Q2 FY2020 Earnings Call Transcript – Oct 23, 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 Q2 FY 2020 Earnings Conference. As a reminder, all participant lines will be in 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 "*" then "0" on your touchtone phone. Please note this conference is being recorded.

I now hand the conference over to Mr. Ankit Arora, Head – Investor Relations from Arvind Fashions Limited. Thank you and over to you, sir!

Ankit Arora Thank you. Hello, everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the second quarter ended and half year Sep 30th, 2019.

I am joined here today by Suresh – Managing Director and CEO and Pramod Gupta – Chief Financial Officer, Arvind Fashions Limited.

Please note that results, press release and earning 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 today by Suresh, who will share the key thoughts about our strategy and financial performance for the second quarter and half year ended 30th Sep, 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 as well. The company does not undertake to update these forward-looking statements publicly.

With that said, I would now turn the call over to Suresh to share his views.

Suresh J Good afternoon and thanks for being present in the earnings call. What I will do over the next few minutes is to take you through the highlights of Q2 performance and then leave the floor open for the questions.

To start with, we had declared at the beginning of the year, there are few things we wanted to focus on, in the current year. Number one is, in an environment of slowing economy and slowing consumption, I think the relentless focus on secondary sales and completely aligning our primary sales in line with secondary sales which in a way should set up Power brands for us continuous good growth with improved profitability and working capital efficiency. This along with a strong focus on working capital reduction across both inventory and debtors leading to cash generation and also, build a very sharp portfolio and exiting some of the brands, which have not yielded good results for us over a period of time.

What I would like you to do is to really view our performance in line with these priorities, we have set up for ourselves during the year. The first good news on quarter two is, Power brands performance has been quite satisfactory. Whatever corrections we had planned to take, we had sort of taken in quarter one and quarter two and three out of four Power brands have shown good progress. They are back to growth with overall double-digit EBITDA. One brand Arrow where we had exited the institutional channel and slightly longer correction with the long payment cycle customers, there is an impact on the Arrow performance. So, leaving alone Arrow, I think we had a good performance of Power brands in quarter two.

We had identified some growth categories where we already have some strong position and where we want to build number one or number two position. These categories we have done quite well. In premium kids wear we have grown at around 29%; innerwear at 45%; and footwear at 41%, all in the categories of the Power brands which we wanted to focus on. Coming to the second, the business group which we talk about the specialty retail, which comprises of Unlimited, GAP and Sephora, we again had a good performance in GAP and Sephora in a market which was sluggish. In Q2, both GAP and Sephora continue to grow very well and they remained profitable. And if you recall, these two brands again did grow very well with improved profitability in Q1 as well.

Unlimited, we are not fully satisfied with the performance for the quarter. But what is important is we have been able to contain the losses in Q2 FY 2020 very similar to Q2 FY 2019 level, in spite of the fact that we had incurred the closure cost of some of the stores which was not there in the base. But overall performance should have been much better.

Then moving on to the emerging brands, as you know that we had declared that four of the brands we will be exiting and out of that, we have exited two brands (GANT & Nautica) and we are in the process of transferring the business to a new partner. And all the exits will be completed in Q3 and among the rest of the emerging brands, Calvin Klein is doing exceedingly well, and I think it is showing signs of becoming one of our Power brands with excellent growth in a difficult market scenario, like-to-like growth of 15% plus.

On the rest of the brands, while the performance looks bad in terms of the higher losses than what it was in the base quarter, that has primarily happened because we took a very aggressive strategy of moving from retail oriented distribution to a wholesale and online oriented distribution, which has an impact on this quarter's profitability. But going forward, I think it is a move in the right direction, because we have closed almost 30 stores between the brands Aeropostale and Ed Hardy, which impacted this quarter's results, but going forward, we will have a much better return by this action. And also, we had done a one-time settlement for sharply bringing down the royalty commitment of couple of brands more specifically in the case of Aeropostale, where we have been able to sharply bring down the royalty for which we have to make a one-time settlement. So, this actually impacted the emerging brands profitability, which is good from the long-term performance of this part of the portfolio is concerned.

Now, coming to the categories where we have leadership or number two, in premium casual and denim which is our strong category where we are market leaders and also the largest segment in the apparel sector, we are back to growth in Q2 with 7% growth. Premium kidswear we have grown at 26%; innerwear at 56%; and prestige beauty at 21%. Good growth in all the categories where we are present, positions ourselves to take the leadership position.

In terms of distribution, we added 40 stores during the quarter. And one point to note is we have been substantially able to increase the distribution of innerwear multi brand stores to 13,000 plus stores.

