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Bombay Stock Exchange Limited
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Mumbai – 400 001.

National Stock Exchange of India Limited
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Scrip Code: 540048

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Dear Sirs,

Sub: Transcript of the Conference Call

We wish to inform you that Q3 FY17 results conference call hosted on 16th February, 2017. We are sending herewith the transcript of the conference call.

Kindly take the above on your record.

Thanking You,

For S.P.Apparels Limited,

K.Vinodhini

Company Secretary and Compliance Officer

Encl: As above



“SP Apparels Limited Q3 FY17 Earnings Conference Call”

February 16, 2017



ANALYST: **MR. ANKIR GOR - RESEARCH ANALYST,
SYSTEMATIX SHARES & STOCK**

MANAGEMENT: **MR. P. SUNDARARAJAN - CHAIRMAN/MANAGING
DIRECTOR - S.P. APPARELS LIMITED.
MRS. S. LATHA - EXECUTIVE DIRECTOR - S.P.
APPARELS LIMITED.
MR. S. CHENDURAN - DIRECTOR OPERATIONS - S.P.
APPARELS LIMITED.
MRS. PV JEEVA - CEO - S.P. APPARELS LIMITED.
MR. V. BALAJI - CFO - S.P. APPARELS LIMITED.**

Moderator: Good day ladies and gentlemen, and a very warm welcome to the SP Apparels Limited Q3 FY2017 Earnings Conference Call hosted by Systematix Shares & Stock Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during 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. Ankir Gor from Systematix Shares & Stock. Thank you and over to you Sir!

Ankir Gor: Thank you Ali. I would like to welcome all the participants and thank the management of SP Apparels for giving us an opportunity to host this call. From the management side, we have Mr. P. Sundararajan - Chairman/Managing Director. We have Mrs.S. Latha - Executive Director. We have Mr. S. Chenduran - Director Operations, Mrs. PV Jeeva - CEO, and Mr. V. Balaji - CFO. I would like to hand over the call to the management for opening remarks post which we can have the Q&A session. Thank you very much.

P. Sundararajan: Good afternoon everyone, I am Sundararajan. I take this opportunity to thank all of you for participating in the conference and I welcome you for the conference.

I would just like to give you some key points on the nine-month performance of financial year 2017. We have seen a healthy revenue growth in the nine months of this financial year, which is with a good improvement in operating profitability. There is also an increase in existing customer business in the orders supported by an increased capacity. We have added 200 sewing machines in the first quarter and further we plan to add another 300 machines by end of March which will be up and running during the first quarter of next year. We saw a considerable increase in the business from Primark during Q2 and Q3, especially from Ireland and UK. We are actively looking to increase our revenues from the new customers for the forthcoming financial year that is for 2017-2018 from US and non-UK. This quarter has an impact on capacity utilization due to the following reasons which are number one is as we have mentioned many times Q3 and Q4 are known as the festive season for the operations whereby we expect more of absenteeism which has happened during this Q3 due to the Diwali holidays. Secondly, due to the sudden demise of the Chief Minister Jayalalitha there has been factory closure in various places for two to three days which led to reduction in our capacity in the operations. Thirdly, demonetization had an impact on the labor because most of the workers had to go to ATM, go to bank for opening accounts for cash and other things, so it severely affected our production plan. In addition to these, there has been an impact on the depreciation of Sterling Pound currency, which has impacted on our top-line sales. With regard the SP UK operations; we have recorded a revenue of Rs.76.4 million from the UK operations. By this, we have achieved an operational breakeven for the first time. We tied up with the new customers, Landmark from Dubai, BHS international, Peacock, and two to three more customers are in the pipeline. We already started with these three customers, so in total we have about four to five customers for our UK office. With regard to the retail operation, we witnessed 70% growth in the retail division in the last nine months of this year. Again, there has been a severe impact of demonetization in various counters, both in the

wholesale channel, distribution channel as well as on the LFS retail outlets. As of December 2016, we had 41 company-owned stores and 3 franchisee stores. We have five new stores to be opened in Q4, two in Chennai; one in Belgaum, one in Yelahanka (Banglore) and one in Coimbatore (Prozone). We have also increased our presence across 145 large format store outlets, so there has been a remarkable increase in the number of outlets in the retail operations. The general outlook about the business of us is that with regards to the backward integration after the listings, we have already installed 19 knitting machines which are up and running. We have also debottlenecked the blow room where there was a bottleneck when we acquired the spinning mill that is one of the points for raising the money, because it was running 90s count which we wanted to convert to captive where we need medium counts. So there was a bottleneck in the blow room which has partly been debottlenecked now. From next month onwards, the capacity of blow room will be from 3200 to go up to 4800 kilos by this mini project. In addition to this, there is going to be a main project wherein we are increasing 5000 spindles and so on. We have also presented the building approval to the government and we are waiting for the approval. We are waiting for the right time to start the project once it has been approved. Regarding the sewing capacity increase I would just like to update, by end of March there will be additional sewing capacity by another 300 machines which in total will be about 500 machines by this fiscal year. Regarding new customer additions, we are in the process of adding two to three customers including one major customer from US which is expected to start in the next three to four months' time and there is going to be one more US customer in the next six months' time and one big non-UK customer which is also going to be in the next six months' time. So during the next financial year we will have our customer base increased from the existing four to five customers to eight to ten customers, whereby there are two things, customer concentration has been slightly diluted and the customer focus is going to be not only in the UK it is going to be in the US as well. This is what I thought I will share with all of you. Now I will hand over back to Ankit. Thank you.

