



“Welspun India Conference Call –
Recent Business Developments”

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MODERATOR: MR. AVI MEHTA – IIFL CAPITAL LIMITED

Moderator Good Day, Ladies and Gentlemen and Welcome to the Welspun Conference Call on Recent Business Developments, hosted by IIFL Capital 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 ‘*’ and then ‘0’ on your touchtone phone. Please note, this conference is being recorded. I now hand the conference over to Mr. Avi Mehta from IIFL Capital Limited. Thank you and over to you, Mr. Mehta.

Avi Mehta: Thank you, Margret. Hi, good morning, everybody. On behalf of IIFL, I would like to Welcome all of you to the Welspun India Conference Call to discuss the recent business developments. From the Company, we have with us the key Senior Management, including Mr. Rajesh Mandawewala – Managing Director, Mr. Altaf Jiwani – Director Finance & CFO and Mr. Akhil Jindal – Group CFO & Head- Strategy.

The call would commence with opening remarks from Mr. Mandawewala, followed by Q&A session. I would now like to hand over the call to the Management for their comments. Over to you, sir.

Rajesh Mandawewala: A very good morning. Let me first thank you for joining this call at a short notice. As you are all aware of the recent media reports about a product specification issue that we have had with one client program of our subsidiary, WGBL. We had issued a release to the stock exchanges on the 20th August 2016 on this . At the outset we want to give you some background that should address many of your questions.

This is a matter of highest importance to us and we are taking it very-very seriously. Our customers rely on us to maintain the highest standards of quality and compliance, Welspun remains committed towards this. We have been very particular about our quality standards, so we are taking this issue very-very seriously. Final product quality is rigorously tested and during the period in question, the product specification in question met all the quality standards. The issue, in fact, was around the provenance of the fiber, the product themselves were rated highly by the end consumers. We have relationships with most of the top retailers for over two decades, let me reiterate that we are fully committed to serve our customers and support them.

In the manufacturing process – we source a lot of materials, raw materials at the intermediary stage as well from various vendors, be it cotton, cotton yarn or greige fabric, we thus want to revalidate all our supply processes and systems. Although growing volumes and programs have resulted in increasing complexity, an issue of this nature is unacceptable to us.

We are in the process of appointing an external independent Big Four Auditor, to audit all of our supply systems and processes to understand the root cause. The audit will give us clarity on a number of questions, including where and how the issue occurred and what steps we will need to take to tighten our processes.

Let me share some facts with you, with respect to our business with Target and also about the product in question. Sales to Target was approximately US\$90 million in FY16 for us which accounted for almost 10% of our overall business. The product in question with Target specifically, represents about \$8.5 million in FY16 for us, which accounted for about 1% of our overall sales and about 10% of our business with Target.

Let me outline the prompt actions initiated by us since Friday evening:

We have initiated dialog with a Big Four firm to start audit on asap basis.

We have and are continuing to engage with our key customers and we are providing all data in support to them to answer any of their concerns and queries.

We have started reviewing our supply chain processes and systems. As you are aware, in the current financial year we have taken major IT initiatives to make our systems more process-oriented.

We expect the audit to be completed in six to eight weeks and we believe we will emerge stronger from this process with tighter controls and robust processes.

With this, I will take a few questions and please feel free to ask questions.

Moderator: Thank you very much. We will now begin with the question-and-answer session. Our first question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: On this, just wanted to understand that over the span of July 2014 to August 2016 there must be various programs that this product would have been supplied, or is it just part of one program?

Rajesh Mandawewala: So, this was one program that we shipped out to our valued customer Target, and so the overall shipments through this period were approximately \$19 million and in the current financial year about \$4.5 million, roughly.

Nihal Jham: And approximately what percentage of the sheets are found faulty by them or any report on the audit part?

Rajesh Mandawewala: So, see this is not about the quality of the sheets, this is about, let's say, the provenance of the fiber. So first, the quality of the sheets is not an issue here and the sheets were rated quite highly by the end consumer, so it is actually a fiber provenance issue.

Moderator: Thank you. Our next question is from the line of Anita Rangan from HSBC Asset Management. Please go ahead.

