

Q4 & FY2009

Investor/Analyst Conference Call Transcript

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Moderator: Ladies and gentlemen good evening and welcome to the SKNL's FY09 results conference call. As a reminder for the duration of this conference all participants' lines will be in listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Ali Rashid from Citigate Dewe Rogerson. Thank you and over to you Mr. Rashid.

Aly Rashid: Thank you Melissa. Good evening ladies and gentlemen and welcome to the SKNL's FY2009 Analyst and Investor Conference Call. We have here with us today Mr. Anil Channa, Deputy Managing Director and COO of SKNL, Mr. Anees Fazalbhoj, Director Business Strategy, Mr. Jagadeesh Shetty, CFO of the company, Mr. Dara Avari, Director of Corporate Affairs, Mr. Salil Bawa, Senior Vice President Business Strategy of the company. We also have with us Mr. Tarun Joshi who is the MD of BHRL.

We will start this conference call with opening remarks from the management after which the floor will be open for an interactive question and answer session. Before we begin I would like to point out that certain statements made in this call may be forward-looking and a disclaimer to this effect has been sent out in the con-call invite. I would now like to invite Mr. Anil Channa to give his opening remarks, over to you Mr. Channa.

Anil Channa: Good evening ladies and gentlemen. Welcome to the SKNL's FY09 investor and analyst conference call where we will discuss the company's financial results and the corporate developments for year ended 31st March, 2009. I would like to begin by highlighting some key corporate developments after which Mr. Shetty would take you through the financial performance of SKNL for the year under review.

FY09 has been an eventful year where SKNL demonstrated strong performances at all levels amidst challenging financial and operating scenario demonstrating the soundness in our business model and the strength of the accuracy of our strategy. The company has posted all-round financial, operating and volumes growth domestically. We have made a conscious and successful effort to strengthen our balance-sheet so that it can support our future growth plans.

During the year through the help of some key acquisitions SKNL's global footprint has also enhanced significantly which is a step in the right direction towards our aim to be the clothiers to the world. I would like to first highlight the SKNL North America BV, a fully owned subsidiary of SKNL which along with its operating partner Emerisque Brands UK has recently been awarded Hartmarx Corporation, the largest tailor clothing company in the US which directly owns and controls over 35 leading brands catering to a diverse set of customers. In January 2009 Hartmarx along with its several subsidiaries had filed for petition, for protection under Chapter 11 of the US Bankruptcy Court. Prior to the court approval of Hartmarx acquisition by SKNL led consortium competitive bidding process was conducted to achieve the highest possible value for Hartmarx stakeholders. Following the bid process the SKNL - Emerisque Consortium emerged as the top bidder and the US bankruptcy court for the northern district of Illinois has approved the sale of substantially all the assets of Hartmarx for a total transaction value of approximately 119 million. SKNL will directly invest 35 million into this transaction. We see huge potential in Hartmarx's business and are truly excited to work towards revitalizing the iconic brands which are included in the company's portfolio. This acquisition will help the SKNL group to establish a substantial footprint in the global arena and

also bring significant business volumes to the company's operation in India through a front end, back end synergy strategy. The final formalities of the acquisition are underway and once the transfer of assets is complete which we expect to happen during this month we will share the complete details of the acquisition.

During the year we were also successful in commissioning our 12.75 million meters per annum state of art HVFC manufacturing facility in Gujarat. Commercial production for this manufacturing facility is expected to commence fully from the Q2 of this year after which it should operate synergistically with Leggiuno. As you may be aware in October '09 SKNL bought over leading Italian high value shirting fabric player. Leggiuno is rated amongst the top three high value shirting players in Italy providing top quality products to leading luxury brands like Versace, Prada, Burberry, to name a few. Leggiuno has an in-house capacity of 1.5 million meters per annum and its remaining requirement of around 3.5 million meters will be serviced by the company's new HVFC facility in Gujarat. The acquisition of Leggiuno is especially significant as Indian shirting players regardless of the quality of the product find it difficult to penetrate the European Luxury Market. Leggiuno already has a healthy portfolio of top clients to whom we now have instant access, not only for the supplies being made through Leggiuno but even for supplies which can be made directly by the HVFC division to these top customers. So apart from gaining instant access to leading brands we have also benefited from gaining access to European design and expertise. Leggiuno operating margins will also be positively impacted as a result of large chunk of its sourcing being provided by SKNL. Integration efforts are nearing completion and we expect Leggiuno's true potential along with our facilities synergistic relationship to be realized this year.

I would also like to touch upon the landmark GIC transaction that took place in June '09 with private equity arm of GIC, Singapore invested Rs 9,000 million in equity and warrants to acquire an approximately 25% stake in Reid & Taylor India Limited. The proceeds of the transaction have been utilized to fund growth plans of R&T and also very importantly to clear both companies out of the CDR scheme. The exit of both SKNL and Reid & Taylor from CDR scheme has significantly increased the financial and business flexibility of both the companies making the environment more suitable for overall growth. Now I call upon Mr. Shetty to take you through the financials.

Jagadeesh Shetty: Good evening friends, despite a very variable and also very challenging year, the SKNL's consolidated financial performance has been encouraging.

In the financial year ended 2009, the company has reported a sale of Rs 2,260 crore as compared to Rs 1,748 crore during the year 2008 indicating a 29% increase over the previous year sales growth. EBITDA for the year grew at the rate of 21% to Rs 488 crore as compared to Rs 403 crore during the year 2008.

I would like to mention that despite subdued sentiments in the economy the company has been able to achieve a 29% growth in sales which we are very happy about. It is a very good performance by the company. We have also been largely able to maintain the EBITDA level. As mentioned earlier, the EBITDA has gone up from Rs 403 crore to Rs 488 crore though there has been a 1.5% drop in the EBITDA percentage; however the company has been able to maintain its growth rate in terms of sales. This EBITDA is after absorbing the increased staff-cost of Leggiuno and the integration efforts since the acquisition of Leggiuno.