V. Balaji: We can start Q&A session please.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone phone. If you wish to remove yourself from the question queue you may press "*" and "2". Participants are requested to only use handsets while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles. We will take the first question from the line of Kashyap Jhaveri from Capital 72 Advisors. Please go ahead.

Kashyap Jhaveri: Thank you very much Sir. In one of the slides in the presentation on this adjusted margins there is a mention that in the revenue and EBITDA you have included realized gains but in calculation of EBITDA we have excluded realized gains. So basically the realized gains would be once where we would have taken hedge, executed the contract, and then the corresponding forward contract would have been unbound is that right?

- V. Balaji:** This is Balaji. In terms of the revenues, which we have added, are exchange fluctuation. Even in the last con-call we have explained to you that at the time of receiving the order itself we are booking the contract and we know that at what rates we will receive the inflows, so based upon that we have included the exchange fluctuation gain. The exchange fluctuation gain is the difference between the spot rate when we are booking the sales and the realization rate. We are including the exchange fluctuation into our revenues and we are excluding the MTM gain or loss, which is on the forward contracts from our other expenses. I have been explaining this to each and every analyst on the road shows and also in a couple of calls about this and looking at it. It was a suggestion given by some of the analysts that you can present the presentation accordingly, so that is why we have done that.
- Kashyap Jhaveri:** Okay. If I were to look at your business wise profitability then let us say you have nine months reported EBITDA of 97.1 Crores. Out of that if I exclude about 12.5 Crores of realized gain and about 1.2 Crores that you unrealized MTM losses then your business EBITDA margin would be about 16.7% is that right conclusion?
- V. Balaji:** You are excluding the exchange fluctuation of 12.35 Crores.
- Kashyap Jhaveri:** And on the losses side also which is included in the other expenses.
- V. Balaji:** Let me explain you again on what this exchange fluctuation means actually. When I get an order from the customer I am hedging my order with the contract. So, what happens is that on the same day itself I know that I am taking an order at Rs.66 against the dollar and hedging it for 67.50, so when I am shifting the goods, the spot rate may be 67, so at that rate my sales invoice would be 67 in spite of knowing that my inflow will be at 67.50. The 50 paisa difference is getting adjusted in the exchange fluctuation, so that is why we are adding and looking at it. The exchange fluctuations need to be added to the revenue that is what we have been saying regularly. It is part of the sales.
- Kashyap Jhaveri:** Yes, I completely agree with you and I understand what you are saying. What I am trying to understand is this just if we leave out that financial aspect of the whole transaction, I understand that we have to add back 12.5 Crores as you rightly mentioned, which I completely agree with, but I am saying if that forwards were not taken at that point of time then your business EBITDA would be about 16.7%. Maybe I can take this off line. What you are saying I completely understand and I take the point.
- P. Sundararajan:** What you say in terms of operations, during the month of June when we have taken orders at Rs.98 against the Pound and when it is getting shipped, it is shipped at Rs.82, but still I have taken order at 98, so operationally you have to include the exchange fluctuation that is what I am saying.
- V. Balaji:** What is realized is Rs.98, sales booked at Rs.82.

- Kashyap Jhaveri:** And the second question is on your volume. Your slide mentions that export volumes are about 36.6 million odd pieces. If you could probably guide us to what is the full year target and what could be in next year?
- P. Sundararajan:** Target should be close to around 55 million pieces for the whole year FY2017.
- Kashyap Jhaveri:** And for FY2018?
- P. Sundararajan:** FY2018, I think we are not be in a position to disclose it as of now.
- Kashyap Jhaveri:** Okay. With respect to FY2018 any order book, which is already there in place or it, will come as and when it comes?
- P. Sundararajan:** We have started booking orders for the month of April and May.
- Kashyap Jhaveri:** Okay. Thank you very much Sir.
- Moderator:** Thank you. We will take the next question from the line of Dhruv Agarwal from Crescita Investment. Please go ahead.
- Dhruv Agarwal:** Sir, I just wanted to understand two things. One is on the increased raw material prices on the cotton price. Do we have a provision of getting it passed in the same time or we have a negotiation period for three or six months kind of window where we cannot pass immediately, but we have to go back to the customer and discuss? Secondly, in terms of the new client that you talked about from existing five to ten, are we already supplying some bit of goods to them now it will be a total new start for us and how you see those scaling up over a period of time?
- P. Sundararajan:** Regarding the raw material thing as we mentioned many times earlier and even during the road shows, our businesses are more of fashion products, which are all like in a project. It is not like throughout the year core line products, so every time when we go for order booking, the new styles will be discussed, costed, negotiated. So, whenever we go for order booking, we take the current yarn price, current labour cost, current exchange rate. So every order is being booked based on the current prevailing market prices and closed at the time of shipment in the next three to four months' time. This is how the factory functions. Regarding the customers, we are planning to increase between three to five customers, maybe we will end up with two or three, it depends on the volumes and things and we need to balance our capacity as well. I have been to Hong Kong, I met a customer, all had been discussed because they are already aware of us very well and they had approached us a few years back, but because of capacity constraint we could not start with them. Now they have an aggressive plan to start directly with the manufactures instead of getting mostly from the importers in US. So, they have changed the sourcing strategy to go direct, which is a very encouraging thing for us because it is win-win situation for both the customer, retailer as well as us as the mediator is being removed. The collections what we have shown them they are so much impressed and our team is going on the 21st and 22nd to meet them for the initial order booking, which is going to get through. Already their team has visited