- Anita Rangan:** Just wanted to know, I mean, what would be the impact on this event on the other customers? Because in US you have the highest market share in the US, so just wanted to understand that. And secondly, also wanted to know, overall this sheets business is what percentage of the total revenue for Welspun?
- Rajesh Mandawewala:** We have and are continuing to engage with our key customers and we are providing all data and support to them to answer any of their concerns and queries. So we stay committed to them and we are continuously engaged with them, is what I would say.
- Anita Rangan:** And what proportion of your overall business is from the US?
- Rajesh Mandawewala:** Say, about two-thirds of our business actually comes from the US.
- Anita Rangan:** So, with this Target is withdrawing only 10% of their business or they are going to withdraw the entire \$90 million worth of business from you?
- Rajesh Mandawewala:** Yes, so let me clarify. So our valued client, Target, is in the process of terminating the entire business with us. There is going to be a transition period in which period we will continue to support our client by shipping the other products, not this product in question but the other products as per the requirement of the client in this transition period.
- Moderator:** Thank you. Our next question is from the line of Shalin Kumar from UBS. Please go ahead.
- Shalin Kumar:** Just wanted to understand, so what exactly has gone wrong? Is it like there is something missed out on our part or there has a misunderstanding happened?
- Rajesh Mandawewala:** So, it is a process issue, so as I said that we will be engaging this Big Four audit firm to relook at our processes, our supply processes. So as we go deeper into this audit, this we will reinforce going forward our systems. And see, in the manufacturing process you source a lot of materials at various stages like cotton, yarns, fabric and since there is a need for us to revalidate all our supply processes and systems, thus the audit.
- Shalin Kumar:** And there is no way we can get back that 10%, basically the whole Target is going away from us, right, so that is kind of irreversible?
- Rajesh Mandawewala:** Yes, so at this moment our valued client is in the process of, let's say, winding down the business with us. Look, we have had a very long standing relationship with the client, so irrespective of what has happened we will continue to support our client and stand responsible. So we will continue to support our client through this difficult period and do whatever it takes.
- Shalin Kumar:** But why such, basically we understand that there is a problem with one product but why suddenly removing all the products? Isn't it a little sharp or little quick fix decision on their part and this may impact your other vendors as well.

- Rajesh Mandawewala:** It is very difficult for me to react on this, but as I said that we are actually engaged with both Target as well as all other key clients and we are providing all necessary support.
- Moderator:** Thank you. Our next question is from the line of Ajay Krishnan from Wasatch Advisors. Please go ahead.
- Ajay Krishnan:** Just want a follow-up on the previous question, to me it seems a little aggressive reaction Target is taking, if they have problem just with 10% of product that you are supplying, their reaction to me suggests that I think it was intentional, because if this was an error then nobody pulls away all that business. So, I mean, the conversation that you had with Target, what exactly did they communicate to you, I mean, are they saying that this was done intentionally by Welspun?
- Rajesh Mandawewala:** So, as I said, we are actually instituting an audit, and the purpose is to look forward and look at our supply systems and processes. So we are taking this issue very-very seriously and just want to make sure that this supply systems and processes are extremely robust as we go forward.
- Ajay Krishnan:** But I think it is a little strange that it is a 10-year relationship which could easily be an error, just a sourcing error that they are willing to terminate the entire relationship, doesn't that strike you as a little strange?
- Rajesh Mandawewala:** So there has been, let's say, a failure on our part, so without any ambiguity the fault is on our side and so it is, let's say, the error is from our side so I guess we have to take responsibility for it. So this is actually not a safety issue and so it is, as I said, the issue is about the provenance of the fiber, so the products are safe to use; so it is about the provenance of the fiber.
- Ajay Krishnan:** So, have you had conversations with other customers already, and what have you heard from them?
- Rajesh Mandawewala:** So we are actively engaged with most of our customers and most of them have, let's say, been supportive and we hope to work with all our customers to see ourselves through this.
- Ajay Krishnan:** And who else have you sold this Egyptian cotton product to, besides Target?
- Rajesh Mandawewala:** So, I will reserve my comments on this, but there are a few other customers as well.
- Ajay Krishnan:** So it is very likely that you will face the same reaction from the other customers as well?
- Rajesh Mandawewala:** So as I said, we are very actively engaged with most of our clients. And overall, this business has formed on itself between 3% and 6% of our overall revenues over the last few years. So, we are actively engaged with our clients.
- Moderator:** Thank you. Our next question is from the line of Siddharth Johri from Allianz Global Investment. Please go ahead.

