mentioned earlier, the management of Alok Industries welcomes you for a plant visit at Silvassa at a time convenient to you; in case you are interested, you can get in touch either with us or with Mr. Thirupathi in Alok Industries. Crisil Equity Research has published independent equity research report on Alok Industries and the report is available in the website. Thanks once again to all of you and have a good day.
- Moderator:** On behalf of CRISIL equity research that concludes this conference call. Thank you for joining us. You may now disconnect you lines.