ZODIAC
FINEST QUALITY CLOTHING

ZODIAC CLOTHING COMPANY LIMITED

APTE PROPERTIES, 10/76, OFF DR. E. MOSES ROAD
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ZOD! CLUBWEAR

Investor Update for the Nine-month Period Ended 31st December, 2008

Overview

For the nine-month period ended 31.12.2008 (YTD '08-09), ZCCL's consolidated turnover was Rs. 241.82 crores. vs. Rs. 207.04 crores for the same period last year. This is a growth of 16.8% YTD '08.

The branded business continued to show growth in double digits year on year despite the subdued sentiment. However, the rate of growth from the second half of November 2008, declined to single digits. The business with independent retailers grew in double digits, as did the company's own retail (despite 3 blockbuster stores, at the Taj Mahal Hotel, the Oberoi Trident and Infinity Mall, being closed during the peak season). However, business with the large organised retailers, whose focus was on continuously selling discounted merchandise from April/May 2008, with a view to protect their top line, declined because of the company's principle of not discounting. Despite this, the branded business grew in Q3, albeit the rate of growth dipped because of the above.

The design-driven international business was stable with a growth of 5% in US$ terms. The unit realisation increased over the corresponding quarter last year, as well as year-on-year due to greater value addition.

The company's EBDITA margin decreased on a consolidated basis to 14%, and to 13% on a standalone basis. Consequently, the consolidated net profit decreased to Rs. 20.30 crores YTD '08, vs Rs. 25.30 crores YTD '07 and the standalone net profit was Rs. 12.60 crores vs Rs. 14.30 crores. This was due to the adverse global and domestic factors that played a major role in Q3. The company could not adequately harvest the sustained Rupee depreciation, which is reflected in other expenditure, as part of forex losses. Commitments for rentals, marketing and personnel costs were made on the basis of growth rates achieved upto September (which were subdued to start with) remaining stable. However, due to the rate of growth declining from mid-November to single digits, the EBIDTA/PAT were impacted.

Consumer demand has been adversely affected by the lack of the "feel good" factor and the barrage of negative news, internationally. The despicable events of 26/11 (Terrorist attack) have further dampened sentiment, as customers stayed away from malls for security reasons.

Given the overall economic scenario and consumer sentiment, the company's performance continues to be gratifying, especially when one looks at the industry across the company's businesses, i.e. branded business, own retail and the design–driven international business. The company is fortunate in having achieved top line growth, which more importantly has been accompanied by a healthy bottom line, despite a reduction in the quantum of profit.

The company's Debt Equity Ratio as on 31.12.08, stands at 0.16 for standalone and 0.13 for consolidated .

The company has been assigned a rating of **A1+** for Fund based bank limits of INR 385 million and Non-Fund based bank limits of INR 57.5 million for the Short Term Facility Programme. This is the highest credit quality rating assigned by ICRA for the short term. The rated LOC carries lowest credit risk. The rating is assigned by ICRA Ltd., an associate of Moody's Investors Service.

Industry Scenario

The slow down in India, which started with automobiles, durables and real estate, went on to affect most sectors across the board. In the clothing industry in India, there has been discounting almost continuously since the start of the financial year by most brands. Zodiac, ZOD! and Z3 are virtually the only brands which are the exception.

India's export of clothing has been under severe pressure due to the sharp decline in demand in the US, the UK and the EU. Export of clothing from India April-September '08 declined by 3.89% in US$ terms. The situation for the Chinese clothing industry has not been much different. It is reported that export from China, of which clothing is an important component, is under serious pressure. Bangladesh has gained market share, on the back of favourable trade agreements with the major importing countries.

There has been sustained depreciation of the Indian Rupee, driven primarily by large outflows of funds by FIIs facing redemption pressure. Inflation has diminished considerably and interest rates have softened somewhat; cotton prices have weakened in line with international trends. In India one sees all this as contributing to sharpening India's competitiveness which, when coupled with cost reduction measures, would translate into major competitive advantage for India that could be harvested when international demand improves – however, the stimulus measures in the US/UK/EU would take several months to have an impact on demand in those countries.

