“Lux Industries Limited Q2 FY-19 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to Lux Industries Limited Q2 FY19 Earnings conference call. This conference call may contain certain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

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. Saket Todi – Promoter& Senior Vice President – Marketing, Lux Industries Limited. Thank you and over to you Sir!

Saket Todi: Good afternoon and a very warm welcome to everyone. Along with me, I have Mr. Udit Todi – Promoter &Senior Vice-President Strategy, Mr. Ajay Patodia – our CFO and SGA, our Investor Relation Advisor. I hope you have received our result and Investor Presentation by now. For those who have not, you can view them on our website.

We are seeing a change in the innerwear industry in India. This industry is expected to double in the next seven years. The growth will be on the back of manufacturing automation which will increase efficiency and global competitiveness supported by emergence of purpose specific innerwear. The Men's innerwear industry will grow exponentially with increasing disposable income and change in consumer's attitude. Post-implementation of GST, we have seen a major transformation in the mass segment from the unorganized sector to the organized sector. Due to the input credit mechanism under GST, the organized sector has had a reduction in the cost instance to a tune of 100 basis points whereas the unorganized sector has seen an increased cost by500 basis points.

I would also like to share with you an update on our winterwear segment which have witnessed good growth in recent times. The overall winterwear market is expected to grow at a CAGR of 5% for the next 10 years. The market is driven by the factors such as product innovation and increased fashion awareness with the weather role-playing in. We derive approximately 10% of our total revenues from winterwear under the brand Lux Cotts Wool and Lux Inferno and have better margins out there. We expect current winter season will witness improved volumes and better pricing. The focus on technology and automation led manufacturing has helped us improve our profitability and has delivered consistently superior quality products to our customers.

We are very happy to report good growth in spite of relatively subdued consumer demand and tightening liquidity. We have witnessed a strong growth during the quarter with the festive season picking in. We expect the momentum to continue. At Lux we have constantly focused on improving and optimizing operational, financial efficiencies which is clearly reflected in our performance and has helped us to deliver good growth which is better than the industry average.

In an industry where there are large number of unorganized and small-scale manufacturing units we have always concentrated on large technology driven manufacturing. Our strategyto bepresent across the entire manufacturing value chain has helped us to maintain product quality which is core differentiator. Innovation is the key to any business and at Lux we have been proactive to recalibrate our product mix to meet the change in the consumer demand.

On the distributor front we are the largest domestic innerwear player by volume. and to achieve this we follow simple strategy. Lux is available where the consumers are and this has been possible due to our core strength of distribution and the goodwill we enjoy with our distributor, dealers and retailers. We continue to invest heavily to improve our distribution and reach in our country.

We have had a very strong presence in North, East and Western part of the country generating approximately 85% of the revenues from these zones. However, we are relatively weaker in the southern states and our endeavor is to focus on that area is by increasing the distributor strength. Considering the young demographics of our country, Lux agreement with CSE Consultancy LLP License owner of the brand One8 to manufacture and market its product globally will help us strengthen our presence in the premium innerwear segment and grab attention of the youth.

During this year Board of Directors have proposed and approved the scheme of merger of JM Hosiery & Company Limited and Ebell Fashion Private Limited with Lux Industries Limited which is on track and which will help Lux strengthen its presence across geographies and product categories. The total revenue of Lux group including JM Hosiery and Ebell Fashion has grown by 30% to Rs. 410 crores in Quarter 2 FY19 in comparison to Quarter 2 FY18. For H1 FY 19 the consolidated revenue grew by 20% to the tune of 815 crores for the Lux Group.

Now I handover to our CFO Mr. Ajay Patodia to provide you an insight of our financial performance.

Ajay Patodia: Thank you Saket ji. Our company reported a strong growth for the quarter and half year ended 30th of September, 2018. Our revenue grew by a record 31% to Rs. 277 crores. EBITDA and PAT were at Rs. 43 crores and Rs 21 crores respectively for Quarter 2 FY19 a spectacular growth of 51% and 61% respectively. Our EBITDA margin has seen a significant improvement by 200 basis points to 15.6% majorlyon account of increase in value-added products and overall cost efficiency measures. We have also seen a healthy improvement in PAT margins by 140 basis points to 7.7%.