Interest cost during the year 2009 increased to Rs 138 crore as compared to Rs 89 crore during the previous year as a result of the funds that the company has raised for various expansion plans that has gone through during the year and it is also because of our constant efforts to exit the CDR we have to pay higher rate of interest to the lenders during this year. Profit before tax for the year stood at Rs 291 crore as compared to Rs 261 crore during the year 2008 indicating an 11% increase. Until the last year the company has been paying lower taxes on account of the carried forward losses. During the current year the company has to pay or pay and provide almost full tax on the profit of the year. Consequently, the tax expenses for the year have increased by about 64% to Rs 91 crore as compared to Rs 56 crore during the year 2008.

Net profit before minority interest for the year stood at Rs 195 crore as compared to Rs 205 crore during the year 2008. The minority interest of Rs 18 crore has been indicated in the accounts, which is about 25% stake in our subsidiary Reid & Taylor which is owned by GIC.

If you have gone through the investor release you must have noticed that all our SBUs have demonstrated healthy growth not just at the sales level but also at the operating level demonstrating the inherent strength in each of the business of the company.

Now just to touch up on some of the key balance sheet figures the company's net worth as on 31st March stood at Rs 1,718 crore. The consolidated debts in the books of account as on 31st March, 2009, stood at Rs 1,696 crore which indicates a debt equity ratio of 1:1. Actually the debt is a little less than one. The debt also includes the working capital facilities of Rs 761 crore. We have a cash balance at the end of the year of Rs 89 crore. The total debt to equity ratio of 1:1 is a healthy ratio and it is comparable to the best in the industry. During the year the company has invested Rs 165 crore on the acquisition of Leggiuno, the Italian SP manufacturer and about Rs 2,201 crore were spent on the various expansion plans creating very useful facility for the company.

This brings me towards the end of the financial discussion and I would like Mr. Anil Channa to add further remarks.

Anil Channa: Thank you Jagadeesh. So before we start the Q&A I would like to mention that SKNL has delivered an encouraging performance at all levels across its business units. In a market environment that was volatile and sometimes arduous for business growth. We have always emphasized the importance of brand, marketing and distribution of that activities and a result of our strong brand presence in almost every segment of the domestic branded textile and garment space, we have been able to grow healthily under challenging circumstances. SKNL is a highly diverse company which is vertically, horizontally and synergistically integrated. We are involved in all fiber categories thereby protecting us from seasonal and un-forcing glitches.

The company is continuously on the lookout for both organic and inorganic opportunities and to that extent remains extremely dedicated in maintaining its growth momentum. We are excited that FY 2010 has started off on the right note with the acquisition of Hartmarx and we are confident that we have the expertise to turn around this iconic American company in a very short time. This year we expect our HVFC SBU in Gujarat to deliver through full potential with the signing of Leggiuno and commencement of the facility at greater capacity utilization.

Our other SBUs of luxury textiles, consumer textiles, ready to wear garments and home textiles are all mature business divisions with strong brands backing them and to that extent we expect them to maintain their growth trajectory. With a well rounded and diverse business model including independent and professionally run business division in place at apt blend and entrepreneurial and professional talent in the management team and an ever increasing appetite for growth we are truly looking forward to what seems to be a fruitful year ahead. So friends, this brings me to the end of our business discussion. Now we would be happy to address questions that you may have. Thank you very much.

Moderator: Thank you sir. Ladies and gentlemen we will now begin with a question and answer session. The first question is from the line of Vishal Jajoo from Centrum Broking, please go ahead.

Vishal Jajoo: Good evening sir. This is with regard to the present economic scenario. How are we seeing this environment in Q1FY10 as far as the textile sector goes with regard what was prevalent in Q4FY09 and Q3FY09 and what is our outlook on that and if you could provide us some view that how would this year be because we saw some 100 bps dips in EBITDA margin so what is the management strategy as regards to the containment of margins or how are we looking at things from this point of view?

Anil Channa: Vishal, actually the small dip in the margin was essentially because in the H1 of last year there was a steep increase in the input prices primarily because of the oil prices going to the

roof globally but then that has been arrested. I think most of the costs are under control now. In fact we have also initiated a lot of internal cost reduction measures which have already borne fruit in the last third quarter and the fourth quarter of the last financial year and naturally this is an ongoing process. Now as far as the Q1 of this year is concerned I think the apparent slowdown at the retail level has actually been lesser than what we had envisaged so I think we will come out with results which are absolutely comparable to what we have been achieving in the recent quarters. So we do not expect any serious impact on them.

Vishal Jajoo: And sir regards to the debt figure, debt as on 31st March, 2008 that is last year was around Rs 1,395 crore, roughly close to Rs 1,400 crore and this year, year on year there is an increase in debt to the tune of from Rs 300 crore plus we have also got sales proceeds from the stake sale that is around Rs 790 crore. So how we trying and what are the management strategy is using these funds for the expansion process and what is the scenario as of now?

Jagadeesh Shetty: Actually we have invested a lot of money in our various expansion plans our factory facilities, partly commissioned in Gujarat and the balance will be commissioned within that. We have opted for funds under the GER so we do not expect a major requirement cost up to that. The due funds come to us as the constitution rate of 5%. The effective cost of the debt according to me should not exceed above say 7%. The interest cost during the last year has gone up, because under the CDR we were entitled to a concessional rate of 7% but since we have paid down the CDR tax in the overall interest of the company, so for the last year the interest cost has gone up but the interest cost as a percentage of sale is definitely under control. And we have cash generations at an EBITDA of about Rs 488 crore as against cost of Rs 138 crore. So we have sufficient cover and we have one of the best debt equity ratios in the industry.

