Q4 FY2019 Earnings Call Transcript – May 16, 2019

Corporate Participants

- Suresh J – Managing Director & CEO
- Pramod Gupta – Chief Financial Officer
- Ankit Arora – Head, Investor Relations

Moderator Ladies and gentlemen, good day and welcome to Arvind Fashions Limited Q4 FY2019 earnings conference call. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing "*"then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankit Arora, Head of Investor Relations. Thank you and over to you Sir!

Ankit Arora Thanks. Hello and welcome everyone and thank you for joining us on Arvind Fashions Limited Earnings conference call for the fourth quarter and fiscal year ended March 31, 2019. I am joined here by Suresh, Managing Director and CEO and Pramod Gupta – Chief Financial Officer of Arvind Fashions Limited. Please note that results, press release and earnings presentation had been mailed across to you earlier and these are also available on our website, www.arvindfashions.com. I hope you had the opportunity to browse through the highlights of the performance. We will commence the call with Suresh, who will share the key thoughts about our strategy and financial performance for the quarter and fiscal year 2019. At the end of the management discussion, we will have a Q&A session.

Before we start, I would like to remind you that some of the statements made or discussed on this call today maybe forward looking in nature and must be viewed in conjunction with risks and uncertainties we faced. A detailed statement of these risks is available in this quarter's earnings presentation. The company does not undertake to update these forward looking statements publically. With that said, I would now turn the call over to Suresh to share his views.

Suresh Good afternoon to all of you. I am very happy to share with you the results of Arvind Fashions Q4 and fiscal year 2019. Given the context of the market this quarter where the consumer sentiments were a bit weak and we saw some downturn in consumption. Therefore, we actually decided, which was also a stated strategy this year, to focus on cash generation, cost efficiency and working capital control. Whatever action we took in this area there were some good results and very quickly the highlights of the financial performance, I think the significant financial performance has been the record profitability of our power brands portfolio where we have been able to increase our EBITDA margin to 14.1% in Q4, which is 60 basis points increment compared to the base quarter. Our efforts to improve our cash generation led to generation of positive cash flow, which also helped us to retire debt to the tune of 160 Crores plus.

From the portfolio point of view, as all of you know that we have four categories, which are focused categories for us. We are market leader in casual denim, we continued to do well in that category with 20% plus growth with improved market share in channels like department store. In kids wear, we are definitely gaining leadership in premium kids wear market where we have grown at the rate of ~1.3x compared to last year. Then, in the case of innerwear, again the growth has been upwards of 1.6x with US Polo innerwear doubling in sales and reaching three figure mark.

In prestige beauty, we have grown at 35%. So, overall our growth rate in focus categories have been very good and in line with our projections. Three brands have done exceedingly well, which we wanted to call out. One, US Polo is fast emerging as India's number one lifestyle brand having crossed the company revenue of more than 1,000 Crores, probably the fastest to do in the apparel market. Flying machine is now becoming one of the significant denim brand reaching the top three positions and GAP, all of you know that we had a challenging time post the introduction of CVD. We had taken multiple actions including indigenization, increasing the wholesale component has helped us to turn the brand profitable with high growth.

On the business side, we had a negative like-to-like growth like most of the value retailers in Q4, which impacted the Unlimited performance both in terms of topline and bottom-line. Now coming specifically to the numbers, in terms of sales, as our focus was more on cash and working capital control, our growth got impacted. We have always delivered 20% growth for many quarters in succession, this probably is one quarter where we took a call to have a flatter growth but improved cash generation. Our profitability improved. We had 80 basis points improvement in operating profit with EBITDA touching 7.3% and 13% growth on EBITDA with 85 Crores of EBITDA.

Two significant actions, which impacted our growth, one we took a call to exit some of our customers who are having long cycle times in terms of credit period in the multi-brand store channel so that impacted our growth and we started exiting some of our emerging brands, both together impacted our growth to a tune of 8%.

Coming to the full year results, I think while the growth has been lower for Q4 I think overall we have been able to deliver 15% underlying sales growth with improved profitability of 80 basis points at 288 Crores of EBITDA, 6.2% of sales, which represent a growth of 26% in EBITDA. We have also improved our ROCE from 5% last year to 6.7% and with some of the actions we took in Q4, we see a further growth in ROCE going forward.

