
Investor Update for the Year Ended 31st March, 2010

OVERVIEW

During the financial year ended 31st March 2010, the profit after tax on a stand alone basis increased by 39% to Rs. 210 Mn vs. Rs. 151 Mn in the previous year. The net profit of Rs. 210 Mn is impressive even when compared to 2007-08's (great year) profit of Rs. 202 Mn. The above performance is all the more significant when viewed with the flat turnover on a stand alone basis of Rs. 2,666 Mn, vs. Rs. 2,667 Mn in the previous year.

ZCCL's profit after tax for consolidated business increased from Rs. 250 Mn to Rs. 262 Mn, (an increase of 4.93%) in the current year, which is also heartening, considering the lower turnover of Rs. 3140 Mn. compared to Rs. 3201 Mn in the previous year.

The different business segments, i.e. the design driven international business from India as well as the branded business and the company's own retail, have performed reasonably well, considering the turmoil in the international markets and the subdued consumer sentiment, both internationally and in India. What is noteworthy is that despite revenues being virtually flat, the company's focus on profitability has yielded results, which are visible, both in the PBT and PAT rising sharply.

Although the top line across the business segments remains flat, this in itself was an achievement – by virtue of the situation described above, as well as by the fact that the company did not discount its products in any of the segments merely to achieve top line growth.

The revenue pattern during the year has been sporadic, with periods showing a

pattern of revival of growth in consumer demand across markets, and other periods where demand reverted to the pattern seen during the lows between November 2009 and March 2010.

ZCCL, without discounting, has ended the year with a modest increase in turnover and a more than pro rata increase in branded margins. Despite the sporadic pattern of sales during the different months of the year, the Company firmly believes that the return to sustained growth is palpable and consequently continues to vigorously pursue its target of profitable growth (increasing the retail presence being a vital ingredient of this target), with financial discipline, cost control and global sourcing and conservative hedging of its forex exposure.

The cornerstones of this performance were:

1. Strict financial discipline in terms of cost control/reduction, and focus on operational efficiency
2. Stringent risk management processes, especially with regard to forex, as well as increased value addition.
3. Keeping the brand values of Zodiac, ZOD! And Z3 and their premium positioning intact, besides protecting the bottom line, has been possible because these brands were the only brands which were not discounted, whereas every other men's wear brand was heavily discounted. The company's understanding of the market place stood it in good stead.

4. Spends on marketing and personnel costs were not trimmed with the expectation that this investment would hold us in good stead when market conditions reverted to full normalcy.

During the year, the company opened 8 new stores and renovated 3 stores (all stores are company-run, not franchised) in keeping with its strategy of investing in the growth potential of retail.

The company's debt equity ratio on 31.03.10 was 0.17 on a Consolidated basis and 0.23 on a standalone basis.

INDUSTRY SCENARIO

A. Overview:

The branded business in India, which had been severely impacted by the fall in consumer demand during FY2008-09 continued to witness demand constraint until June '09. From July '09 onwards, the industry has witnessed two phenomena - i.e.

- (a) The economy segment - the bottom of the pyramid, has been growing modestly, almost consistently, since July, and,
- (b) The premium segment, in which the growth has been sporadic/erratic with some months showing handsome gains and other months continuing to show lack of the feel good factor. The target consumer for this segment has the money, but due to

the lack of the 'feel good factor', prioritising of expenses on big ticket items, as well as discounting by brands in this segment that were in distress, have all resulted in a flat to modest growth for brands that had not been discounted. The brands that were discounted have shown a slightly higher increase in their turnover, but have incurred losses again in FY 2009-10.

In the prevailing business environment the company's competitors' brands weakened considerably due to these being aggressively discounted. By comparison, the Zodiac and z3 brands, strengthened considerably vis-à-vis the competition, to a large extent because none of the three brands, i.e. Zodiac, ZOD! and z3 were discounted. This, while resulting in a subdued top line, contributed to the brands' strength as well as the strong bottom line. The product extension of suits and shoes to the Zodiac brand has received most encouraging response from the consumers.

India's exports of clothing have declined from USD 10.933 billion in FY 2008-09 to USD 10.644 billion in FY 2009-10. In USD terms the exports declined in 9 of the 12 months. Even in INR terms, it declined in each of 6 months of the year. What has been even more significant is that this was on an already low base. In the second half of the previous year i.e. October 08 - March 09, the post-Lehman period, there was a decline each month in Rupee terms and a decline in 5 of the 6 months in USD terms. Needless to highlight, clothing exports have consistently been falling short of target for the last 3 years.

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In the present scenario, where cotton yarn, and consequently fabric prices have risen significantly, the competitiveness of India's exports has eroded considerably, not only of clothing, but also of yarn, fabrics and made-ups.

The clothing industry, unlike the spinning and weaving industries, is not able to pass on the increase in costs to their customers. This is because of competitive pressures, where India's competitor countries are fiercely competing for a share in markets where demand has been affected adversely due to the global economic slow down. Although recession is "officially over", in most of the markets, the economic growth as well as retail sales have not shown any significant upturn in most markets.

With our competitor countries getting fullest co-operation from their respective governments, they are able to grab market share from India. This is partly because India's clothing exporters are still not being fully reimbursed on incidence of taxes (both State and Central) on inputs. The issue of the industry being insulated from service tax on goods

Intended for export, also remains only partially addressed. Even on service tax that is paid and is eligible for refunds, the actual disbursements of refunds are largely outstanding.