Vishal Jajoo: And going forward would the full tax rate to the company be at 33%?

Jagadeesh Shetty: Yes you know we had carried forward losses and we had advantage of the CDR restructuring earlier but this year you have seen that we have provided for the tax in full and even in the concluding year the tax would tend to be close to the full rate which is now about 30% but we may get some benefit of the deferred tax on account of the commencement of the new facilities. We should be close to the border line.

Vishal Jajoo: Okay and this exceptional item of Rs 57 crore, is it on account of stake sale to GIC?

Jagadeesh Shetty: No, this Rs 57 crore is on account of our exit from the CDR we have paid some of the lenders and there is a gain on settlement of the debts of the lenders as per the CDR package. So it is a one-time exceptional item but in all the comparison of the financial figures which we have discussed where we are comparing EBITDA before the exceptional items, when I say we have Rs 488 crore of EBITDA for the last year as compared to Rs 403 it is before the exceptional item.

Vishal Jajoo: Okay thank you.

Moderator: Thank you Mr. Jajoo. The next question is from the line of Jaibir Sethi from Noble, please go ahead.

Jaibir Sethi: First, with regard to the margin slippage which was seen in H2FY09, you mentioned that some of the costs have now stabilized but would you see any downward impact on margins in H1FY10 from aggressive discounting. And recently there was an announcement of an equity raising in SKNL in the form of a QIP so what would the funds from the equity raising be used for and what will be the basic intent there?

Anil Channa: Actually the marginal reduction in the EBITDA in the last year was because the first half was having a very high input cost which was basically led by oil but right now I think all the input costs are under control. Internally our administration costs have also been toned down. We

have taken several measures for that. Frankly I think for H1FY10, we should be able to maintain margins better than Q3FY09 and Q4FY09. Regarding this equity, I think Jagadeesh would like to say something.

Jagadeesh Shetty: Yes the QIP that we are planning is to fund our various expansion plans. We think this is a right time to invest in the capacities. We are putting up quite a few facilities including the process house, the backward integration for our HVFC in terms of yarn - we will be utilizing these funds for creating very useful facilities for our company.

Jaibir Sethi: And other than the yarn and the processing facility any other Capex that you have in mind?

Jagadeesh Shetty: Yes, we are expanding our weaving facilities, we are modernizing one of our Chamunda Mills in Dewas. We are putting up stitching units for garments and we are backward integrating the manufacturing of cotton yarn.

Anil Channa: So our strategy on all these expansion plans is basically that now substantial volumes have been established across each of our divisions. As you are aware we have been banking a lot of our marketing on outsourced model so gradually now we are confident of a bigger volume coming in so we thought it is better we integrate part of the volume which we are selling into backward plant so that we are able to give a better customer satisfaction and the turnover can be increased. These capital cycles can also be brought down. All this is a part of our strategy.

Jaibir Sethi: That was all from my side.

Moderator: Thank you Mr. Sethi. The next question is from the line of Ankit Babel from Dolat Capital, please go ahead.

Ankit Babel: My question pertains to Hartmarx, the total EV at which we have bought this is around \$120 million, okay and I have also read that it is in association with Emerisque. I just wanted to understand that is it 50-50 kind of breakup or is it 100% owned SKNL? How is it functioning? Because \$35 million is the cash outflow from SKNL so would the same amount be getting outsourced from Emerisque?

Anil Channa: The transactions the way we have structured is that SKNL will be owning 95% of the share capital of Joint Venture and 5% would be given to Emerisque which is actually a sweat equity for them because we have identified Emerisque as our operating partner so that we do not have to spend too much management time into the day-to-day operations. Our entire investment of \$35 million would actually be going towards the shareholding of the Joint Venture.

Ankit Babel: Okay, so moving forward, the whole sales of Hartmarx would be getting consolidated into SKNL or only the profit from the JV would be included in the profit figures of SKNL? How would it work out?

Jagadeesh Shetty: The operation is going to be on 95% subsidiary as one of us said. We would be consolidating line by line items, the way the accounts are consolidated in any case it would be a consolidation of sales, expenses, and the profit may be to the exclusion of 5%.

Ankit Babel: So we had clubbed sales of about Rs 2,250 odd crore this year. Hartmarx had sales of more than \$500 million last year. So what are the expectations for FY10, what kind of sales are we looking into and what kind of profitability are we looking into from the company?

Anil Channa: Yes Ankit, last year Hartmarx had done about \$490 odd million but this year when we have prepared our operating budget looking at some of the brands in which they were not very well positioned, I am considering the strength of some of other brands we reoriented the whole business plan and we expect from July to June next year, I mean that is what is the new financial

year is going to be for this new company for Hartmarx. July 2009 to June 2010 because we will be making acquisition in July so we have to count it from this period only. So this year we are expecting the sales to be roughly about \$370 million and they are already achieving a run-rate equivalent to that so we have consciously downscaled it looking at the sentiments in the US market and looking at the relative viability of each of the brands so we have downscaled the operation a little bit and I think we will be able to announce a formal strategy on this once this acquisition is fully completed.

Ankit Babel: Two or three years back the company was into profits and it is only last two years when the company has run into losses. Now would you be certain in the situation which we are experiencing in US are we so confident that we will turnaround the company in the first year or when are we expecting at least at operating level and net level profitability to come from the company?

Anil Channa: Yes because of the downscaling we have done we are expecting that this year's EBITDA would be in the region around \$24 million for the first year and that would be gradually be scaled up to a level of almost about \$100 million in the next three years and there is a complete business plan in place which unfortunately I can only release once this acquisition is done because I am bound by certain NDA provisions right now but this business plan has been made through a lot of advisors who are working on this deal. We have our famous operation advisor Alvarez and Marshal who have been engaged for working out the operating plans so we are very confident in achieving those numbers.