Coming specifically to the way forward, during the next quarter, some of the action we took in Q4, we intend to continue in Q1 as well which might impact our growth and profitability. Particularly two actions, we have decided to push the sales, which we normally do to the trade channel in the month of June to July, that will impact our growth and profitability in Q1, but will get adjusted in Q2 and second, we will hope to exit some of the emerging brands in which we wanted to exit low performing emerging brands, which we wanted to exit in Q1 for which we may take a one-time loss. These two will probably affect our growth and profitability in Q1, but we see our growth, improvement in profitability and improvement in ROCE to accelerate in Q2, Q3 and Q4 so that we would be able to deliver our normal high growth by end of the year with improved profitability and improved ROCE, which we hope to touch double digit next year. So this gives a brief commentary of our performance in Q4 and full year 2019 and with this I would like to open up the session for questions.

Moderator Thank you. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Chirag Shah from CLSA. Please go ahead.

Chirag Shah Just a quick question, so you spoke about the general slowdown that the industry seeing the value retailing segment, now according to you what is leading to that, why are we seeing that kind of a consumption slow down and for what kind of negative L2L numbers we have seen, if you can just talk a little bit more around Unlimited year because it looks like a large part of the profitability swing that we have seen in the quarter is because of the losses that we have made in Unlimited during the quarter, so if you can just touch upon Unlimited is slightly more in detail?

Suresh Yes Chirag. As far as Unlimited is concerned, I think we started growing quite well. In Q4 what happened was that the upside we expected in the value retail did not happen, maybe it’s to do with huge amount of discounting which happened in the month of December itself. As a result generally the value retail in terms of the LTL, which has been pretty robust in Q3, dipped in Q4 and in the case of Unlimited two things happened, one is negative LTL of around 6%, and also along with that we also had planned increase in investment behind advertising, the combination of negative LTL and an increased advertisement spend led to this higher loss in Q4. The overall drop in consumption during the quarter also impacted value chain quite a bit, particularly the value fashion was growing much faster compared to the rest of the industry that got seriously hit in Q4. So that is the reason why we have led to this kind of losses and we have taken all corrective actions and going forward, possibly we should not have this issue.

Chirag Shah Sure. We are early in the middle of the first quarter, so do you think the trend that you saw in Q4 is reversing or the trend is continuing into Q1?

Suresh We saw a slight upsurge in the demand, I would not say that there is a major swing positive, but definitely it is much better than the month of March. I would say that, in general month of March was one of the worst for the industry and more so for the value retail, but definitely April was good and then May is good, but still I think till the election gets over, the general expectation is that the market will be a little bit subdued and things should start looking up post-election.

Chirag Shah Perfect, okay and if I may just ask one more question. The change in the policy that we are seeing where we will push the trade channel into Q2 rather than Q1, do you think we will also have some kind of revenue loss on account of that or it is just more of an accounting thing where rather than pushing it in June we have pushed it into July?

Suresh No. It is just shifting of the sales from June to July, so it will get covered up in July. I just mentioned it so that it will have an impact in Q1 topline as well as bottom-line.

Chirag Shah Sure. I have more questions I will join the queue later.

Moderator Thank you very much. The next question is from the line of Nishit Rathi from CWC Advisors. Please go ahead.

Nishit Rathi Just wanted to understand how should we think about Unlimited in your expansion plan is now going forward especially given like this unexpected Q4, will you continue to ramp up Unlimited the way you were thinking about or will you like to take a pause and get to some profitability level before we are going to scale this up again?

Suresh No. I think what we will do is to make sure that at the current scale we are able to reach breakeven before doing a rapid expansion, I am not saying that we will not expand, but we will not do a rapid expansion till such time we consolidate and make sure that we reach at the breakeven at the current scale of business.

Nishit Rathi Should we expect any kind of breakeven number happening in FY2020 or will it be slightly more pushed out?

Suresh See we may require to close some of the loss making stores, then we have in our portfolio almost 75 to 80% of stores which are very healthy from the store EBITDA point of view and whatever store EBITDA these set of stores are generating, should cover our corporate cost, so that's the entire focus of consolidation. We feel that in Q1, we may still have some negatives on account of closure of stores, but going forward we see the chain progressing well towards breakeven in H2.

Nishit Rathi Will it be fair to assume that for the full year you will be close to breakeven in this?

Suresh We will not be breakeven for the year, but I think we will exit the year comfortably breakeven.

Nishit Rathi Can you give us some sense as to what kind of Q1 should we expect because there are too many things that are happening in Q1. You are looking to exit certain brands which were there, so what kind of a one-off of loss can we expect over there, you are looking to shut certain stores and you are also looking to push out some of the things. What kind of an impact could it have on your overall full year trajectory for at least power brands and other brands?