We believe that the Government and the clothing industry need to act in tandem to achieve stable growth going forward, when international demand revives. The issue of service tax refund on services attributable to export has been addressed in the stimulus package of December 2008. However, there is a major challenge in the execution of this refund, which is being discussed with the Government, who have formed a high-level Committee chaired by the Cabinet Secretary (which also includes the dynamic Deputy Chairman of the Planning Commission), to address issues of this kind. The signal the Government sends by having formed this Committee, is most heartening.

Revenue Analysis

1. Consolidated Turnover Rs. 24182 lakhs YTD December 2008
   Vs Rs. 20704 lakhs YTD December 2007.

2. Standalone Turnover Rs. 19994 lakhs YTD December 2008
   Vs Rs. 16540 lakhs YTD December 2007.

3. UAE Turnover AED 402 lakhs YTD December 2008
   Vs AED 444 lakhs YTD December 2007.

Analysis : YTD December 2008 Vs. YTD December 2007

- EBITDA : Standalone Down 7.25%
  Consolidated Down 12.90%

- PAT : Standalone Rs. 1260 lakhs Down 12.65%
  Consolidated Rs. 2030 lakhs Down 19.80%

EPS	:	Standalone Rs. 15.03 Vs. Rs.17.25 (on expanded equity post ESOP) Consolidated Rs. 24.21 Vs. Rs.29.92 (on expanded equity post ESOP) (The AED, which is pegged to the US$, has appreciated sharply against the Euro & Sterling)

The company's branded business of the Zodiac, ZOD! and Z3 brands, despite the subdued sentiment until end-September 2008 and further decline in sentiment from mid-November 2008, continues to grow, albeit comparatively the rate of growth is somewhat subdued.

10 new stores were opened during Q3 '09, taking the YTD store openings to 18 (19, if the Taj Mahal Hotel Shop, which re-opened end-December '08, doubling in size is considered). The company's policy of ruthlessly closing down unprofitable stores continues, with 2 stores being closed during Q3 '09. The company's own stores have maintained like-to-like growth through to the end of December 2008, besides generation of additional sales from new store openings. As of December 2008, the company had 72 stores. All these stores are company run, not franchised.

During YTD '09, personnel costs, marketing spends and store rentals grew over the comparative period YTD '08. 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 based on the growth rate achieved upto September-end being sustained. The company could not adequately harvest the sustained Rupee depreciation, which is reflected in other expenditure, as part of forex losses.

YTD '09 Capex is Rs. 23.00 crores, which has been generated from internal accruals. The company has begun to build surplus liquidity, as a matter of prudence in view of the challenges ahead.

The company's derisking 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. 611 lakhs, 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 31.12.2008 and the resultant net loss aggregating Rs. 1072 lakhs has been recognised and debited to the Profit & Loss Account.

With a view to protecting the downside, the company has hedged a major portion of its highly probable cash flows through to April/May 2009, as a result of which the company could not adequately harvest the opportunity presented by the sustained Rupee depreciation, especially in Q3 '08. The company has no exotic derivative exposure. The only derivative the company has signed is a "Vanilla" hedge for 60 months ending May 2012. , i.e. a simple forward cover/hedge for under 10% of the average of the company's exports for the last 3 years. This is technically classified as a derivative only because the tenure of the hedge is beyond one year.

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

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<u>Outlook</u>

We continue to feel that the subdued consumer demand arising from the economic situation should stabilise by the middle of the current calendar year. The building blocks in terms of new stores, further addition to the number of stores (albeit at a slightly decelerated pace) and the additional impetus from the brand Z3 (which has surpassed all projections despite the economic scenario), are in place.

Store rentals are being re-negotiated in the scenario of declining rentals, wherever our agreements with the landlords permit. This would naturally impact the bottom line when the evolving situation is harvested.

International business, though extremely challenging, continues to be stable and profitable. The company has taken several steps to sharpen its competitiveness during these challenging times, which should yield results when demand in the international markets stabilises.

Although our customers in the international markets are considered “blue chip”, and have a flawless track record, in view of the prevalent global situation, we have insured our receivables (except under Letters of Credit/Documents against payment at sight), with one of the three major globally-reputed credit insurance companies as a measure of abundant caution.