our factory, nearly everything is through, probably the first order we might get in the next one or two months' time. Another customer is already an existing customer, because of the capacity constraints we had to exit them because they were US customers and we could not definitely manage their volumes. As I mentioned before that if we allow the American customers naturally I would not go with the existing UK customers who are associated with us for many years. So we need to give provision of capacity for them also for the growth. Now since we have increased the capacity to 500 machines, next year we are going to go for another 500 to 600 machines, so definitely we have room for inviting more customers, bigger customers also. We have approached our old American customers and we got a message that they are interested, they will come back to us very shortly. Actually in a month's time or two definitely the things will start with them also. There are two to three more customers and we are looking at them. I am very confident that we will have the customer concentration very properly distributed.

Dhruv Agarwal: About the stated ones, what all growth that we are talking about, the Capex will be in line with what you have stated earlier as well?

P. Sundararajan: Exactly. We are very much in line with that.

Dhruv Agarwal: On the domestic retail side because of the demonetization and all that you mentioned in your notes, Diwali month was pretty decent, but post demonetization and all that things have been slightly bad. Has it come to normalcy and do we see the break-even again just getting slightly delayed and it will be coming by the next year first half or something?

P. Sundararajan: The normalcy is recovering, but still not as we expected and regarding the breaking even probably still it will take about another two quarters to three quarters. This quarter we have spent more for the advertisements during the third quarter, which we have not done in the previous quarter, so we are hoping in the next two to three quarters we will be able to break-even.

Moderator: Thank you. Ladies and gentlemen, in order to ensure that the management is able to address questions from all participants, please limit your questions to two per participant. Thank you. We will take the next question from the line of Sangita Purushottam from Cogito Advisors. Please go ahead.

Sangita Purushottam: Sir my question is related to how do you look at the growth unfolding in the next couple of years given that you have invested a lot in capacity? Do you have a sense of what kind of growth you are targeting and what is likely to be impact on the margin?

P. Sundararajan: As we have mentioned before we are always expecting 15% to 20% growth Y-o-Y that is for sure and that will happen. We always try to see that if we can make a little jump anytime if possible, for which we may have to wait for the right time in terms of the capacity and other things. Otherwise ideally the best thing is 15% to 20% growth, which we definitely will be able to achieve. On the profitability side, yes, since we are going for the backward integration and it will start from the next year onwards which will start giving us a benefit in terms of internal savings, consumptions, etc. The whole thing we will start experiencing the benefit.

Sangita Purushottam: Is it possible to quantify the level of impact that you are likely to see on the margins from the backward integration, that is number one. Secondly, in our existing business, if we look at our businesses without the benefit of backward integrations do we have any leverage to grow the margin there either in terms of operating leverage or anything else?

P. Sundararajan: Yes, of course, there are two things. One is we are going to improve the margin by backward integration that is for sure, even leaving that aside we have mentioned many times before that we have room for improving the productivity from what currently we are doing and we have the opportunity of improving the productivity efficiency by another 5% Y-o-Y for the next two to three years' time, which will definitely give us a lot of benefit in the bottom line.

Sangita Purushottam: Okay. I had one last question, which is relating to your domestic business. Now I understand that you have put out good quality and right products in the market and there is obviously demand and that is sort of picking up, but how do you look at this business in terms of capital allocation? How much do you think would you want to spend on growing this business and how are you thinking about it, if you could just share some of that?

V. Balaji: In terms of domestic retail business, on the investment front, on the retailed stores which we have raised closely around 28 Crores from the IPO, we spent putting up 70 new stores, which will be closely around 40 lakhs per store including the basic stock for the store. So, it will be like 22 lakhs for the interiors, 8 to 10 lakhs on the rental advances, and 8 lakhs on the basic stock. So, the investment for next 70 stores is already raised. In terms of the working capital for the distributor channel, which is the essential division, I think over a period of two years we have supported them with good amount of investment and I think they will support the working capital with the funds, which we have already allocated. So, there should not be any huge amount of investments in the essential division also.

Sangita Purushottam: Okay. So, what basically you are saying is a lot of the investments that we made and from here on it is anything at all it is likely to be any incremental working capital which may be required to increase the penetration. Is that fair idea?

P. Sundararajan: You are right.

Sangita Purushottam: Okay. Thank you very much.

Moderator: Thank you. We will take the next question from the line of Ujwal Shah from Quest Investment Advisors. Please go ahead.

Ujwal Shah: Thank you for taking my question. Sir, I just wanted to understand the Brexit impact on margins for the quarter and we were planning to renegotiate prices with the customers post Christmas, so how have the talks been over this period?

V. Balaji: We have discussed this in the last call also. We said that Q3 would be the quarter where you will find the Brexit impact because of the Pound depreciation and that would be supported by the

ROSL duty drawback, which has been given by the government. It will no away affect the EBITDA in toto. So, if you look at our EBITDA, we have improved our EBITDA Q-o-Q on the garment front alone. So, looking at that, there is no impact of the Brexit in total. As we move forward with the customers on the negotiation front, yes we are able to transfer certain amount of depreciation effect to the customer and they are also improving their retail rates in UK, so slowly this will completely get adjusted, maybe in another quarter.