Suresh Power brands will not have any problem. It could be a quarter shift from Q1 to Q2, but as you have seen in Q4, we have substantially improved the power brand profitability, so I think we will be delivering whatever we have stated as far as power brand is concerned, there will be a marginal drop in growth for the year, but I think in terms of profitability and return on capital employed, the power brands will be very, very healthy. There will be a onetime loss for the exit of some of the emerging brands. It is very difficult for us to estimate at this stage. What we are trying to do is to do all the correction in Q1, so that we get into Q2 in a high growth scenario that can improve profitability, improved ROCE. So you may have a subdued quarter while I am not able to give out any specific number, but Q1 will be subdued with a very substantially improved rest of the year.

Nishit Rathi And also if you could give some sense on working capital, what should we expect going forward specifically in terms of inventory days and in terms of receivables. You have exited Q4 much better than Q3, but how should we think about when we look at FY2020?

Suresh In Q4, we took a very conscious call in terms of controlling receivables, I think which we again would be able to achieve. In overall terms, we have four days drop in net working capital this year, we want to further drop that by another 10-15 days next year, which means release of close to 200 Crores after whatever money required for the growth.

Nishit Rathi Okay. So you are basically targeting to reduce your working capital by 15 days if possible?

Suresh Yes.

Nishit Rathi And will that also mean that the current Rs.2000 Crores worth of capital employed you are looking to kind of reduce that to more like 1,800 Crores because the Rs.200 Crores release will kind of go towards debt?

Suresh Yes that is what we are looking at.

Nishit Rathi Okay. I will come back in queue for more questions.

Moderator Thank you. Next question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham Sir, my first question was that if I look at the annual growth that we have done, possibly in the emerging brands. As I understand that these have obviously been brands that we have recently come up with, the growth of 5%, is that you were targeting for this year? I understand that we have curtailed our debtors in the power brand segment and specialty retail had the issue with Unlimited, but more in the emerging brands side, I mean we would have expected the growth to be higher considering that these have only been brands which have recently been launched, I am sure the stores would have still not reached maturity?

Suresh No, actually if you come to emerging brands, we were taken a call to exit few brands, so we have started downsizing those brands and then actually while there is a full sales of those brands in the base, those brands are not there in the current quarter sales and as far as the rest of the emerging brands which we are retaining, what we have also done is to increase the profitability, we have actually de-risked the model from retail dependence. So we are also making the model more wholesale and online driven. So what we are focusing on is to probably take a moderate growth in emerging brands in the current year and then go for an improved profitability and starts looking at generating some ROCE. So that is the thing and if you take out the effect of the discontinued brands, we will still deliver a double digit growth on emerging brands, but definitely the focus is not on growth, but have a very de-risked emerging brands portfolio, which can deliver both profit and start looking at generating ROCE.

Nihal Jham Sure Sir, if I understand right, you will be looking more at MBOs and online rather than going for EBOs going forward?

Suresh That is right. The department stores, online and multi-brand stores.

Nihal Jham Sure Sir. Just continuing on the question on this emerging brand and you said that you are looking at rationalizing some of the brands in terms of say the positive EBITDA impact or the positive impact on ROCE. Could you give us a sense that in case you go ahead with the plan of reducing these brand, what could be the financial impact of that?

Suresh Positive delivery in terms of EBITDA, but next year probably we may not have the ROCE. So 2020 will be a positive EBITDA, 2021 onwards we will start to see positive ROCE.

Nihal Jham Sure. Is it possible to share that what was the kind of losses these brands that you are planning to exit made in the last year?

Suresh We do not share brand wise numbers at this stage. So you can assume that most of the losses are only the exiting brands and not the retaining brands.

Nihal Jham Fair enough. I will take that. Just one last question on Unlimited actually. We saw that in 2015 we went ahead with a significant restructuring where Megamart stores were converted to Unlimited and years after which you saw an improvement in LTL. As we are seeing the performance, at least the last three to four quarters for Unlimited has been little patchy, maybe growth has not been coming in as expected. So do you believe that there is still some kind of restructuring to the format that needs to be done or adjust the macro, which is the reason why Unlimited has not done well?

Suresh Restructuring on the format is not really required because I think what we need to make sure is that we sort of go parallel in terms of expansion and in investment and marketing, and not make both investments ahead of the time. So what we are now doing is more consolidation I would not say restructuring, consolidation to make sure that even with the current scale, we are at breakeven before getting to rapid expansion. We will expand, but not rapid expansion.

Nishit Rathi Fair enough Sir. I will get back in the queue for further questions.

Moderator Thank you. Next question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta Thanks for taking my question. Just wanted to understand this moderation in growth that you have highlighted in the start of your presentation as well, is this something that you are concerned about weakness sustaining especially given the commentary that the other peers in the apparel as well as consumer space have been indicating?