Now coming to our half-year performance:

Our revenues stood at Rs. 540 crores versus Rs. 457 crores signifying a growth of 18%. EBITDA for H1 FY19 stood at Rs. 82 crores as compared to Rs. 61 crores in H1 FY18, signifying a growth of 34% year-on-year. The EBITDA margin increased by 180 basis points year-on- yearto 15.1% for H1 FY19. PAT for H1 FY19 stood at Rs. 40 crores as compared to Rs. 29 crores in H1 FY18, recording a growth of 38% year-on-year basis. The PAT margin stood at 7.4% for H1 FY19.

With this we will now open the floor for question and answers.

Moderator: Thank you very much. Ladies and gentleman, we will now begin the question and answer session.The first question is from the line of Himanshu Nayyar from Systematix Shares & Stock.Please go ahead.

Himanshu Nayyar: Just wanted to understand this quarter's P&L a bit in detail because on one hand we see a gross margin decline if I include subcontracting expenses of around 350 basis points and other expenses have seen a 530 basis points decline as a percentage of sales. So, what has really happened in the quarter if you can just give reasons for the same?

Saket Todi: Our major cost which is the selling and promotion expenses has reduced drastically because of the bigger scale of the turnoverbut on absolute basis it has remained the same as of last quarter or even lower than that. And with the increase in revenue the percentage has gone down which has helped us getvery good profitability.

Himanshu Nayyar: what would be the key reason for decline in the gross margin, maybe increase in cotton prices which we did not pass on or the mix has deteriorated a bit?

Saket Todi: No, the mix has almost remained the same but the cotton prices have been increasing the month on month since the last 6 to 7 months. , and alsowith the tight liquidity and the huge competition during this season there was an effect on our the gross margins as well as there has been an increase in the cost of the jobbing and our subcontracting expenses,. So, that has been passed on in this current quarter.

Himanshu Nayyar: On the working capital side if you can just let us know the sort of initiatives taken and whether they have really help does bring down the working capital as well.

Saket Todi: working capital have remained the same. As you know in the market the liquidity is very tight so we are trying to control the debtor days and that is the first step to control the working capital. The second step would be to control the inventory cycle as it has an impact on the debtor days so to get the correct picture of working capital cycle I would advice you to analysethe whole year of FY 18-19 as six months is a very small time to see the correct picture.But I would say we have been successful in achieving the 1st step

Himanshu Nayyar: Secondly on the advertising spends; have we brought them down as well which has helped us control our other expenses significantly?

Saket Todi: Yes, it has.

Himanshu Nayyar: Can you give a number for the year as to how much of a reduction can we see there or do you have a budget in mind that you will be spending on advertising for this year?

Saket Todi: We have a budget of approximately 7%.

Himanshu Nayyar: The Ebell and JM continue to perform very strongly so obviously everyone would be waiting for the merger, so any timelines which you cangive us or what's the status, where exactly we are in, any approvals etc. which are still awaited if you can just update us a bit on that.

Saket Todi: We would say it is ASAP.

Himanshu Nayyar: Can we expect the merger to be completed by end of this year, FY19?

Saket Todi: We are trying our level best. Let's see.

Moderator: The next question is from the line of Saurabh Ginodia from Stewart & Mackertich. Please go ahead.

Saurabh Ginodia: If you can give the volume growth for the quarter.

Saket Todi: The volume growth will be approximately 28% to 29%.

Saurabh Ginodia: And for the half year?

Saket Todi: Half year it would be around 17%.

Saurabh Ginodia: What kind of volume growth are you expecting for FY19?

Saket Todi: For FY19 we are expecting a (+15%) growth.

Saurabh Ginodia: How has been the demand after Q2 when we have just entered the festive season?

Saket Todi: The festive season is still going on. The sales are still on so it's really hard to comment on it right now but the demand is good.

Saurabh Ginodia: If I look at your numbers of JM Hosiery in Q1 you have done sales of 82 crores and in Q2 it has been 64 crores. So, Q-on-Q there has been a sharp decline of around 20% odd so is there any cyclicality in the business or should one perform this number?