P. Sundararajan: Not only that we are also pressurizing our raw material suppliers to support us during this crisis time. So, we are able to get something at the lower price, for example dyes, chemicals, threads, yarn, etc. We are getting lot of support from others also because they also understand this Brexit situation. So, this has smartly been mitigated.

Ujwal Shah: Right Sir. Can you quantify the negotiation prices with the customers?

P. Sundararajan: As I told you that these are all project-based orders, this cannot be similar. One order cannot be similar to the other one. Freshly costed, freshly quoted and freshly negotiated.

Ujwal Shah: Okay Sir. In terms of retail business, we all know that demonetization did have an impact on the retail side, but if we exclude that impact where do we see Q4 going as such the next year? We were expecting a break-even this year in terms of business prospect, new advertisement cost and all that, what is the outlook in terms of growth? You rightly mentioned on the break-even side next two to three quarters we might, but in terms of growth for the business how do you foresee post demonetization?

V. Balaji: In terms of growth, you know that we strategically have two divisions there, one is DRS and one is the essential. DRS means direct retail stores. So retailed stores as we are increasing our store base and our presence with LFS is also growing, so our revenue from DRS should be in line with what we expected and it should be better than what we have done this year. With respect to essential also, we have come down in our estimations what we have estimated during the month of November and December. I think we should grow in the same rate of what we have done last year.

P. Sundararajan We will be able to maintain the same growth rate, so in terms of the wholesale business distribution channel, we definitely expect the growth. I think you are aware about the regulations, so we will be in a better position to grow.

Ujwal Shah: Okay, right Sir. Guidance numbers for the Capex for this year and next year?

V. Balaji: Capex in terms of backward integration whatever we have given in the RHP stands good and on the sewing capacity front, we are expecting 20 Crores of Capex this year and 20 Crores of Capex next year.

Moderator: Thank you. We will take the next question from the line of Ravi Naredi from Naredi Investments. Please go ahead.

- Ravi Naredi:** Sir what is the EBITDA margin in retail and garment separately, can you bifurcate?
- V. Balaji:** I think we have an EBITDA of closely around 21.7% on the garment front. If you look at our presentation in page number 6 we have provided information both for nine months and for the quarter. For retail, we have a negative EBITDA. We have closely around 2.5 Crores losses on the EBITDA front this quarter.
- Ravi Naredi:** Okay. Sir, what is the plan to grow in three to five years' time horizon in retail sector?
- V. Balaji:** In terms of number of stores we will be putting up 70 new stores as planned in the RHP. I think it should take our revenue growth on the DRS front from what we will achieve this year closely around 27 Crores to closely around maybe 200% of what we have done this time. In terms of essentials, we should grow in a similar fashion. We will achieve 25 Crores this year and we will grow in the similar fashion to DRS in the essential division also. So, we should be closely around 200 Crores of revenue in another three years' time.
- Ravi Naredi:** Any dividend policy you have framed or are you going to frame?
- P. Sundararajan:** I think in all our road shows and even in our last two con-calls, which we have done, we have informed that we will have a 15% on PAT for dividend.
- Ravi Naredi:** Okay. Thank you very much Sir and all the best.
- Moderator:** We will take the next question from the line of Kshitij Kaji from Edelweiss. Please go ahead.
- Kshitij Kaji:** Good afternoon Sir and thank you for taking my question. Sir, just two questions I have. Firstly, what is the capacity utilization this quarter and what is the optimum that we can go to in the subsequent quarters?
- V. Balaji:** Capacity utilization this quarter is closely around 78%. The CMD has given you reasons on the festival season and on the demise of our chief minister, and the demonetization front. So these three things affected our utilization this quarter. So, if you look at our last one-and-a-half years of utilization, we have been closely around 88% to 89%. We can go up to 92% after this quarter.
- Kshitij Kaji:** Okay Sir. My second question is that what number of sewing machines are you closing this year at?
- V. Balaji:** We should be closing closely around 4000 machines and the utilization should be closely around 88% to 89% as I said.
- Kshitij Kaji:** Okay Sir. That is all from side. Thank you very much and all the best.
- Moderator:** Thank you. We will take the next question from the line of Chintan Shah from Kitara Capital. Please go ahead.

- Nimish Desai:** Actually this is Nimish Desai. Sir, part of my question has already been answered, but a little more on a specific on your US client, can you just tell me that how much capacity they have blocked in terms of number of machines or lines from our existing capacity?
- P. Sundararajan:** This is too early to comment on this because it will take some time. They will try for one or two seasons and only then they will increase the quantities. We will be having a business share of about, I would say, 10% to 15% will be from the new customers.
- Nimish Desai:** Should this client particularly have a high-end value product or low-end value product?
- P. Sundararajan:** We cannot talk more on the new client. They are in line with what we are currently producing. There is nothing deviating from what we are today.
- Nimish Desai:** Okay. Thank your Sir.
- Moderator:** Thank you. We have the next question from the line of Amish Kanani from JM Financial. Please go ahead.
- Amish Kanani:** If you can remind us about the government incentives that you mentioned? How is it placed in terms of whether it is continuing for the next two years and also the changes in the contract labour act that the government has proposed how it will benefit our sector in general?
- V. Balaji:** I do not think there is a change in the policy because this government has clearly stated that whatever foreign trade policy which they have come out with is for a period of five years, at least for the time which they are in power. So, I think the next two to three years there will not be much changes in the foreign trade policy, which they have come out with very recently.
- Amish Kanani:** In terms of incentive, is my understanding correct that incentive was about 5% and what was it earlier?
- V. Balaji:** Refund for us in duty drawback is closely around 7.5% plus ROSL of 3.05%, in total it should be close to around 11% plus we got the MEIS of 1.85% or 2% based on the country.
- Amish Kanani:** Okay. What was it Sir, if I have to compare that, is it all fresh additional benefit that has come?
- P. Sundararajan:** This 7.5% duty drawback has been in existence for many years and the license MEIS has been for many years. The only new change is ROSL that is refund on the state levies, it was also in existence by the state government to refund on the sales taxes, now this has been made in other way as ROSL flat 3% on turnover, so that we do not have to apply for the sales tax officers. There is an additional increase of I would say about 1%.
- Amish Kanani:** Okay. In terms of contract labour and the related question, is there any change in the contract labour, which is helping us to grow?