Suresh We do not really look at this sustaining. I think we have very clearly stated that our first priority is to improve profitability and return on capital employed. We felt Q4 is a right time to do because overall sentiments were weak. So no point chasing growth during that time and consumption itself is weak, so I think that has played out quite well at the end of it because we have been able to improve our profitability, we have been able to generate cash and reduce our debt. So this is the call which we took, I would say to clean up our receivables position etc., which you will find that in Q1 also we may do some of it, but most of the clean up in Q1 will be related to the brands, which we were exiting where we want to completely exit the brand and release whatever capital is blocked in those brands, so that we can resume our growth and profitability and ROCE from Q2 onwards. So that is how we are looking at what happened in Q4 and what we plan to do in Q1.

Avi Mehta But the brand rationalization I understand, you also indicate towards long credit customers also being rationalized, is that something that is more or less done?

Suresh That is more or less done. What we will do in Q1 is to rephase the sales to the trade channel in line with the demand pull. So we will not do the sales in the month of June, but we will do it in July. It is a question of adjusting between quarters when you look at the results of H1, there will not be any difference.

Avi Mehta So once the rationalization process is over, is there guidance on margins that you would be able to share for the segments, is there anything that you would want to kind of highlight how much we look at margins as we go forward?

Suresh At this stage, I think we will stick by the original, I mean whatever we have given in the investor presentation, we will continue to aspire to improve our EBITDA, you will find a knock in the current year FY20 because of this exit, but underlying EBITDA will be pretty close to what we have committed in terms of EBITDA improvement.

Avi Mehta Okay Sir and lastly, the IndAS 116 could you kind of give us a sense on how it would change our P&L or any impact that you could share that would play out?

Suresh I will hand over to Pramod and he will be able to explain better.

Pramod Gupta We are looking into it because being a physical retail company leases have a significant impact on us like any other retail company, we are in the process of evaluating the impact, but the good thing is that whatever we will be doing for FY2020 we will also be restating or at least providing the comparable numbers for FY2019 and therefore as and when we are ready we will come out with those details and fully explain the impact of that both on the previous year as well as the current year.

Avi Mehta Sir your preliminary analysis does it suggest any PAT impact, I understand the EBITDA impact.

Pramod Gupta As of now we are not yet ready to comment on that.

Avi Mehta Okay Sir. That is all from my end. This is very helpful. Thank you very much.

Moderator Thank you very much. Next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah One can you share the underlying numbers or the base numbers for this quarter for power brands, specialty retail and emerging brands that you have shared for the current quarter?

Suresh Base quarter means you are talking about?

Anand Shah The Q4 FY2018 numbers. Similar to Q4 FY19, which you have reported 746 Crs for power brands, 231 and 192 Crs for specialty retail and emerging brands.

Ankit Arora It is part of the factsheet on the reported wise numbers, if you need the restatement of Ind-As 115 adjusted numbers, I can connect with you post the call and I will give you those numbers.

Anand Shah Okay. I will take it, no issues. And second question Sir was on this rationalization you're doing on the trade channel essentially for this long credit cycle customers is basically you are rationalizing the number of MBOs for power brands?

Suresh Not, number of MBOs, Anand. Basically what we are saying is we have few perpetually delaying payments from some customers. We said that we will not sell to those customers unless it is on a cash basis, so that had an impact on the topline which we have taken a knock in Q4.

Anand Shah Some of these customers you have rationalized basically?

Suresh That is right, yes.

Anand Shah Okay and was this sort of accelerated because of the slowdown or in general you took this call where you are seeing any bad debts?

Suresh No. We are not seeing any bad debt in fact we have no bad debts problems. What has happened is that market cash cycle has really elongated, so it is a call we took – we had to somewhere draw the line and say that we will not do business if receivables days goes beyond a certain limit. So it's that cutoff we took and say the customers who are above the cutoff, we will not do business and there is no issue as far as bad debts are concerned.

Anand Shah Okay and is it possible to call out what percentage of contribution these customers contribute to your revenue or so?

Suresh See, we had an 8% growth loss because of these set of customers. See it is not a permanent growth loss, Anand. So it is also like we become very straight and if our brands are powerful, at some stage they will come back to us with a better payment terms. So I would say it is a one time hit we give to make sure that we are disciplining some of our customers.

Anand Shah And you are saying part of this may flow through in Q1 as well?