Ankit Babel: Okay so this \$35 million is the cash outflow. The rest would be the debt part which would remain in the books of Hartmarx or how will it go?

Anil Channa: No, we are actually introducing a new set of lenders so rest of the money would be raised through the new set of lenders within the US with no recourse to SKNL India.

Ankit Babel: Okay, so if I talk of Hartmarx then the equity would be \$35 million and the rest around \$85 million would be the debt part, which would comprise of the EV?

Anil Channa: No, there are some assumed liabilities when we talk of EV. The total debt that company will take will be much lesser than that. It will be in the region of about \$50 million. On the rest of it there are some accrued liabilities which are basically book entries that also forms part of the EV for computation purposes.

Ankit Babel: See ultimately I just wanted to know when it could be EPS accretive because we are making an investment and the sales are so high that going forward on blended basis the margins would have to take a very big hit but ultimately if we see volumes then when can this actually be EPS accretive?

Anil Channa: Well I would guess it is EPS accretive almost from the first year itself.

Ankit Babel: Because with \$24 million in just the EBITDA at net level would you be able to incur some profit in positive?

Anil Channa: Yes of course.

Ankit Babel: The next one was on this QIP. Our current market cap is around Rs 950 crore and we are planning to raise Rs 1,000 crore so it is just doubling our equity. From the shareholders point of view this is huge dilution at current market price. Now again, would it be so much of EPS accretive that ultimately from shareholders point of view we do not lose anything.

Jagadeesh Shetty: The QIP of Rs 1,000 crore is an enabling resolution, enabling the thought process that we had gone through. I agree with you at this juncture we are not raising Rs 1,000

crore at all. We have no plans to raise Rs 1,000 crore. Though the figures are not yet crystallized so if you ask me, if you get a meaning it will not be in excess of about \$70 or \$80 million. This was an enabling thought process of that time.

Ankit Babel: \$70 to \$80 million meaning again around Rs 400 crore.

Jagadeesh Shetty: That is the maximum and that is an ensemble of a quite a few growth plans. So if we are creating very useful facilities which are business accretive and EBITDA accretive and this comes at cost, combined with the TUF loans that we have. We have done a lot of analysis but that is going to definitely increase our earnings and the returns on the EU capital.

Ankit Babel: In the initial remarks you have indicated that we are at a comfortable debt to equity ratio. So my first query is can we raise Rs 400 crore via debt? And second query is that if we are raising through equity there is almost 40% dilution and we are basically investing into backward integration which again does not impact sales directly. I do not know whether it would impact the margins or not because I understand for backward integration there could be some improvement in margin but would again the improvement in margin be so drastic that ultimately it is an EPS accretive thing.

Jagadeesh Shetty: I would like to assure you we have gone through the whole process of these calculations. All the projects that we are now putting up are not backward integrated. Where there is a leading expansion there is a process house, there is a stitching unit and a backward integration for cotton yarn and they are very useful facilities and this equity coupled with the debt that we are raising at an effective cost of 7%. It is strengthening the earnings of the company certainly we have gone through this process I would like to assure you that.

Ankit Babel: So this equity you are saying is better than debt?

Jagadeesh Shetty: No, no I am not saying equity is better than debt. What I am saying the equity raising through this QIP and the debt that we will be taking through the scheme at a cost of 7% a combination of these two is a win-win situation for our balance sheet and returns on the management.

Ankit Babel: How much are we planning to invest in the next two years because we have not seen some major investments in the last couple of years but suddenly so heavy investment into the business and I just wanted to know the rational behind it and how much are we going to invest in absolute terms - Capex plans basically?

Jagadeesh Shetty: No, as I said we are adding very useful capacities, which are related to the business. We are not expanding out of our core strength. We have a running business, a solid branded business in textile and this is to further the market that we have already established and you would please notice that we are not plundering into areas which are not our core competency. And you can of course later on send a detailed analysis of the report on the investment that is being done by the company.

Anil Channa: Ankit, I will just add to this. Given the present presence of our brands and the potential of those brands we feel quite comfortable in being able to increase our market share especially when some of the marginal players are stumbling a little bit I mean it is again a part of a strategy we feel that probably this is opportune time for us to be able to increase our market share by doing whatever Jagadeesh has already highlighted.

Ankit Babel: Okay and I would like to have a copy of the analysis and a list of where we have invested.

Anil Channa: Yes sure.

Ankit Babel: Thanks sir.

Moderator: Thank you Mr. Babel. The next question is from the line of Nalin Ladiwala from Shanti Asset Management, please go ahead.

Nalin Ladiwala: My question is related to Hartmarx. Could you tell us what is it that you have actually bought? What are the fixed assets and what are the other assets in Hartmarx that we pay \$120 million for as enterprise value?

Anil Channa: Nalin, unfortunately as I said I am bound by some NDA provisions until the date of the closing and will not be able to give all details and the broad picture I have already given to you. I can assure all of you that the acquisition price is a very-very good price for us. I can only assure of that right now.

Nalin Ladiwala: I understand that. I guess that you would have paid for brands and all that but we are really grappling at is actually the business of Hartmarx as we understand is tailoring, am I correct?

Anil Channa: No, no that is only about 50-55% of the business. That is on the men side and then there is a women side business which is around 30% and then there is a sports' side which is again another about 15%. So there is a very diverse brand portfolio they have.

Nalin Ladiwala: They do not have any weaving facilities.

Anil Channa: No, no they do not have that. They have some stitching facilities where there are three factories within the US, so that is being downscaled significantly because there are some parts of the things which cannot be done outside. It can be done only here. So, all that is going to be downsized significantly depending on the demand potential in the next years to come.

Nalin Ladiwala: The reason for asking this question is because you mentioned that your partners would be entitled for sweat equity and really we do not understand what their strengths are. Could you please highlight that? Because we thought that SKNL is the one with the strength who would actually bring in the domain expertise etc what you have for a turnaround.