- P. Sundararajan:** We do not have much of contract labour. I do not think it is applicable for us. It is only for those factories that are mainly dependent on contract labours.
- Amish Kanani:** Okay. So, we do not engage and we do not plan to do also. Second question of mine is what is the breakup between fashion versus basic in our current turnover, and how do you see it changing over the next two to three-year period?
- P. Sundararajan:** Currently it should be around 30% basics and 70% fashion. Going forward, what we are planning for is 50:50. So, it will have a proper mix in our production shop floor.
- Amish Kanani:** Okay. One related question was what is the breakup between UK and US, what is the Pound versus USD exposure?
- P. Sundararajan:** There is no US business. We are doing business in US currency to UK customers.
- V. Balaji** USD should be close to around 55% to 58%. GBP should be closely around 33% and the balance should be Euro.
- Amish Kanani:** Okay. So the extent of loss that we had from the Pound is to the extent of one-third of our business.
- P. Sundararajan:** One-third directly. Of course, UK market because of Brexit again there will be a little bit of impact on the USD also.
- Moderator:** Thank you. We will take the next question from the line of Dikshit Mittal from Subhkam Ventures. Please go ahead.
- Dikshit Mittal:** Good afternoon Sir. Can you tell what is the time lag between the time you get the order and by the time you dispatch and recover the revenues?
- P. Sundararajan:** It ranges between three months and five months.
- Dikshit Mittal:** Okay. Because we saw a sharp Pound depreciation in the month of June. So, this quarter that we have got, I think the reference rate should be around 85-86, in terms of Rupee to Pound?
- P. Sundararajan:** This quarter yes, average.
- Dikshit Mittal:** Okay. The new orders that we are getting in at current exchange rate, are they giving you the same margin or the impact is still yet to be passed? Even if you are billing in dollars, the effect should be there right because they are not changing the selling price in Pound in UK,so have the retailers been able to pass on this impact or it is still pending?

- P. Sundararajan:** They have not increased their selling price yet. As we discussed earlier also, we were able to push certain portion and they were able to absorb certain portion of margins in the orders, which we have taken in Q3 to some extent.
- Dikshit Mittal:** Okay. For Q3 can you give the average exchange rate in terms of Rupee to Pound that we book in the revenues? In the revenue book, what is the average that we have booked?
- V. Balaji:** Maybe I can share it with you subsequently. I do not have the numbers now. For costing purpose we are maintaining 83 on the pound front.
- Dikshit Mittal:** Okay. So, bulk of the impact has already come in this quarter margins, right?
- P. Sundararajan:** Yes.
- Dikshit Mittal:** Okay. So, from next quarter onwards this is the way that we should look at?
- P. Sundararajan:** Yes.
- Dikshit Mittal:** Okay. Secondly, can you give the revenue per machine that we have achieved in Q3?
- P. Sundararajan:** Closely around 15 lakhs.
- Dikshit Mittal:** It has come down from 16 to 15 purely because of lower utilization.
- P. Sundararajan:** Yes, it is annualized for 12 months.
- Dikshit Mittal:** Okay. After this Capex on spinning and knitting, what will be our level our backward integration in percentage, how much of the yarn that we do in-house and how much knitting we will be doing in-house?
- P. Sundararajan:** Once the projects are completed, 100% of yarn produced in the spinning mill will be consumed by us, which will only contribute to about 60% to 70% of our requirement.
- Moderator:** Thank you. We will take the next question from the line of Raunak Murjaria from Edelweiss. Please go ahead.
- Raunak Murjaria:** Good afternoon Sir. Can you give us the volume number for the Q3 this year as well as the last year in terms of number of pieces?
- P. Sundararajan:** Around 11.46 million pieces this quarter versus 9.19 mn Y-o-Y.
- Raunak Murjaria:** Okay. Secondly, I just wanted to check on the number of sewing machines. I think you mentioned that in the first quarter we had already installed 300 machines and in the coming quarters we will be installing 300 machines right?