Some of the other highlights of the quarter, our own online business, which is our website NNNow.com, we are scaling up quite well. And it has now started contributing 10% of the total online sales, which I think will give us a greater control over the online sales in terms of what we would like to do to reach the millennial consumers. We have taken multiple actions in terms of reducing our debtors specifically, the action of exiting long payment cycle customers and aligning primary sales to secondary sales. They started yielding results, while the reduction of Rs. 46 crores may appear small, but I think considering that this is a period we are entering into the festive, this reduction is significant and will also set the ball rolling for a further higher reduction of debtors as we go forward.

In the case of inventory, there has been a marginal increase largely due to lower sales in Q2 compared to the plan and the channel correction action we took in terms of the stock returns. Both of them impacted the inventory numbers. But again, we have a very strong action put in place to bring down the inventory levels by end of the year.

The next few charts actually do the financials. Probably, I will cover it more during the question and answer on the financials. And coming to a quarter three outlook, we are quite confident that our growth in Power brands specifically the three brands which has shown good growth trajectory in quarter two will continue to grow profitably. And in the case of Arrow, we expect that pain of one more quarter and normalcy both in terms of both growth and profitability to return back in Q4. All the exit of the identified emerging brands will be completed, we expect the emerging brand profitability to be impacted in quarter three, mainly because of the one-time settlement which I talked to you about on royalty and some of the store closure cost which will occur in quarter three. And we will have an improved performance in terms of reduction of inventory and further improvement in debtors position at the end of quarter three. And of course, our sales will completely be aligned to consumer offtake. So, that whatever corrections we have planned in channel stocks will be more or less get completed in Q3.

So, with this I conclude my presentation and leave it to you to ask me and Pramod any questions.

Moderator Thank you very much, sir. Ladies and gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Kunal Shah from Carnelian Capital. Please go ahead.

Kunal Shah The first question, I would like to ask more of a strategic question. When I read your annual report, on a sales of like almost Rs. 4,500 crores, we have got payables of Rs. 1,200 crores and a total borrowing of Rs. 824 crores. So, I mean, when you look at the business to generate Rs. 4,500 crores, which has got power brands, we need to have like almost Rs. 2,000 crores of borrowings in terms of payables and debt. So, what is the view of the management on this particular aspect of the balance sheet? And then, probably I will go ahead with other questions.

Moderator Thank you. Ladies and gentlemen, we will now begin with the Question-and-Answer Session. The first question is in the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah So, firstly, on this Arrow brand essentially, where does it stand now in terms of revenue? How much decline you have seen versus the FY 2019, if you can share some numbers? And what kind of damages is sort of permanent like you exited institutional business, which may not come back and so essentially, where do you see this brand in FY 2021?

Suresh J Anand, as you know we do not share specific brand numbers. But what I can tell you is that the corrections we have taken in Arrow, more or less will get completed in three quarters and we should be back to normal in quarter four. And what is permanent is going to be the institutional sales, which is around 10% to 12% of the brand sale. So, we will probably start with that 10% lower base. Other than that, we see absolutely no problem in the brand performance. And it should be back to its normal course because it is one of the second largest brand for us in terms of size and also in terms of profitability. I am sure that it will be back on course from quarter four.

Anand Shah But what kind of a dip it would have seen so far in H1? From your absolute numbers no but let us say what kind of decline you would have seen?

Suresh J Around you know 20% to 25% kind of a decline.

Anand Shah Including the institutional exit?

Suresh J Yes

Anand Shah Okay. So, from that base, essentially, we expect normalcy to return?

Suresh J I mean, actually if you really look at the performance on two retail channels both retail as well as department stores, brand has done very well. The entire drop is on account of the correction in the multi brand stores channel and the exiting of the institutional channel.

Anand Shah Okay. But you do see the off-take in terms of secondary in Arrow that continues to grow at a different pace?

Suresh J As far as these two channels are concerned, the brand has really now come back. And as far as department store is concerned, we are maintaining our market share. But our growth of department store has been little bit tepid during the year. So, that will have an impact on the brand as well. But there is no change in the market share position of Arrow, in fact it has only strengthened in the sports section. So, the way we are looking is around

25% kind of drop in the first three quarters and then things should start stabilizing from quarter four.

Anand Shah Okay. And the other three Power brand essentially, the realignment between primary and secondary, is that completely over now or post Q3?

Suresh J More or less complete, maybe a little bit in Q3, more in Flying Machine. Otherwise, we are through with that.

Anand Shah So, essentially from Q4 onwards, you should see both the entire Power brand portfolio back to growth?

Suresh J Yes, because we have actually grown in Q2 itself, in these brands and one very significant thing is the growth of Tommy Hilfiger as well, because the two brands Tommy and Calvin has shown very impressive growth, which is a good indicator that in the premiumization, these two brands are really benefiting.

Anand Shah Okay. And so when you say you have grown essentially then the Power brands portfolio, the decline we are seeing is largely because the Arrow is it?