- Siddharth Johri:** Actually, part of my question has been answered previously. But in terms of your other clients, and in terms of a resolution to this entire dispute, what is the best case that you are looking at? Because obviously the worst case is that entire businesses from these particular clients being cut off, just like Target has done. So, how does this whole thing work, I mean, because they have sold the products and obviously a bit of liability issue here, because Target obviously is giving refunds. Is that something that, I just want to understand what is the best case from your perspective in terms of how this pans out?
- Rajesh Mandawewala:** So look, we have a very long standing relationships with most of our clients and we have had an impeccable track record over a couple of decades, and we are hoping to work through this with our clients to find an amicable resolution to this. So there has been this process issue and so we hope to work through them, we have had very-very fruitful relationships with all our customers. So we will continue to work with them to find a resolution.
- Siddharth Johri:** And just one quick follow-up on the data point, so 3% to 6% of revenues for the two year period was actually this product for the last two years, right?
- Rajesh Mandawewala:** This is an annual estimate over the last several years, so we have been around that mark across all customers.
- Siddharth Johri:** And also in terms of the provenance issue, is that specific only to this particular product or in the process you have found that that has been a problem that has been more widespread? I know it is early days, but still.
- Rajesh Mandawewala:** Which is why the audit, as I have said, we are looking to appoint one of the Big Four firms and the idea is to actually look at the entire supply chain and our supply processes so that we can bring about robustness in the whole process.
- Moderator:** Thank you. Our next question is from the line of Akhil Kalluri from Credit Suisse. Please go ahead.
- Akhil Kalluri:** Sir, just wanted to check that besides the termination are you anticipating any other further penalties as well?
- Rajesh Mandawewala:** So, we are working with our client on this, as I said, this Target has been an esteemed client for us, we have enjoyed a very fruitful relationship with them. As a company we are responsible for all our business with them. So we will work closely with them to find this resolution which meets their requirement.
- Akhil Kalluri:** And sir, based on your current discussion with Target, by when do you estimate that the entire revenues, by when will they wind down the business, any timeline that you have?
- Rajesh Mandawewala:** As I said, the purpose here is to make sure there is continuity of product and we will continue to work with them as long as they would need us to supply the other products. So, from our

side our side the intent is to maintain the continuity and cause, as little misery to the client as possible.

Moderator: Thank you. We will take one last question which is from the line of Ashutosh Somani from JM Financial. Please go ahead.

Ashutosh Somani: Sir, just wanted to understand the audit process a bit more clearly. So, we have supplied this Egyptian cotton for the last two years and is the audit conducted on a monthly or a quarterly basis by Target, because this has not been detected over the last two years but just wanted to understand this better.

Rajesh Mandawewala: The audits are a regular part of our business, and not only for this one issue but for multitude of things, so we are constantly undergoing audits with all our facilities, so it is a regular process. And the Big Four audit firm that we have appointed actually is to, as I said, look forward and reinforce our supply processes so that there is absolute certainty around this supply process going forward in the future.

Ashutosh Somani: Sir, my question is more in terms of Target's audit process, how come this has not been detected at Target's end over last two years and how it has been detected now, what initiated the enquiry?

Rajesh Mandawewala: So, I will reserve my comment on this one.

Moderator: Thank you. Ladies and Gentlemen, due to time constraint that was our last question. I would now like to hand the floor over back to the management for closing comments.

Rajesh Mandawewala: So, I hope we have been able to address some of your concerns. And as I said, we are taking this thing very-very seriously and we will come out of this stronger and do what it takes to maintain our impeccable track record with our customers. Thank you for your support.

Moderator: Thank you. On behalf of IIFL Capital Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.