- V. Balaji:** We have installed 200 machines and we will install another 300 now.
- Raunak Murjaria:** Okay. For next year, you have given the guidance of 500 to 600 machines. I think earlier we have given the guidance of 700 machines.
- P. Sundararajan:** You are right, 700 for the second year and 800 for the third year. It depends, it can be even 1000 machines next year, we are not sure, it is depending upon the situation. In three years' time, definitely we will increase by 2000 machines.
- Raunak Murjaria:** I just wanted to understand since we are adding new clients and you are reducing your guidance on new machines.
- P. Sundararajan:** We are not reducing the guidance. It was a rough number which we have stated 500-600 machines.
- Raunak Murjaria:** Okay. That is it from my side.
- Moderator:** Thank you. We will take the next question from the line of Moiz Tambawala from Florintree Advisors. Please go ahead.
- Moiz Tambawala:** Good afternoon. What was the total number of sewing machines that we closed the quarter with?
- P. Sundararajan:** Closely around 3760. Utilized is 2896, which is 78%.
- Moiz Tambawala:** Okay. What was the export revenue for the quarter and the duty drawback as well?
- V. Balaji:** Export revenue was closely around 109 Crores. We will have 13% on duty drawback.
- Moiz Tambawala:** Okay. And the split between the B2B and the retail sales?
- V. Balaji:** B2B was 5 Crores and retail was 8 Crores, so total revenue of 13 Crores.
- Moiz Tambawala:** Okay, thank you so much.
- Moderator:** Thank you. We will take the next question from the line of Gaurav Agarwal from E&R Advisors. Please go ahead.
- Gaurav Agarwal:** Thank you for the opportunity. Sir, I just wanted to understand the context of seasonality in your numbers. If you can provide last four to five years how has the Q-o-Q growth been, this quarter being negative, last Q-o-Q being positive. I really do not have data to understand the context of this quarter?
- P. Sundararajan:** It is like this, in the four quarters, Q1 and Q2 will be more than Q3 and Q4 because of the festival quarters. If you see historically, always Q3 will be lesser than Q2.

- Gaurav Agarwal:** Okay. Which one is the highest quarter Sir?
- P. Sundararajan:** Q1 and Q2 more or less same.
- Gaurav Agarwal:** Okay. On the retail front, people must have asked this question in the past as well, what is the thought process, in investing in a lower margin, lower ROI business, when we have such a good cash generating garment business? Going forward as we go along you will put more money into the business, the EBITDA will continue to be lower on the whole level, so how do you see the numbers over a three-year or four-year perspective?
- V. Balaji:** We have been telling in all the road shows that whatever we have raised from the market of 28 Crores will be used to put up new stores and what we have already invested in the working capital, the essential will support itself and are self-sustainable. There will not be a big diversion from here.
- Gaurav Agarwal:** Okay. If I understand you correctly, 28 Crores will be the maximum capital allocation that will go towards the retail?
- V. Balaji:** In terms of Capex, yes.
- Moderator:** Thank you. We will take the next question from the line of Abhishek Budholia from Individual Investor. Please go ahead.
- Abhishek Budholia:** As I saw in your investor presentation, we outsourced the knitting facility due to backward integration, what amount of knitting capacity you plan to integrate?
- V. Balaji:** As part of our knitting process, until we raised IPO funds, we were 100% outsourcing. Now we are planning to bring at least 40% to 50% in-house, so that the spinning output and the knitting facility is matched.
- Abhishek Budholia:** Okay, it means 42% knitting capacity we are planning to integrate going forward?
- P. Sundararajan:** Yes, correct.
- Abhishek Budholia:** Okay. In terms of sewing machine as you told that 78% is current capacity utilization. In terms of spindle capacity, what is our current capacity utilization?
- P. Sundararajan:** In terms of spindles, we are close to 100% utilization. We are outsourcing yarn from elsewhere also, even if there is less utilization, our spindles will be completely utilized.
- Abhishek Budholia:** Okay. It means we also outsource some amount in terms of spindles.
- P. Sundararajan:** Yes. Around 50% will be outsourced.

- Abhishek Budholia:** Okay. On spindle front, we are planning to integrate or not?
- V. Balaji** Yes, that is why we have raised funds from the market. It is fully integrated, spinning and knitting, dyeing and the garment.
- Abhishek Budholia:** Okay. So, we are planning to integrate fully. Thank you.
- Moderator:** Thank you. We will take the next question from the line of Sangita Purushottam from Cogito Advisors. Please go ahead.
- Sangita Purushottam:** Sir my question was that in terms of your growth of 15% to 20%, how much will come from existing clients and how much is likely to be coming from the new clients? That is one question. The second question is that you mentioned that over a period of time your product mix between essentials and fashion will go 50:50. Will it not impact the margins and your operating margins actually come down because of that?
- P. Sundararajan:** The first one is that it is a combination of customers growth, some probably would have reached nearly a saturation point, where there will be Y-o-Y about 5% growth anyway will be there because we will be adding more departments in the existing customers and there are some customers we are yet to still grow at the level of say 10% to 15%. There are again existing customers where we need to really grow for another two to three years by 20% to 25% because they just started. The new customers are going to be 10% to 15% of the total business. With regard to the mixing of fashion and basics, I mentioned before that there will be a pressure on margin on the basics, but the volumes are big and this will help us in the productivity where we will have a mix of fashion as well as the basic one, where the efficiency output per machine and the export value per machine will increase, which will again in turn help us in reducing our overheads percentage.
- Sangita Purushottam:** Okay. Net-net we still expect overall our margins..
- P. Sundararajan:** Yes, it will be similar to what we are currently getting.
- Sangita Purushottam:** Okay. It depends on the currency?
- P. Sundararajan:** Yes, it depends on the currency of course.
- Sangita Purushottam:** Overall, therefore are you saying that despite moving to 50:50 weightage of basic and fashion given the efficiency our margins will still improve?
- P. Sundararajan:** Yes, very much, definitely. That is one of the reasons why we want to have the mix.
- Sangita Purushottam:** Okay, all right, thank you.