Suresh Actually in Q1, there are two things – one is there is no discontinuation as we have done in Q4, second is what we will do is we used to do the multi-brand stores billing in the month of June, but we realized that actual demand happens in the month of July, so that means we are almost spending one month just having the stock at the distributor place and, that means your payment cycle time is going up by one month without any reason. So we are just shifting the dispatches closer to the demand, that's all we are doing. The bigger impact is going to be because of the exit brands, at this stage clearly estimate the loss, but that is where I think we will have an impact.

Anand Shah Okay. But you do not see any loss as you said on the sales because of the rationalization of these customers?

Suresh No, not at all. It's postponement, what we are doing in terms of the trade sales we will get adjusted in Q2.

Anand Shah Okay. Perfect and at this moment you are not able to share the quantum of loss or is it possible to share the revenue or so for the brand that you look to exit in the emerging brands?

Suresh No. Emerging brands, the brands which we are exiting is close to 200 Crores last year, so that is the quantum of brands, quantum in terms of sales, which we are exiting in the current year.

Anand Shah And this is incremental because you have already exited one or two brands in Q3 already?

Suresh We have not exited, we have planned exit so the sales is coming down. Once we decide to exit, you will know that although we keep the brand but its sales starts coming down. So full exit I think will happen in Q1 because this requires also an agreement from the original owners of the brand so that negotiation needs to be completed and then fully exit.

Anand Shah And Sir, this 200 Crores brand revenue kind of cull out will happen. Is that four brands?

Suresh Yes.

Anand Shah Okay. So this will entirely happen in you are saying starting Q1 and it will show up in the FY20 numbers?

Suresh Yes. That is right. We are trying to do everything in Q1 Anand so that we are focused on delivering growth with profit and ROCE Q2 onwards, but that also requires some amount of reconciliation with the original owners of the brand and all, but we are still hoping to complete it in Q1.

Anand Shah Okay and there would be an associated swing also, right in EBITDA because some of these would be loss making?

Suresh I agreed. Yes that is what I said there will be one time loss on exit of all these brands.

Anand Shah No. One time loss I agree the termination fee that perhaps you are taking right?

Suresh Yes.

Anand Shah I was saying that these four brands at 200 Crores revenue, will they already be profitable?

Suresh No, they are not profitable. They were marginally loss making. So from that point of view actually it is a 200 Crores and whatever loss we made on the 200 Crores will not happen in the current year, but the exit loss will be higher than that.

Anand Shah Okay. And just lastly now that you are seeing this slowdown and demand in general and there is some rationalization that you have done, any numbers that you have called out in terms of guidance for your power brand specialty and emerging brands especially in terms of revenue?

Suresh Yes. See I think as far as the power brands are concerned Q1 will be a more or less a flat kind of revenue, but rest of the three quarters we will get a strong revenue growth and overall business we are looking at a revenue growth of more than FY19 revenue growth if you take out the impact of all the discontinued brands.

Anand Shah Okay adjusted for the 200 cull out that you are doing in emerging, you are looking at underlying of better than FY19 for full year?

Suresh Yes.

Anand Shah Okay. Thanks a lot.

Moderator Thank you. Next question is from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel One on the balance sheet side on the inventory, the exit inventory has gone up by close to around 260 Crores, specific reason for that?

Suresh Two reasons Maulik, one I think is our sales have been lower than the original plan to some extent, power brand was quite deliberate, but if you take the number of days, actually it hasn't gone up between last year and this year, which is a good indicator that in spite of the sales being lower than the plan we have been able to control the inventory at the same number of days.

Maulik Patel Okay and in terms of the earlier question on Unlimited as we have the plan to double our sales, I mean number of stores in the next three to four years and we are investing into advertisement and other part of the area where the Unlimited is not present. Do you think that margin would be suppressed for another one year or it will be little longer period before the margin will be low single digit?

Suresh No. The call we have taken is how do we sort of consolidate the business with the portfolio profitable stores and get to a breakeven level before really expanding rapidly like the way we had planned adding 30, 40 stores every year, that kind of an expansion we may not do immediately, we will continue to expand in the current year, but with a very clear eye on improving the profitability and making it breakeven after certain closure store related losses.

Maulik Patel Okay. So what could be the number of stores we are planning to open this year for Unlimited?

Suresh The focus is on profitability, so we have some stores which are already leased, but balance we will have to see how the year pans out.

Maulik Patel Okay. And in terms of any guidance to the capex, which we planned to do this year?

Suresh This is very similar to our normal capacity ranging between 100 to 130 Crores.

Maulik Patel Okay and the last question is particularly on power brands, though this quarter there was no growth and you have mentioned that challenge we faced in the month of March. Will we see that the growth accelerate or probably growth revive in subsequent quarter, is there scope for margin to expand in power brand or the margin which we have put for this financial year approximately around 12.5% that is the optimum margin for the power brand?