Anil Channa: As far as we are concerned we are definitely there on the strategy and the monitoring part but as far as Emerisque is concerned their skill has been a turnaround specialist because this company naturally has gone into the doldrums and it is been quite under-managed, their skill lies in the turnaround strategy. They have been doing in the past. One of the recent examples was Lee Cooper which they took over about three years back in collaboration with another financial partner and we evaluated the entire team the way they do the brand building the repositioning of the brand, the way they attacked the supply chain management I mean they are a very professional team I can assure you and we saw a lot of value addition coming from there and concurrently it also helps us in not devoting too much of management time so that was the consideration why we put them here.

Nalin Ladiwala: How many people from your partners would be involved in terms of management, for Emerisque and will this be the only job for them?

Anil Channa: Yes, Yes it is a full time devoted job for them, committed to this.

Nalin Ladiwala: Okay. So a team of how many people?

Anil Channa: Roughly about a dozen.

Nalin Ladiwala: Okay I understand that. Could you comment on your working capital cycle for SKNL India? That's the number which needs to be taking away a lot of capital and pushing down returns. What is your comment on that?

Anil Channa: See working capital cycle is dependent upon the sales model which we follow. We actually follow the distribution pattern to the whole sellers predominantly unlike some of the other companies which go on a distributor model. Typically what happens is in a distributor model is we can have a shorter cycle but then the brand may get its image little destroyed but they resort to some kind of a discounting which is not conducive for long term growth prospect of the client. Secondly, we do not resort to any kind of factoring of the accounts receivable or the debtors. So probably these are the reasons where you should compare us with competition. May be you will feel that it is a little longer but that given the market scenario for a branded product, if it is a commodity product the model is a little different but for a branded product company, by and large this is the model we found which will succeed in the market.

Nalin Ladiwala: Sir what the disconnect is that we always found and thought of S. Kumars as a brand company and that is how I guess it is put across. But a brand should have a level of trend which gets reflected in the numbers of working capital cycle, all margins or may be together. And so that is the disconnect on the working capital cycle and that is the reason for my question. So is there no way, what you are saying is that all other brands would have a similar working capital cycle?

Anil Channa: Yes I think, barring the commodity players if you see the brands, by and large they would be in a similar cycle. Barring where they are doing a factoring of their debtors or may be they are doing some kind of distributor model. So that is the market requirement.

Nalin Ladiwala: Sir then, what is not coming across is if we look at ROCE may be we can discount it a bit on the sense that we are in an expansion phase and money going in into other. The ROCE is certainly not a very attractive proposition at this point of time and could you give us some sense as to by when it could be attractive and what number would you think is attractive.

Jagadeesh Shetty: Currently in the ROCE there is about Rs 500 crore of investment that has gone into the new factories that are partially commissioned here. The Jhagadia home textiles and HVFC units, now whereas on the application of the capital you find this Rs 500 crore already invested but in terms of returns this year FY09-10 partly can be utilized fully in FY11. Now once you start seeing the calculation for this then we do have proper ROCE from the business that is happening. Now I do agree that the working capital cycles as compared to some other industry may be larger but we have a very healthy EBITDA which is about 20-21% which is from the benefit of branded business that we have. As Mr. Channa said that we do the discounting sales to the minimum and the sales are made to the wholesale dealers without any distributor discounting, so if you take cognizant of these factors we do have a respectable ROCE.

Nalin Ladiwala: What would be this number adjusted for the investment? Let us remove the investment session that means which have not been delivered on returns. What would be the number for S. Kumar existing branded portfolio of business?

Jagadeesh Shetty: We do have close to about 20%.

Nalin Ladiwala: I would tend to believe that would be an attractive number.

Anil Channa: No, ideally we would like to move up to 25% in fact you know when we are looking at new business opportunities we always say that our benchmark is going to be 25% but then you have to understand that we have transited from a consumer textile business which was traditionally a low EBITDA business and then gradually we are moving up the value chain by introducing newer brands like Belmonte and Carmichael House in the home textile area and then building up the synergy models with the overseas companies. So, the objective of all that is to move up the value chain so that the EBITDA margins can be stronger and better and much more sustainable. That

definitely would help us in improving our ROCE in spite of the sluggish working capital cycle to a level of even going up to the 25%.

Nalin Ladiwala: Right, probably we can work on the numbers on this but what the disconnect again I get is we are getting into a backward, on one hand we are talking about brands moving up the value chain and on the other hand we are intending to get into yarn sewing which probably is there some reason to be, some rational description into the whole broad scheme of things for yarns.

Anil Channa: See the rational is if we look at what is available in the market that would be a very commodity kind of a product. Now if we want to get to a higher value added item we need to have some part of this yarn coming out from our own facility whereby we can do a lot of play on the product mix and on the kind of fiber and things we use. That is the thought process behind it. That actually helps us in diversifying our product mix which we are not able to do currently based on the existing sources available domestically.

Nalin Ladiwala: We have been going through an investment phase - does it not make sense to first let that consolidate and give some return before we embark on another one which leaves investors unclear as to what kind of returns are we looking at the huge investments we have already made. Would that be fair, do you have any comments on that?

Anil Channa: I think Jagadeesh will be able to give you the details. I do not know why there is a perception that the investments have not yielded the dividend. I think there have been yields in the dividends and dividend in terms of the return but I think Jagadeesh can share the details with you later.

Nalin Ladiwala: Sure, sure. Fair enough. Thank you.

Moderator: Thank you. The next question is from the line of Divyesh Shah from Pragma Equities, please go ahead.

Divyesh Shah: Good evening sir. My question is regarding our acquisitions. We as a shareholder have a fear that we are going too far aggressively for international acquisitions. Will you please justify your acquisitions of Hartmarx? Because you must have known in last many years Indian companies are acquiring global companies and like Tata has acquired JLR, Hindalco has acquired Novelis. So we fear that whether this international company will be profitable or not. Can you assure the investor?