- Moderator:** Thank you. We will take the next question from the line of Ravi Naredi from Naredi Investments. Please go ahead.
- Ravi Naredi:** Thank you again for giving me the chance. In retail, in existing system we are getting losses. Why we not go in franchisee model or other model where we can do not suffer losses?
- P. Sundararajan:** It is one of our roadmaps that we are increasing the franchisees Y-o-Y. Within the next one year's time, we will have at least about 10 to 20 franchisee stores. We mentioned before the build, operate, and transfer. So, the performing stores will be transferred to the franchisees and we will open the new one. Also, we will look for the franchisee who has got the space, who is already in the business, who can also take some of our businesses as franchisee. We are not ruling it out. That is one of our roadmap plans.
- Ravi Naredi:** Okay. So, definitely we are taking efforts to minimize the losses in retail.
- P. Sundararajan:** Only the backend expenses need to be mitigated. As we grow bigger and bigger, with this kind of backward expenses, we are very confident we will be able to break-even and make profits.
- Ravi Naredi:** In how many years?
- P. Sundararajan:** We expect to break-even in the next two quarters and in the worst scenario by Q4.
- Ravi Naredi:** Okay, thank you.
- Moderator:** Thank you. We will take the next question from the line of Aswin H from Individual Investor. Please go ahead.
- Aswin H.:** Thank you, just one question. The EBITDA margin improvement because of backward integration, what should we expect that to be?
- P. Sundararajan:** Anywhere between 200 to 300 basis points.
- Aswin H.:** On the overall sales or only on the relevant sales?
- P. Sundararajan:** EBITDA margin means it is on the garment sales only.
- Aswin H.:** Okay, thank you.
- Moderator:** Thank you. We will take the next question from the line of Bharat Sheth from Quest Investments. Please go ahead.
- Bharat Sheth:** Good afternoon Sir. Relating to previous question, when we are going for 50:50, per machine how much EBITDA improvement and improvement in efficiency do we expect? What is

approximately we are currently making and how much we would like to increase from the current level?

P. Sundararajan: When we have a blend of this both, the efficiency will definitely go up by another 5% to 10% over a period of one year's time. This will improve our revenue per machine because output is going to be more. We are working on that kind of formula so that our backend expenses are diluted.

Bharat Sheth: Okay. I joined the call a little later. What is the status of our backward integration currently?

V. Balaji: In terms of knitting machines, out of 40 we have received already 19 and all 19 have effectively started production. In terms of spinning, what we have done is we have done a mini project wherein our existing capacity has been improved to 4800 kg per day. So that now we are increasing the capacity and on the expansion front on the spinning project we have submitted for approvals with the government and we are waiting for the approvals to be cleared by the government. You know because of the political scenario in Tamil Nadu, we are getting delayed here. In terms of balancing of equipment, we have already completed. Currently the spinning is fully balanced, right from blow room to cone winding. For expansion, we have submitted the papers to the government for approval and then we will start ordering the machines and the building.

Bharat Sheth: Okay. How much EBITDA improvement that we expect because of using our spindle capacity fully?

P. Sundararajan: It will be around 200 to 300 basis points.

Bharat Sheth: Only spinning part we have completed.

P. Sundararajan: We have improved it to 4800 kg.

Bharat Sheth: How much EBITDA improvement we expect because of that only?

P. Sundararajan: That alone I think should be 25 to 50 basis points. Definitely 0.5%, yes.

Bharat Sheth: Okay, that we will see from next quarter onwards or Q1?

P. Sundararajan: From Q1 FY18.

Bharat Sheth: Okay, thank you. That is all and all the best Sir.

Moderator: Thank you. We will take the next question from the line of Jatinder Agarwal from Relax Capital. Please go ahead. Jatinder your line is un-muted, please proceed with your questions. As there is no response, we will move to the next question from the line of Duby Rex from iThought Financial. Please go ahead.

- Duby Rex:** Is it possible to know the average realization in garment business?
- V. Balaji:** Average realization is close to around Rs.103.
- Duby Rex:** Okay. One more question on the retail front, in the next one year how much would you be spending on ad approximately?
- P. Sundararajan:** This year I think our spend budget has been completed. We are yet to account Rs. one more Crore in this quarter. The next year budget is close to around Rs, 3 to 3.5 Crores.
- Duby Rex:** Okay, fine. Thank you and all the best.
- Moderator:** Thank you. We will take the next question from the line of Sunil Kothari from Unique Investments. Please go ahead.
- Sunil Kothari:** Thank you very much Sir. What is the realization per machine or revenue per machine in nine months?
- P. Sundararajan:** Annualized realization is close to 15 lakhs.
- Sunil Kothari:** But I think we have done roughly garments total 449 Crores, so divided by 3100 machines, it comes to 15 lakhs in nine months, so I am not able to understand.
- P. Sundararajan:** You have taken including the operational income of duty drawback.
- Sunil Kothari:** Okay. Normally what we expect?
- P. Sundararajan:** It depends on the product, depends on the efficiency. It is only a yard stick, I suggest let us not go by that. It is only for us to measure internally.
- Sunil Kothari:** Okay. This is the revenue from around 3100 machines?
- P. Sundararajan:** For nine months we have done. Average running machine were 3125.
- Sunil Kothari:** Okay. We have product some 11.46 million pieces in Q3 and relevant numbers also you have given for last year. Can you give me nine-month garment production and Y-o-Y numbers?
- V. Balaji:** 38.62 million for nine months and for the same last year nine months it is 25.83 million.
- Sunil Kothari:** Thank you very much.
- Moderator:** Thank you. We will take the next question from the line of Mahendra Jain from GreenEdge Wealth Services. Please go ahead.