Suresh I would not call it as an optimum margin, but we do not see expansion in this year, that is in FY2020 because we also will be aggressively growing after Q1, there are pockets in portfolio where we want to now advertise separately and grow, but going forward, we can see an improvement that is coming out on account of operational leverage once it scales up beyond a certain limit.

Maulik Patel Okay. Sorry just last one more question. On the emerging brand issue there is a consolidation, we are exiting some of these brands. So, in that group, will there be a decline in top line for the emerging brand as a whole in FY20 or it will be a flattish growth?

Suresh If you take out the discontinued brand sales from the base, there will be a growth of double-digits.

Maulik Patel Okay and if I say that in March 31,2019 all those brands are there, or it has been exited only in the month of April onwards?

Suresh All the brands are there, but out of the four brands, couple of brand sales were pretty low, but two brands were having sales in Q4 also, but a complete exit we are targeting to do it in Q1, maybe it will get spill-over in Q2.

Maulik Patel Okay and I understand that as part of the agreement within the brand owners if we exit the brand we have to pay certain penalty?

Suresh That is not penalty. There is some royalty settlement we have to do, which is what we are negotiating to even bring it down.

Maulik Patel So as all these brands are unprofitable and probably we will see the release of the working capital also when you will completely exit that?

Suresh Yes.

Maulik Patel Okay and what that could be the number if you can give some idea on that to know about the amount of working capital, which we can release from that?

Suresh No Maulik, as I told you that we are looking at a drop of 200 Crores in capital employed, so this is also part of that.

Maulik Patel Okay. Got it. Thank you Sir and wish you all the good luck.

Moderator Thank you. Next question is from the line of Saurabh Patwa from HDFC Mutual Fund. Please go ahead.

Saurabh Patwa Thank you for taking my questions. Sir, I had two questions. One was any expectation of loss of inventory or you would have some inventory in pipeline for these exiting brands, like agreements with various retail outlet, like in various malls, so would you have some kind of cost related to that?

Suresh Not really because we have planned to exit over a period of time. So we have planned our inventory to come down in line with that exit and we have already taken decision whatever stores we want to close. In this case actually, only two brands have stores, other two brands was not having any stores. We have already taken some closure decision and already that is budgeted, I mean that is already expensed out in FY2019 results.

Saurabh Patwa Okay. This question is related to Unlimited. So when we switch from Megamart to Unlimited, there were second set of stores, which were already profitable, okay and that partly led to breakeven of Unlimited initially, but subsequently once we have started adding more stores it has again moved back to more kind of losses, so is it like when you are saying that you would look to close few loss making stores, a bulk of those would be the ones which would open recently?

Suresh Not necessarily. So we have actually some of the stores opened last year, and this year also which are doing quite well. I mean we are talking about maximum 10 to 15 stores which we are targeting to close on a total of around 100 stores.

Saurabh Patwa Okay and how many of the stores, which were earlier profitable, if you could I am not sure whether you have this number but earlier Megamart stores, which we have retained how many of them would be profitable right now?

Suresh See, very difficult to say at this stage. Another reason for increased loss this year is additional marketing investment, which we did in Unlimited.

Saurabh Patwa Okay. That is it from my side. Thanks for taking my questions.

Moderator Thank you. Next question is from the line of Nishit Rathi from CWC Advisors. Please go ahead.

Nishit Rathi Sir just wanted to understand if we had broadly the way we were thinking about the margins and the revenue was that you would be improving your margins every year, now there are two one-offs, which I understand, which you are saying, one is the one-off of shutting the 200 Crs worth brands, which will lead to one time expense, and second, you will be shutting the Unlimited stores, which I do not know how you will be calling because that would be something which you continue to do?

Suresh We call it as an exceptional item.

Nishit Rathi So ex of that one-off, will we be continuing on that trajectory or do you think that trajectory also stops in this current year?

Suresh No. I do not think so. If you take out the one time charge, we expect to track on that trajectory only.

Nishit Rathi So that 6% margin that you delivered this year could be more, ex of the one-off of the brand you are shutting?

Suresh That is right, yes.

Nishit Rathi Also if you are shutting the brand there is a one-time cost of paying the fees, but there is also an expense, which is the overhead of those brands which the brands were absorbing, now does it get absorbed in your current business, or how will that work?

Suresh See we were also spending money on advertising in those, while it is not a big amount, there is an advertising, there is a direct people cost, so those things will get saved. I agree with you that some of the support cost, which is overhead will have to get spread across rest of the brands.