Saket Todi: No, if you would see in the JM there are products which is mainly in the outer wear segment for which the main season would be April-May-June so there was a good sales number during that quarter. And during the second quarter month JM had product which is of lesser seasonality. So, the first quarter of JM would always be more than second quarter.

Saurabh Ginodia: In the Q1 con call you have stated that Company has started its foray into eastern Africa, who has been development happened overall on the export side?

Saket Todi: Development has been very good. We have started working in countries like Kenya, Mozambique and Zambia and aseveryone knows that rupee has depreciated a lot. So, this has helped us in developing more foreign countries with a steady and speedy growth.

Saurabh Ginodia: Do we anticipate any price increases going forward in Q3?

Saket Todi: No we don't expect any price increases.

Moderator: The next question is from the line of Prerna Jhunjhunwala from B&K Securities. Please go ahead.

Prerna Jhunjhunwala: Could you help us with brand wise revenue growth and number if possible?

Saket Todi: Brand wise revenue growth approximately Venus is the mass segment would be little more than the average. Venus would be approximately 35%, Cozi would be approximately 25% and on export and others to be there would be approximately 25%.

Prerna Jhunjhunwala: About winter inventory, has the winter sales started for you or the major sales would start in Q3?

SaketTodi: Our major sales for winter wearhappens in Q2.

Prerna Jhunjhunwala: Major sales happen in Q2 because it is B2B majorly?

Saket Todi: Yes.

PrernaJhunjhunwala: can you brief us about your exports because rupee has depreciated and are you seeing a faster growth than your domestic sales and how do you hedge for exports if at all you do?

Saket Todi: We are seeing a faster growth in export but it doesn't just rely only on the rupee, it relies on the other foreign currency as well where we are exporting. Like if you see there are two countries whose currency has depreciated more than the rupees so in those countries e.g. Turkey, export is really getting very difficult. But like UAE which has a direct relation to US dollar, their export has been growing well

Prerna Jhunjhunwala: Do you hedge your export sales and generally what kind of order book do you have for exports?

Saket Todi: Approximately we have an order book of around $1.5-$2 million every month and we have hedged around $6 million.

Prerna Jhunjhunwala: That means your three months annual sales you have hedged?

SaketTodi: Yes Quarter.

Moderator: The next question is from the line of Pratim Roy from Stewart & Mackertich. Please go ahead.

Pratim Roy: If you can give the bank specific year-on-year volume for Lyra brandand One8

Udit Todi: When we talk about Lyra which is coming underEbell Fashions Private Limited, so there has been a growth in revenue of about 35% both quarterly and half yearly and out of which about 27%-20% would be volumes and balance about 7% to 8% would be value growth.

Pratim Roy: What about Onn and One8 over premium band because premium band is contributing a huge chunk of the revenue, so what is the volume growth on that part?

Udit Todi: As far as One8 is concerned we are under the production process of One8 and we have not yet started selling the product. We are expected to start in selling by around Q4 so the sales figure will start coming in Q4 and right now its work in progress.

Pratim Roy: And for Onn?

SaketTodi: For the ONN brand we have seen, a volume growth of around 22%.

Pratim Roy: And that is year-on-year number, right?

Saket Todi: Yes year-on-year.

Pratim Roy: And value growth?

Saket Todi: Value growth is around 3% to 4%.

Pratim Roy: What is the current average ASP for the premium brand?

Saket Todi: For the premium brand our ASP is approximately Rs. 110.

Moderator: The next question is from the line of Kalpesh Parekh from Prabhudas Lilladher. Please go ahead.

Kalpesh Parekh: Saket couple of questions, your top line target what you’ve set as a vision for FY20 I believe this is for standalone like 1500 crore top-line target what you have set?

Saket Todi: Yes.

Kalpesh Parekh: So, now with this merger taking place probably in all possibility these numbers will get revised upward because post this merger probably once we see FY19 numbers that would be consolidated numbers?

Saket Todi: Let us clarify this point once again. Whenever we are talking about our vision and when we talk about the figure, so since the merger has already been approved by the board we are looking at consolidated figures and at a consolidated level FY18 we had achieved roughly about 1600 crores and going forward the growth target that we are aiming to aspire is about 15% to 18% on a consolidated basis. But as of now when we are looking at the half yearly figures we believe we have already over achieved that expectation and we always try to do that in the future as well. But on a conservative side we would take a growth estimate on a consolidated basis at about 15% to 18%.