Suresh J Completely because it is a large brand with 25% decline.

Anand Shah So, ex-Arrow, your Power brands portfolio would be positive even in Q2?

Suresh J Yes.

Anand Shah Okay. And this double-digit EBITDA you mentioned for three out of four Power brands that is margin?

Suresh J That is right, yes.

Anand Shah So, 6% margin in Power brands and double-digit ex of Arrow?

Suresh J Yes.

Anand Shah: Okay, perfect. And just on Unlimited what was the kind of store closures cost you have book this quarter and overall in H1 combined and is the store correction there done? How many stores you close there?

Suresh J So, here again we are not giving a separate cost. See, if you really look at it, around Rs. 20-25 crores kind of cost is what we have incurred in closure of stores and then liquidating some of the inventory with the closure stores.

Anand Shah And ex of the store closure cost and all would Unlimited losses have come down or they would be stagnant?

Suresh J It will come down Anand. What actually we had mentioned is, we have now trimmed the number of stores to the profitable stores. Still we have a few store to close, mainly which we will not close because of lease commitments. So, we have six more store to close, if you take aside those six stores, balance stores are all profitable. But having said that, with the balance stores you know we do not have the scale to cover some of the fixed costs. So, we are building a very strong online business as well in value. So, combination of this 80 profitable stores plus online is when we see the losses sharply coming down.

Anand Shah Okay. And lastly, why the rights issue of Rs. 300 crores? As far as I understand your capex was going to be limited and your capital requirement will be limited plus will get us working capital.

Pramod Gupta Anand basically, this is to just de-risk the balance sheet and manage the debt equity ratio because after the first-half losses and the IndAS 116, which also had an opening balances adjustment, our balance sheet ratios need to be corrected. And plus, there is a general slowdown while there is a very aggressive plan and making sure that we stick to our opening commitment of during the year releasing both debtors as well as inventory and that we still standby. But, there is a deterioration in debt-equity ratio on account of both the losses that have been incurred in the first-half as well as in due to IndAS 116 and when there is a general liquidity stress in the market, we felt that it is better to sort of de-risk the balance sheet than to you know leave it to the future.

Anand Shah But it will be more to balance of the debt to equity, otherwise you know between capex and cash flow from operations, you still have the positive number, right?

Pramod Gupta Yes. And it is rights issue and therefore it is anti-dilutive.

Moderator: Thank you. The next question is from the line of Vaishnavi Mandhaniya from Anand Rathi. Please go ahead.

Vaishnavi So, firstly, why are we exiting the institutional sales channel in Arow?

Suresh J See, we had I think mentioned in the last presentation as well. The institutional business is mainly business of the pharmaceutical company because Arrow used to be our favorite gift items given to the doctors. Now government has come with the regulation, saying you cannot give more than Rs. 500 worth of item to doctors. So, because of this regulation, they are not in a position to give Arrow shirt as a gift. So, we exited by choice to since the brand itself cannot be gifted for which the pharmaceutical companies used to buy Arrow shirts.

Vaishnavi Okay. And how many stores of Unlimited did we shut during the quarter?

Suresh J We had shut totally eight stores. Total 14 stores out of that eight was during the quarter.

Vaishnavi Okay. And last question, sir, basically the emerging brands losses which was supposed to come down in the second quarter because the exiting will be done. So, we will see losses coming in the second-half as well because of at least in the third quarter we will see because of the stores closure and the royalty payment that we are making?

Suresh J Yes that is what I had mentioned, because we have taken the call to completely de-risk the business. Typically, the retail business impacts the profitability. Now with the department stores and online, the brands will become profitable, but we will that one-time hit when you close stores and liquidate inventory of those stores. And also in Aeropostale case, we have made a very good reduction in our royalty commitments. So, because of that we need to put in a certain one-time payment. Both are good from the next longer -term point of view.

Moderator Thank you. The next question is from the line of Vinod Bansal from Franklin Templeton. Please go ahead.

Vinod Bansal Hi, Vinod here. Few questions. One, on the debt, the debt has increased from March to September quarter, could you first confirm the exact number of debt including the short term maturities that sit in current liabilities and why it has gone up?

Pramod Gupta Our short-term debt is really small; it is in the region of Rs. 30-40 crores. So, it is not a very large number.

Vinod Bansal So, including that if I may sir, what is the total debt today as of September 30th?

Pramod Gupta It will be you add another Rs. 45 crores.

Vinod Bansal Okay.

Suresh J In any case between March to September, there is always a seasonal increase in the debt that happens and therefore, if you see last year also our September debt was higher than the March because there is a seasonal festival season buy which has happened. And number two, this year in the first-half we have had cash losses that have added to the borrowing. That is the primary reason why the debts have gone up. But, we are standing by our commitment of reducing our both inventory and debtors as compared to our March ending position of 2019. So, therefore, they will be a reduction as we go along in the rest of the year.