Anil Channa: Yes, as far as the profitability part is concerned definitely we have gone into all the details and we made business plans which will confirm to what I have stated earlier and we definitely will achieve those results. Now as far as the strategy of acquisition is concerned, well there are two sides to the coin, when the international markets are very strong, very favorable the valuations become very high which is probably what has happened in some of the acquisitions made by some of the Indian companies also. But today's market, yes the market is soft, there is no doubt on that but then the valuation will also come down thus actually it creates a lot of business sense especially where we get a front-end and a back-end synergy. That is the basic tenant of all of our acquisitions and after having evaluated that only we have taken these decisions.

Divyesh Shah: No but we fear that we are chewing more than what we can digest. This is our main fear because right from domestic companies we are going to the international companies whereas the world scenario is international company is coming to the Indian market as a domestic market. Domestic market is a huge market so why not only domestic market rather than going to the international market and with many risk factors? So that is a main fear as far as investor is concerned.

Anil Channa: If you look at our acquisition let us say of Leggiuno, this is a company which is doing a unit realization of 8 Euro per meter. Now in India the best of companies are doing around \$5-\$5.5,

so do you see that kind of gap coming in because \$8 would translate to something like about \$11-\$12 today. So between a \$5 to \$11 is the gap in the sale realization. Now through the synergy of Leggiuno if we are able to move up by value chain naturally it gives us a lot of advantage. So we have evaluated all these pros and cons before actually venturing into these kinds of acquisitions. And as far as Hartmarx is concerned, apart from the domestic potential, we have the potential of even internationalizing the brands which again could lead to a lot of royalty revenues and we could possibly even bring the brands into India at some stage which I am not saying is going to happen next year or one year, that we are yet to evaluate, but I mean those are the potentials. So, on a standalone basis, we have assessed these companies and we find that whatever investments we are committing that is going to be EPS accretive and therefore probably the kind of valuations which are available, it's justifiable to get it through them.

Divyesh Shah: Okay. And sir, regarding our Jhagadia plant, high value cotton fabrics, can you just elaborate how much turnover it will be in this year because we are starting from quarter two? And at full capacity, what will be the turnover and operating margin for high value cotton fabrics?

Anil Channa: The margin is in the region of around 35% EBITDA.

Jagadeesh Shetty: The unit is totally operating for the full year; we should have a turnover of about Rs 280 crore from high value fine cotton add on.

Divyesh Shah: Okay. And what is expected interest outgo for this year 2010?

Jagadeesh Shetty: It should be about 10% more than the current year, whereas our EBITDA should go up by more than 20%.

Divyesh Shah: Okay. Thank you.

Moderator: Thank you Mr. Shah. The next follow-up question is from the line of Nalin Ladiwala from Shanti Asset Management. Please go ahead.

Nalin Ladiwala: The margin for Leggiuno in the investor communication is negative in one place and positive in the other place. Could you just clarify what the number was?

Jagadeesh Shetty: We had a negligible contribution from Leggiuno. Now, this is the first quarter of integration of the business into our company, there have been setup cost and I think that should move positive.

Nalin Ladiwala: Okay thanks. Sir, what will be the sales for Reid & Taylor for the whole year, FY09?

Jagadeesh Shetty: The Reid & Taylor sale for this year is Rs 654 crore which comprises of Reid & Taylor fabrics, Reid & Taylor garments, and Stephens Brothers.

Nalin Ladiwala: Okay. And what was the Capex that you incurred this year and what would be expected in the next year, total Capex?

Jagadeesh Shetty: We need to do it year wise. We have quite a few projects in hand and we have implemented. I think we will send out a communication to the investors what exactly would happen during this year and what will spill over to the next year. It would be advisable to have a final budget done by the business heads, may I share with you in our next communication.

Nalin Ladiwala: I was under the impression that we have the license to sell Reid & Taylor and other branded products only in India and other parts of South Asia, so would we be able to sell our current existing brands in US? Could that be possible?

Dara Avari: We have the license for the Reid & Taylor in the Middle East and India and the neighboring countries of India. The Reid & Taylor UK has the license to sell in US.

Jagadeesh Shetty: Also I do think acquisition of Hartmarx has been contemplated as the method of selling the Reid & Taylor brand in the US from SKNL's perspective.

Anil Channa: In fact, if I may add here the brands of Hartmarx, let's say Hickey Freeman, that's actually absolutely in the superb premium category which is competing directly with most of the Italian brands like Zegna.

Nalin Ladiwala: Okay. Sir in the previous investor's meet we have been saying that S. Kumars are clothiers to India. Now we are trying to become clothiers to the world. So it is fair to be ambitious, I am not objecting to that, but could it be the gaps in the business model which we would want to sell by way of organic acquisitions toward this?

Anil Channa: See whenever we've made any communication, our vision has always been just clothiers to India and also to the world tomorrow. So question about tomorrow has now arrived. As I said, our strategy has always been such that we look at those kind of companies which are not commodity based but which are brand based having a very high design content and product development content and having a very good distributor relationship in that country in which they are located, at least having a very good distribution base. So, that has always been our strategy. If it is high up in the value chain, then only we start looking at it, otherwise we are not interested. It has been consistent with our strategy.

Nalin Ladiwala: Yes. I appreciate it, sir. Wish you all the very best. Thanks.

Moderator: Thank you Mr. Ladiwala. The next question is from the line of GD Agarwal from Kelusa Capital. Please go ahead.

GD Agarwal: Sir, the question is we generated about Rs 250 crore of cash profit, increasing debt of Rs 300 crore and money from GIC about Rs 800 crore, so that makes a total of Rs 1,350 crore cash. Where was it used?