Kalpesh Parekh: So, should we read this number as somewhere around like 2500 crores on a group basis as a vision for 2020, presuming 15% type of growth rate?

Saket Todi: It's a basic math even if you say growth 1600 crores at 16% for two years I'm assuming we will be landing at somewhere around 2150-2200.

Kalpesh Parekh: But as a vision you can set it as 2500 that's why I said 2500?

Saket Todi: Definitely.

Kalpesh Parekh: And in terms of margins when I am seeing your margins vis-à-vis the Ebell and the other companies margin, are they very differentiated like JM's margin or broadly they would be remaining same?

Saket Todi: When we talk about the margins for the group companies the margins for JM Hosiery is roughly pretty much similar to Lux Industries Limited and when we talk about Ebell Fashion it's slightly on the higher side as compared to Lux Industries. So, it would be about 150-200 basis points higher.

Kalpesh Parekh: So, probably we should see on a margin curve also?

Saket Todi: Yes, on a consolidated basis you will be seeing the blended average of margins increasing as well as the JM Hosiery and Ebell Fashion has been growing a bit faster than Lux Industries so even that will help us boost our margins on a consolidated basis.

Kalpesh Parekh: Any other segments that we are targeting in next two years as such like the way we have targeted winterwear?

Saket Todi: There are lots of stuff which the Company is already exploring because whenever any negotiation is under process it's not meant to be disclosed. So, at this point of time there are lots of discussions which are work in progress and as soon as something materializes we will make sure our investor community is the first person to get informed about any such deal.

Moderator: The next question is from the line of Ankit Agarwal from ARC Capital. Please go ahead.

Ankit Agarwal: How do we see our winterwear brands share in the coming quarters? I suppose we have signed Mr. Bachchan for winterwear brand so if you can throw some light on it.

Saket Todi: This is the first year where we have launched Mr. Bachchan in our winterwear category. So, the initial response with our dealer community has been very positive and the demand which we have seen at the primary level has been very strong and going forward since this is a very first season so we will wait for the results to come out.

Ankit Agarwal: My second question was on our premium brand One8 which we are launching under our in house premium brand Onn, so how do we see our product mix changing in the coming quarters with the launch of One8 under the brand Onn? And if you can throw some light on what kind of margins we will make on this brand?

Saket Todi: As we mentioned earlier the brand the One8 is still under production and work in progress and the sales will be booked only in Quarter 4, so Quarter 3 would not see any launch of the brand One8. It will only be during the Quarter 4 that the products will get launched and since that will be the very first quarter for the brand One8 it would be a very small figure to make any kind of impact on the overall balance sheet. So, we need to give it a couple of quarters so that it can significantly contribute to the top-line and bottom-line.

Ankit Agarwal: So,can I assume thatthe margins will be usually higher because it is our premium brand?

Saket Todi: Yes so this One8 brand which is under the premium category, the margins will be on the higher side compared to the overall portfolio of Lux.

Moderator: The next question is from the line of Nirav Savai from JM Financial. Please go ahead.

Nirav Savai: Just wanted to note that what are the key growth drivers for this 30% growth? Is it because the base was relatively lower if we see September '17 quarter?

Saket Todi: Yes as you correctly mentioned, it is somewhat biased because the base effect is coming into play. Last quarter due to the GST implementation we saw a preponement of sales from Q2 to Q1, so therefore whenever you are looking at the Q-o-Q growth, year-on-year so itwill be slightly inflated. So, it would be a better if you look at the half yearly growth over half yearly growth which gives you an accurate picture of the Company's growth.

Nirav Savai: What is the trend in exports and what must be our contribution from export of this overall revenue if we see first half as well as Q2?

Saket Todi: The export is growing very rapidly and the contribution would be around 11% right now.

Moderator: The next question is from the line of Manan Mehta from MM Securities. Please go ahead.

Manan Mehta: What is your current capacity utilization at the Dankuni plant?