- Mahendra Jain:** Thank you for giving the opportunity. I would like to understand what will be the formula of pricing between franchise and our company? What will be the margin in MRP in all these things?
- S. Chenduran:** In terms of margins to the franchisees, it will be 35% to 45% depending on the sale or return of goods, or if they buy it outright, ORP. It depends between the range of 35% and 45%.
- Mahendra Jain:** Okay. Second question is on franchisees returning goods to the company, how that thing will be taken care of? Because in a lot of these models, goods which are not sold or outdated or old design, they generally return it to the company. So, how it will be treated?
- S. Chenduran:** Whatever sales we are projecting or talking about is only the net sales, but since you asked that question whatever returns we get, we have other channels where we can sell it at discount, but whatever margins we are talking about inclusive of discount. Generally, in the distribution channel we are doing only the basics, vest, brief, track pants, etc.
- P. Sundararajan:** As the business goes and the distributors are set and the business is set, there is going to be only very small, minimum amount of return that is also due to stock correction. We do not anticipate in a long term any big return. In the B2C business model, it is all sale or return, there again they have channels to liquidate the stocks after a few months.
- Mahendra Jain:** Okay. You mean that we are not promoting fashion to retails, only basics?
- P. Sundararajan:** In B2C there is fashion only, but in B2B only the basic product, where there is less of returns for stock correction purpose only. In B2C, there is yet, after the season after four or five months, there will be some leftover in some of the styles where again we have our own outlets, there are so many other channels, where we liquidate it. So, we have a target period that all the stocks should be liquidated and deadline is there. So, we give some schemes or discounts and ensure that it is liquidated. These are all built-in in our margins.
- Mahendra Jain:** Okay, thank you Sir.
- Moderator:** Thank you. We have the next question from the line of Jessica Doshi from Sharekhan Ltd. Please go ahead.
- Jessica Doshi:** Thanks for taking my question. I just wanted to know what is the current debt position of the company?
- V. Balaji:** Currently we have 168 Crores of debt.
- Jessica Doshi:** Okay. For our expansion what you have mentioned for the spindles, the 5000 spindles what you are going to plan go ahead, how would that be funded?
- V. Balaji:** That will be funded from the IPO.

- Jessica Doshi:** Okay. How much would be the Capex for that?
- V. Balaji:** It will be around 45 Crores for the spinning alone.
- Jessica Doshi:** Okay. What is the comfortable debt-equity ratio that you are looking into? Is this debt comfortable for you?
- V. Balaji:** Now, debt to equity is 0.5. We are comfortable with it. We should not be beyond 0.5.
- Jessica Doshi:** Okay. Thank you so much.
- Moderator:** Thank you. We will take the next question from the line of Jatinder Agarwal from Relax Capital. Please go ahead.
- Jatinder Agarwal:** I am extremely sorry Sir, I could not come on the line during the previous attempt. I have a very dumb question. I looked at this company only fairly recently. I understand the children garment realization for you is about Rs.100 per garment or a little lower Rs. 100. As a customer, I cannot think of we buying for our kids anything less than 250 or 300 here in India. Could you explain what are the hurdles for you to launch some of these products within the country rather than actually just looking at exports as a market?
- P. Sundararajan:** I have been mentioning to everyone, unless and until we break-even this Crocodile brand mens wear we are not in a position to move forward because first and foremost thing is that we need to convince ourselves and convince the investors that this business can survive and can make profits. So, I am waiting for this and after that we are not ruling out the possibility of childrens wear as well as ladies wear. We will wait until we break-even in the mens wear.
- Jatinder Agarwal:** And that will also be from the same Crocodile brand?
- P. Sundararajan:** That will be our own brand or we will acquire some brands. We also have one brand - Natalia.
- Jatinder Agarwal:** Is it online Sir?
- P. Sundararajan:** It is not functioning and not active at all.
- Jatinder Agarwal:** Okay, that is it from me Sir. Thank you very much.
- Moderator:** Thank you. We will take the last question from the line of Abhishek Budholia from Individual Investor. Please go ahead.
- Abhishek Budholia:** Thank you again for giving me the opportunity. What is the credit term we currently offer to our customers in inventory?

- V. Balaji:** The inventory will be on the order basis, so any inventory in the system is based on the order, which we get from the customer. So, the inventory will be closely around 90 to 120 days based on the order requirement. On the receivable front, it varies from customer to customer again. For TESCO it is 60 days TT payment and for Asda it is 45 days. So, it varies from customer to customer. In toto, you should have 55 to 60 days of receivables in the book for garment division.
- Abhishek Budholia:** Okay. It means max-to-max 50 to 65 days that we offer.
- P. Sundararajan:** Yes.
- Abhishek Budholia:** Okay, thank you Sir.
- Moderator:** Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Ankir Gor for closing comments.
- Ankir Gor:** Thank you Sir. Thank you participants for attending this call. I would like to handover the call to management for their closing comments. Thank you.
- P. Sundararajan:** Thanks to all the participants and I am confident that we were able to answer all your questions. If you still have any ambiguity or anything, feel free to contact us at anytime at your convenience. Thank you.
- Moderator:** Thank you. Ladies and gentlemen, on behalf of Systematix Shares & Stock Limited, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.