Jagadeesh Shetty: We settled CDR lenders last year of about Rs 600 crore.

GD Agarwal: Sir that would go out of debt from last year, right?

Jagadeesh Shetty: No, that would go out of the money that we have raised from GIC. There has been a capital expenditure incurred for our Jhagadia plant of about Rs 200 crore and we have invested into Leggiuno of Rs 165 crore. So, that broadly dices up to the figures that you are mentioning.

GD Agarwal: No sir, but what I am saying increase of net debt of Rs 300 crore, so when the Rs 600 crore is paid, then last years number would look at Rs 700 crore and not Rs 1,400 crore, right? Then I will say this Rs 800 crore debt increase to just say Rs 1,700 crore, an increase of Rs 900 crore of debt. Is that a wrong way of looking at it?

Jagadeesh Shetty: No, it's not actually a wrong way but there also has been increase in the current asset liability of the company.

GD Agarwal: That's what I am asking. Sir, how much is the increase in working capital, I mean this year it is Rs 761 crore of working capital, right?

Jagadeesh Shetty: Yes, there has been an addition to the current assets and other loans and advances in totality is about Rs 700 crore more than what it's been in the last year.

GD Agarwal: On the Emerisque, they get only 5%, right, and that's one time share and do they get every year some money fee for managing the business?

Anil Channa: Yes, there would be a fee structure also which could be quite nominal compared to the total operating budget. Roughly, whatever manpower has been engaged, some of them are part of Emerisque but naturally we are engaging a lot of professionals, who will be the key to running the business.

GD Agarwal: Okay. So they will take salary or whatever for....

Anil Channa: Yes salary components would be there. That would be entirely on Hartmarx, it's nothing to do with us.

GD Agarwal: And just another question, \$24 million of expected EBITDA, we just pay \$120 million which is five times probably at the bottom of the cycle. I just want to understand who other competitors were where it's a small asset for other guys; I mean how did we end up getting this?

Anil Channa: I don't think it is a small asset...

GD Agarwal: No, what I am saying is whether it's a small asset or whether it was good luck, whether we were smarter than others or...

Anil Channa: That is the strategy. We were smarter definitely but it was our strategy we worked on and that works very well.

GD Agarwal: Basically, I mean we see a lot of other companies but even under bankruptcy people are not able to get cheap but we are getting it five times EV/EBITDA, I mean it looks really cheap.

Anil Channa: But that is based on a lot of realignment of the business model so it's a lot of hard work which is going to go into it. Already we have initiated that. So it's not available on a platter, definitely I can assure you.

GD Agarwal: Because on a normal business, is it about two times EV/EBITDA, they had about peak or normal EBITDA of about \$40- \$50 million a year or was it quite like that?

Anil Channa: See, it all depends on how we are leveraging it. As I said we look at the business very closely and we downscale that sales projection to \$370 million this year and for the next one year and based on that, we have arrived at these numbers.

GD Agarwal: And when you say back-end and front-end synergies, what do you mean, can you export fabrics from India or not?

Anil Channa: Yes, of course, we can.

GD Agarwal: Okay. So, would those be very small numbers, like \$10 - \$15 million or that could be higher?

Anil Channa: All our transactions where we supply to our subsidiary or subsidiary controlled by us, basically there has to be arm's length approach so the supply chain of American company and the supply chain of the Mysore plant, they would have to pitch in with each other. And based on arm's length approach, they would decide how much they can actually offer at the prices they want to sell at. I mean there is not going to be any dictates from the top management as to what they should be doing. After all, both of them need to be surviving in the competitive world.

GD Agarwal: Yes fair. And on the debt, what should we expect the FY10 debt to be around?

Jagadeesh Shetty: Yes. As I said, we would be about 10% more than this year's 11%.

GD Agarwal: That was interest cost?

Jagadeesh Shetty: Supposing debt against 20% increase in the EBITDA, I mean that's the thumb rule that I will follow.

GD Agarwal: I thought that guidance was for interest cost, so is that for absolute levels of interest as well?

Jagadeesh Shetty: Yes, I mean interest could be a product of debt level.

GD Agarwal: Yes. Where should you know we expect depreciation to be?

Jagadeesh Shetty: Depreciation would go up by about 25% because the Jhagadia plant will be totally commissioned and I would see a significant increase in the depreciation level.

GD Agarwal: When we look at the business, without making any Capex, just the existing infrastructure, what is the top line that is achievable for the next two, three, four years?

Jagadeesh Shetty: It's difficult as I need to take so many factors into consideration because we have always been working at a level where we are strengthening our manufacturing facilities and taking into account the same situation in the market. But if we like to put on our capacities as we were, I would think then that would take us about 10% increase in the sales level. But if you see us performing for the last three, four years, we have been talking about 30 to 35 per cent increase in our revenue over the years.

GD Agarwal: Sir, the reason why I asked that question is, I mean if we make about Rs 200 crore every year and we got this Rs 900 crore, then the EBITDA should increase by Rs 200 crore just on the basis of this and then we have a normal business also generating more money. So our EBITDA should increase by about Rs 200 crore to Rs 300 crore- was the thought process behind asking this question.

Jagadeesh Shetty: I would think it's a combination of so many factors. We need to see business from a very long perspective and that's how we stimulate the feeling in the organization that this is the time that we expand and invest and take our capacity to a better level. So, that as a business, we are strengthening ourselves to take care of any volatility in the marketplace. That's what we have been doing. We started out with one or two brands five years ago. Today, we have brands spreading across all economic segments. That makes us stronger. We have various businesses; we are not only into fabric business, we are in home textiles, the garments, consumer textile and at the brand level, we have Belmonte towards the lower brands, then we have Reid & Taylor, then we have Stephens Brothers. So when we have this strategic well defined various businesses, the risk that we are exposed to the volatility in the textile industry or volatility in the economic situation is very less, and that I would consider is one of our major benefits. We haven't put all our eggs into one basket and whatever capacity additions and expansions that we are doing, we are doing within our core competency. We are not expanding into steel or cement. We feel that this is the right thing that we are doing.