Saket Todi: As we mentioned in our previous con-call when we talk about the hosiery industry there is no such concept like capacity utilization because the mode of production under which we are operating is pretty much flexible. So, it's more of a marketing and warehousing concern rather than manufacturing everything ourselves. So, for us capacity utilization wouldn't be the correct metric for judging the performance of the company. But just to give you an overall picture whenever we talk about our Dankuni plant right now the situation is such that we are almost fully utilized under the Dankuni plant and within the next 2 to 3 years we will also be looking at expanding our production facilities.

Manan Mehta: Can you highlight any kind of savings that you have got from this plant in terms of percentage to cost?

Saket Todi: As you have alreadyknow thatthe Dankuni plant was commissioned in 2016 and since 2016 till date the EBITDA margins of the Company have been improved primarily on account of taking some of the steps of production in-house such as the cutting and knitting. and also a lot of other efficiencies of scales have kicked-in due to which there has been an improvement of 100-150 basis points to the EBITDA margin because of Dhankuni Plant.

Manan Mehta: Any CAPEX plan that we have for the next 1 or 2 years?

SaketTodi: In the next 1 or 2 years we are not looking at any major CAPEX. It would only be repair and maintenance. But within the next 2 to 3 years we might be looking at some CAPEX.

Manan Mehta: Any number to that?

Saket Todi: No such number right now because it's still under discussion.

Manan Mehta: I wanted to get your sense on strategy on your distribution network like expanding our large format stores and other outlets.

Saket Todi: So, what is your specific question?

Manan Mehta: Your distribution network, how would you plan to improve your reach, any strategy on that?

Saket Todi: We are already focusing a lot on large format stores and modern retail and day by day if you see the retail format in India is also changing. Its moving slowly and steadily towards the modern trade so even we have increased our presence in the modern trade, our contribution from the online sales has also been significantly increasing compared to last year and currently although it will be difficult to put a figure to it but qualitatively it has significantly increased,. And geographically we are also increasing our presence in South India which was negligible2 years ago

Manan Mehta: How about your B2C reach, so right now we are more towards our distribution side but how about the B2C side, how do we plan to increase that?

Saket Todi: Right now our major way of distribution is through a dealer network, wholesaler network and the large format stores. So, the dealers sell it to the wholesalers who sell it to the retailers who sell it to the consumers. currently we are not directly associated with our consumer except few exclusive brand outlets which arenine right now. But when we grow those EBOs as well as in thepast we have also launched few consumer schemes which links the Company directly to the consumer which in future we might continue depending on the market scenario.

Manan Mehta: On your e-commerce platforms do you see much of disruption due to online portals like Amazon and all those players and what kind of margins are you making currently on the e-commerce?

Saket Todi: Not at all currently the online segment contributes to around 1% to 1.5% of our total company size in which the major contribution is the premium segment.

Manan Mehta: Any target that you would like to share on the top line growth for the next 1 or 2 years?

Saket Todi: We should be growing at the rate of (+15%).

Moderator: The next question is from the line of Ankit Agarwal from ARC Capital. Please go ahead.

Ankit Agarwal: Just a follow up question in relation to our export. Can you throw some light on what is our current share of export and what kind of margin do we generate on our export sales?

Saket Todi: Currently our export contribution is around 11% of the total turnover which generates an EBITDA marginsof of around 18% to 19%.

Ankit Agarwal: What kind of margins do we expect on our export sales going ahead in next 2 years?

Saket Todi: Similar margins.

Ankit Agarwal: So, it would be on similar lines, right?

Saket Todi: Yes.

Ankit Agarwal: The margins which we are generating right now will those be sustainable going ahead? Will we see any improvement in the margin in the next 2-3 years?

Saket Todi: Yes. There should be improvement in the margin further. That's mainly might be because of the product mix.

Ankit Agarwal: So, we expect our product mix to change going ahead like more of premium and less of mass?

Saket Todi: Yes.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now like to hand the conference over to the management for their closing comments. Thank you and over to you.

Saket Todi: I take this opportunity to thank everyone for joining on the call. I hope we have been able to address all your queries. For any further information kindly get in touch with our Strategy Growth Advisors, our Investor Relations advisor. Thank you once again and wish you all a very happy Diwali.

Moderator: Thank you very much members of the management. Ladies and gentleman, on behalf of Lux IndustriesLimited we conclude today's conference. Thank you all for joining us and you may now disconnect your lines.