Nishit Rathi Okay, but then ex of the one-off, we will be tracking our increase in margins and you will let us know what exactly the number is for that one-off, which will not get incurred next quarter?

Suresh That's correct.

Nishit Rathi And the other thing which I wanted to understand is how long we are going to try and figure out before we say that okay Unlimited is something, which you want to discontinue. The question I am trying to understand is we have been seeing starts and stops in Unlimited for some time now and when we have so much of opportunity in the other side of the portfolio. I am just trying to understand in terms of capital allocation and your resources and time, which could be used. How do you think about it in that sense?

Suresh As we have clearly stated that we definitely want to reach breakeven after whatever is the closure cost, so that I think is our first milestone. Then we will decide about the next step.

Nishit Rathi This is just a suggestion and you can completely chose to ignore it if you like, but the question I am trying to understand is should we take breakeven as breakeven and profitability and in the stated ROCE goal that we have for this company. Because, I think the capital employed will be substantial in this format right?

Suresh Capital employed is not substantial because there is little working capital in this format. It is more fixed asset only.

Nishit Rathi Inventories also.

Suresh A little bit on fixed assets. So the idea is definitely not only just the profitability, we need to start making ROCE at some stage.

Nishit Rathi Is that somewhere near or do you think it will be only after you reach a particular level of stores, which where we start thinking of ROCE?

Suresh No. I think the target is to get the breakeven in the current business. So once we reach that I think whatever stores we will add from then on actually should contribute to the bottom-line, which in turn should give the ROCE, so our original target was on 2021 is when we want to reach this position. We will just see how the year goes and then we will take a call.

Nishit Rathi Okay. That is it from my side. Thank you.

Moderator Thank you. Next question is from the line of Trupti Aggarwal from White Oak Capital. Please go ahead.

Trupti Aggarwal Thank you so much Sir for this opportunity. I just have a couple of questions. One is that on this specialty retail would it be possible for you to tell me what is the split between Unlimited, Sephora and GAP in terms of revenue and profitability?

Suresh Trupti actually we do not give the brand wise breakup, so we always give the three business group wise results, power brands, specialty retail and emerging brands.

Trupti Aggarwal Sure, but would you be able to give me some qualitative sense on how the performance of Sephora and GAP has been?

Suresh I think Sephora has always been growing well and profitable. Again we have called out as that as one of the significant performance in our presentation and we also called out the turnaround on GAP in our presentation.

Trupti Aggarwal Sure and sorry I did not get a chance to look at the presentation.

Suresh You will understand both Sephora and GAP performance.

Trupti Aggarwal But other details of the number of stores and area etc., in the presentation?

Ankit Arora Let us connect and take this offline to help you understand on both of these brands.

Trupti Aggarwal Sure. Just one last question on the working capital, I think apart from the inventory and the receivables, we see that even the trade payables have dropped vis-à-vis the last year, is that correct?

Suresh It's compared to December quarter position, because that is exactly what I also stated, that has been our focus in Q4, there is some series of action, which I have sort of elaborated in my commentary and also answering many questions.

Trupti Aggarwal Sure and the other assets, which are some loans and advances security deposit, they are still maintained at about 830 Crores. I just want to know that what this number would look like in the years to come because I think there was GST receivable

Pramod Gupta That also includes the SOR sales that we have and therefore there are returnable inventories which are included in that. We have a certain amount of deferred tax assets and therefore as we go on the profitability path we will have the deferred tax asset getting utilized, so while we do not give out a specific guidance on any of the numbers, but it is very much in our focus to sort of make sure that barring the inventory that is in line with the SOR customers which again we will continue to focus, but this is very much an area when we talk about 200 Crores working capital reduction. It is as much on the inventory receivables as well as OCA – OCL and we are only if at all strengthening the process for review of every item of assets for its conversion into cash and that focus will continue.

Trupti Aggarwal Sure. That is helpful. Just one last question if I may quickly ask, what is our plan in terms of the number of EBOs that we plan to roll out for our power brands plus emerging brands?

Suresh See this year we are targeting expansion largely in small towns, so we have identified almost 75 Tier-3 towns for expansion, so probably we would expand there.

Trupti Aggarwal Okay. How many stores?

Suresh Yes around 125 to 150 stores in total.

Trupti Aggarwal Sure, okay. Thank you so much Sir.

Moderator Thank you. Next question is from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah Thanks for the opportunity. Suresh, the value retailing itself has got redefined materially in the last four to five years, so now we have a very different set of value retailing players, who are targeting Tier-2, Tier-3, so these are at price points, which is very unique to them which is up Rs.500 average ticket size, and then there is also national players who are achieving this opportunity in a different price point, so where do you see Unlimited as a model gravitating towards?