GD Agarwal: Okay sir, thank you.

Moderator: Thank you Mr. Agarwal. The next question is from the line of Ankit Babel from Dolat Capital. Please go ahead.

Ankit Babel: Just a follow-up question. When could we expect the QIP to get into the market?

Jagadeesh Shetty: We haven't actually firmed up a date that I can tell you, but in the next couple of months.

Ankit Babel: And we were about to introduce some new brands into the casual category, what is the status, would we be introducing it this month or the next month?

Anil Channa: We shall be doing it from the winter season.

Ankit Babel: Okay. Actually, in FY10, if you take into account the full integration / consolidation of Hartmarx and introduction of new brands and also taking dilution into effect, what kind of top line guidance would you like to give including everything on the profitability? This year, we have done somewhere around Rs 200 crore in profit and Rs 2,250 crore in sales, so what could this figure be for FY10 including all these things?

Jagadeesh Shetty: I think I need to do some budgeting exercise with our business heads. It's a very valid question that you are asking. But at the moment as you said there are quite a few factors which are affecting this and quite a few factors which are very optimistically taking both these figures which you quoted upwards. We need to do some budgeting exercise and we should come back with a proper communication in the next session of discussion with you.

Anil Channa: Yes, but as a ballpark, I think for the financial year, it probably would be around Rs 1,200 crore, I mean as Jagadeesh rightly says, we have to do the final assessment still but the ballpark is around Rs 1,200 crore.

Ankit Babel: I am talking of SKNL Company as a whole.

Anil Channa: I thought you said for the international acquisitions.

Ankit Babel: No, company as a whole.

Jagadeesh Shetty: That's the addition to the present level what Mr. Channa is saying from the international business, plus the domestic business in my understanding would grow about 20% and the figure quoted by Mr. Channa is the revenues from the international operations.

Ankit Babel: Domestic 20%, international Rs 1,200 crore. And on profitability- I need to do budgeting and then count?

Jagadeesh Shetty: Yes, I think.

Ankit Babel: Because in the next year, a lot many things are getting changed into the company and it's very difficult for us to look at some figures because we are venturing into international markets where we don't have much experience, we have done acquisitions, we are introducing newer brands. So just from an analyst point of view, we just wanted to have some kind of figures in mind that what is the company targeting and how far it is achievable?

Jagadeesh Shetty: That is fair. I think we are in the midst of doing this exercise taking all factors into account and whereas we are optimistic that the things are turning out to our advantage. But in terms of figures, we should be able to send out the communication as we talk next time perhaps over the results of the Q1FY10.

Anil Channa: Ankit, just to add to this, even into the international acquisitions basically we assess the whole business model the teams are in place. By and large, we are sensing that the retail off-take is likely to pick up during this year. So I don't think we should be so pessimistic about this honestly. You see especially since the teams are in place and we know the strategy they are following, it's been monitored on a regular basis.

Ankit Babel: Because sir until and unless I get some feeling on your analysis what you said that you will discuss later, I feel that at net level, it could be very difficult for us to have some positive numbers at because the company is going into losses for the last two years and till the situation is not that good, you are also scaling down the sales figure from \$490 to \$370 million. So at lower sales, we are thinking of some positive EBITDA and also positive PAT. It's slightly difficult. Until I get some more details it is difficult to say we will be doing something on positive side.

Jagadeesh Shetty: I wish to add that we have SBUs which are operating as independent companies. Each of the SBUs has its own team right from the production level, marketing level to the execution. So at the company level, we are now constricted by so many things happening simultaneously. As you have mentioned because there is an independent team to take care of this and they are done after thorough study and proper appraisal by the institutions. So those things are definitely taken care. I don't think we run the risk of management of doing a few things at a time. And we also have the synergies of the domestic business supporting the international businesses. We should be able to supply a sizable amount of the products from India of course at a very arm's length and that is not at the cost of the domestic operations, it is in addition to it. These sales are accretive to the domestic operations. So I am as the finance manager totally convinced about the various positive aspects of what we are doing. But as I said in terms of number, we will communicate to you when we discuss the 1st Quarter's results.

Anil Channa: Yes. Ankit, to this, I will add that when you talk of the US acquisitions for instance, as I said, there is a new lender also coming in, they have also assessed the business plan and this feasibility of us being able to achieve those numbers and on that basis, they have committed to debt coming into the company. So it's not that the plans have been formulated. Yes, the company was under managed that's why the valuation went very bad and into a negative situation. But we have made specific action plans to reverse that. There are several things which we are doing, which as I said once the transaction is closed, probably we will be able to share much more details with you. The fact that new lenders are coming in, based on our business plan that I think should speak volumes itself.

Ankit Babel: When will this transaction get completed, probably first half of this month?

Anil Channa: Yes, during this month, there are too many moving wheels. After all it's a very lengthy process but I think we are very near to it now.

Ankit Babel: Okay fine, thank you sir.

Moderator: Thank you Mr. Babel. As there are no further questions, I would like to hand the floor back to Mr. Anil Channa for final comments. Please go ahead sir.

Anil Channa: Thank you very much ladies and gentlemen. I am very happy that all of you could spare the time to be able to enable our team to clarify most of the points, a few points which Jagadeesh has said that he will be circulating that I am sure would satisfy the balanced needs also. So I can assure you the way we are looking at it, we see a lot of growth coming in this year both in the domestic as well as through our international strategy. So I am hopeful that the times to come would be even better than what we have been seeing in the past. Thank you very much again and we look forward to talking to you soon.

Moderator: Thank you gentlemen of the management. Ladies and gentlemen, on behalf of SKNL, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

-Ends-

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