With the clothing industry being capable of fulfilling the important objectives of the government, i.e. being the second largest generator of employment after agriculture, the industry is an important tool for achieving inclusive growth as well as being able to provide gender sensitive employment. The vitally important role of this sector needs to be acknowledged and needs addressing – either by reining in cotton markets by intervention, or by adequately reimbursing taxes paid on inputs by the clothing industry by increasing duty drawback appropriately.

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The volatility of the forex rates (Rs. 52.00 to Rs. 45.00 per USD during April 09 to March '10) has not made matters any easier. Besides, the industry's cost of funds is much higher than that of its competitors.

The TUFS scheme, which seeks to address the needs of the industry somewhat, has also been found wanting. Reimbursement of subvention under this scheme from July 2009, i.e. nearly one year, is still outstanding. The industry's request that the banks be directed to charge net interest to the industry under TUFS has also fallen on deaf ears.

India has slipped to 6th Position in the export of clothing during FY 2008-09 and would perhaps have fallen even lower during 2009-10, judging by reports in the press, of Bangladesh having overtaken India in export of clothing..

The company's exports having ended flat with, average unit value realization as well as profitability having improved, which is creditable in the prevailing situation.

REVENUE ANALYSIS

1. Consolidated Turnover Rs. 3140 Mn YTD March 2010
Vs. Rs.3210 Mn YTD March 2009.

2. Standalone Turnover Rs. 2666 Mn YTD March 2010
Vs. Rs. 2667 Mn YTD March 2009.

3. UAE Turnover AED 49 Mn YTD March 2010
Vs AED 51 Mn YTD March 2009.

Analysis : YTD March 2010 Vs. YTD March 2009

- EBITDA : Standalone 14.47% - Up 32%
Consolidated 14.78% - Up 14%

- PAT : Standalone Rs. 211 Mn - Up 39%
Consolidated Rs. 262 Mn - Up 5%

- EPS : Standalone Rs. 25.10 Vs. Rs. 18.04 (on expanded equity post ESOP)
Consolidated Rs. 31.22 Vs. Rs. 29.76 (on expanded equity post ESOP)

2 new stores were opened during Q4 '10, taking the YTD store openings to 8. The company's policy of ruthlessly closing down unprofitable stores continues, with 3 stores being closed during Q4 '09, taking the total to 4 in 2009-10. The company's own stores have maintained like-to-like growth through to the end of March 2010, besides the generation of additional sales from new store openings. As of March 2010, the company had 72 stores. All these stores are company run, not franchised.

During YTD '10, personnel costs, marketing spends and store rentals grew over the comparative period YTD '09. These are attributable to new store openings, increase in head count due to new store openings along with the service tax component on rentals and marketing costs.

YTD '10 Capex is Rs. 125 Mn, which has been generated from internal accruals. The amount invested in Shop Deposits for the year ended March 2010 was Rs. 93 Mn as compared to

Rs. 81 Mn in March 2009. The company has begun to build its liquidity, as a matter of prudence in view of the times.

The company's de-risking initiatives have considerably cushioned the company thus far against the volatility across the globe.

Accounting Standards

In order to recognise the impact of fluctuation in foreign currency rates arising out of instruments acquired to hedge highly probable forecast transactions in appropriate accounting periods, the company has, from this year, decided to apply the principles of recognition set out in the International Accounting Standards, which are also reflected in the Accounting Standard 30 - Financial Instruments-Recognition and Measurement. The management is of the view that it would be more prudent to do so in view of the wide fluctuation witnessed recently. As a result, the impact of unrealised loss (net) consequent to foreign currency fluctuations, in respect of effective hedging instruments represented by forward covers to hedge highly probable cash flows from future exports aggregating Rs. 0.4 Mn (previous year Rs. 61 Mn), mainly on account of "Plan Vanilla Hedge" ending on May 2012, i.e. a simple forward cover/hedge for under 10% of the average of the company's exports for 3 years. This is technically classified as a derivative only because the tenure of the hedge is beyond one year - are carried as a Hedging Reserve to be ultimately set off when the underlying transaction arises, in the Profit & Loss Account, as against the practice of recognising the same in the Profit & Loss Account on valuation at the end of each period, if any.

Other foreign currency financial assets and liabilities that do not qualify for hedge accounting have been revalued/accounted as on 31.03.10 and the resultant net gain/(loss) aggregating Rs. 1.4 Mn (previous year [Rs.148 Mn]) has been recognised and credited/debited to the Profit & Loss Account for the year ended March 2010.

The company has no exotic derivative exposure.

A sub-committee of the Board, chaired by Independent Director (Mr. S.M. Datta, former CMD of Hindustan Lever Limited), was constituted for guiding the Forex Policy of the company through these turbulent times.

As a matter of good Corporate Governance, the promoters have confirmed that they have not pledged any part of their shareholding.

OUTLOOK

The branded business continues to hold great promise - with signs of revival of consumer demand and the strength of the Zodiac/ZODI/z3 brands, with the product quality and fashion content being of the best global standards and with the company's infrastructure of company run stores being strengthened, besides its strong linkages with national chains and independent retailers, one looks forward to harvesting the opportunities that seem to be evolving.

Design-driven international business, though extremely challenging, continues to be stable and profitable. The company has taken several steps to sharpen its competitiveness during

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these challenging times, which should yield results when demand in the international markets stabilizes.

The US market seems to have achieved a turn around which is an opportunity India must use (given the pressure on the Chinese to allow the Yuan to appreciate to its realistic level) to achieve a quantum leap in its trade in clothing with the US, both by regaining lost market share as well as by capturing further market share.

The medium and long-term outlook continues to be optimistic, with the demographics substantiating that the target audience is growing exponentially and is poised for handsome growth, notwithstanding the short-term blip encountered in these challenging economic times.