Suresh See there are two things Tejas which is happening in the value category, what we used to define as value, used to be Rs. 550 kind of average price points, where the higher price point is used to be around 999, some of the players we were talking about actually are operating at around Rs. 250-280 average price point, so Unlimited is more in the Rs. 550 kind of price point, we are not really at the lowest trend of the apparel market. So we are one notch above I would say compare to the value, some of the value retailers, you are mentioning.

Tejas Shah Sure and second do you think considering that we are targeting that space where a lot of national players are also eyeing so we have value retailing from it, from Westside and we have even Pantaloons which is creating franchise there with the value retailing format, so do you think that space is also now getting very crowded for us to have a very profitable value proposition for longer term.

Suresh Tejas, the current estimate is that the market is going to move from around 3-4 billion currently to 12 billion dollars, so if it is 12 billion, we feel that four-five players could be a billion dollar players can be in the market and we need scale and we believe that once you reach 2,000 to 3,000 Crores kind of scale, in that way you create barrier to enter the market. So it is a huge market opportunity because we are looking at this unorganized market getting covert into organized, so four to five national players with billion dollar turnover of each should not be a problem in this market.

Tejas Shah Sure. That is it from my side and all the best.

Moderator Thank you very much. The next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah Just question on Unlimited, so you are guiding for 10 to 15 store closures to happen in FY2020 from the current 100 level?

Suresh Yes that is right.

Anand Shah Okay and your earlier guidance was so you are looking at 15 to 20 store expansion in general right for Unlimited over the next year, so next year one should be more like a 75-80 kind of number?

Suresh Yes. I would say 85-90 kind of number.

Anand Shah Okay. So you will add some stores and you will close the unprofitable?

Suresh Yes. Net addition could be 5 to 6 Crores.

Anand Shah Net addition could be, and then again you will continue to add 15-20 depending how the model is progressing.

Suresh That is right.

Anand Shah Okay. Do you see the Unlimited revenue is to be in the flattish kind of zone or how do you see Unlimited revenue playing out?

Suresh Unlimited revenues we are seeing a growth Anand because I think we are also seeing a good online opportunity in Unlimited. So the online part of Unlimited is scaling up quite well with Amazon, so it is not just the store revenue alone, but the Unlimited set of brands listed in Amazon also is now doing quite well. So we see a scale up happening there, which may give us a marginal growth in spite closure of the stores.

Anand Shah Okay. But still it may be in the 5-10% ballpark or so?

Suresh Yes.

Anand Shah Okay and you were spending a lot of advertising to promote the Unlimited brand, so will it remain at that elevated levels or that will come down in FY2020?

Suresh See these are actually spending in six to seven markets last year Anand and what we want to do is to really focus on three markets where we have profitable stores, but spend adequately in the three markets, so in terms of overall advertisement spend will come down, but in the markets where we are present we will be pretty aggressive on advertising.

Anand Shah Okay. And just one or two book keeping question is your depreciation number has gone up sequentially quite a bit, so are there any one-offs and if we see the run rate, what decision one should take?

Pramod Gupta Anand, this is essentially like the additional capex that has happened this year as well as the full year impact of the last year capex.

Anand Shah So but there is a bunch of that is happening here in this quarter?

Pramod Gupta Yes. There is a bunching of that has happened in this quarter.

Anand Shah Because quarter is 44 Crores, your general run rate has been whatever 37-38 Crores or so, so the run rate should continue at that base right on the 44 Crores?

Pramod Gupta Yes. So because we also evaluated the useful life of certain assets as per the new IndAS provision and then decided to sort of charge some of the assets.

Anand Shah Okay. And just lastly on the gross margin we have seen very expansion Y-o-Y, any specific reason for that?

Suresh Actually Anand we had mentioned that the cost efficiency was one of the key objective, so we controlled discount during this quarter, which has helped us to improve gross margins.

Anand Shah Okay, perfect. Thanks a lot.

Moderator Thank you. Ladies and gentlemen that was the last question for today. I now hand the conference over to Suresh for closing remarks. Over to you Sir!

Suresh Thank you everybody for joining us on the call today. Appreciate you patiently listening to us. I hope we have been able to address all your questions for now, but if you have any more questions please feel free to reach out to Ankit. We look forward to speak with you again in next quarter. Thank you.

Moderator Thank you very much. Ladies and gentlemen, on behalf of Arvind Fashions Limited that concludes today's conference call. Thank you all for joining us. You may now disconnect your lines.