Vinod Bansal Your pre-tax losses or post-tax losses is about Rs. 133 crores for the first-half?

Pramod Gupta Yes, but you have to look at the PBT and not PAT because since the PBT losses are higher, so that is adding to the deferred tax asset which is not a cash item.

Vinod Bansal Your pre-tax loss was Rs. 200 crores and your debt on 31st March was Rs. around 820 crores.

Suresh J So, that is why I am saying you need to compare it with the last year number of debt. And when you look at last year, then the increase is around Rs. 200.

Vinod Bansal Your pre-tax loss then will be Rs. 180 crores, okay, so it is mainly losses.

Suresh J Yes.

Vinod Bansal Okay. This rights issue of confirming that it is entirely, the moment you raise the money you will pay off the debt, it does not go to capex at all. So, your debt will go down by about Rs. 300 crores straightaway?

Suresh J Absolutely.

Vinod Bansal: Okay. And I presume the promoters would also be participating in the rights issue?

Suresh J Yes. Rights by nature is that and that is exactly why we went for rights issue.

Vinod Bansal: No, rights by nature include everyone but people have right to forgo their rights

Suresh J No, there is no question for them

Vinod Bansal: There was no talk of any rights issue till about three months back, I am still surprised, and we had foreseen that the losses would continue for at least couple of quarters and the slowdown will remain. So, nothing in the business that has happened is new or unforeseen to us. So, I am a little surprised by the decision to do rights now. Any comment on that?

Pramod Gupta See, as I had mentioned even in the while answering Anand basically there is a need to de-risk the balance sheet and the debt-equity ratio has deteriorated with the twin impacts of the first quarter the first half losses as well as the IndAS 116. So, therefore, it is important that, especially when there is an economic uncertainty, we sort of de-risk the balance sheet and just ensure that. I mean it is a good thing for the company that that you know we are de-risking balance sheet.

Vinod Bansal No, I agree. I am just a little curious because we have been in touch, there have been quarterly calls and this question ever came up to be recapitalizing the company. Are we saying that the last three months if not the first half has been worse than what we had anticipated when you set out on this target of course correcting our growth and profitability?

Suresh J In any case, yes, it is price sensitive information. So, probably we will only discuss when the decision is taken.

Vinod Bansal Right. Staying on the balance sheet your days have not improved at all in days of sales from 2Q versus 4Q last year and 2Q this year, despite us cutting our long lead MBO channel. Any update on that, why we have not seen improvement?

Suresh J You know that when you are constraining the channel, your sales tend to come down. So, therefore, even whatever substantive actions you take, you denominator itself is coming down because you are taking conscious action. So, I would at this point in time focus on the absolute reduction rather than the ratios at this point in time and in any case, as we further improve it in the in the rest of the year, hopefully then the number of days will go down. The other way to look at this time this has happened because we are really at the edge of the festival season. Like last year, the festival season was mid-November, I would say Diwali whereas this time as you know that, it is the last week of October. So, in spite of the fact that we have actually billed for the festival season, we have been actually able to reduce the debtors in absolute Rs. crores.

Vinod Bansal Reduce from which levels, sir, from March level or last September level?

Suresh J You have to always look at debtors from September to September because there is a seasonality involved because in March all the billing is lower whereas September is when billed for the season.

Moderator: Thank you. The next question is from the line of Sagar from Deep Finance. Please go ahead.

Sagar Just going with the earlier question this Y-o-Y debt reduction, debtor's reduction is also pretty miniscule from 1,000 to 980. So, could you answer that please?

Pramod Gupta I think Suresh has answered that and there is a seasonality involved and therefore, there is a reduction vis-à-vis last year, what we have focused on is that in terms of the quality of the debtors, in terms of ageing it has improved in terms of what was there in the bucket of more than 120-180 days. So, that has improved. Also like for example, Suresh mentioned that in case of Ed Hardy and Aeropostale, we are moving away from retail sales to more wholesale. So, all of these add to the debtors. So, therefore, I do understand that there is a context to the total number. But there is also an improvement in the ageing that we have been looking at and that the ageing has improved. And, and as we sort of improve the ageing as we go towards the end of the year, our absolute number of the debtors will go down further, comparative like-to-like period. So, net of seasonality we will have pretty good reduction in the debtors between now and the end of the year.

Sagar Okay. And I think Suresh mentioned on this, one-time settlement for Aeropostale for bringing on the royalty payments for future. So, was that booked in Q2 or will it be booked in Q3?

Pramod Gupta Across two quarters.

Sagar Okay. And how much is the quantum of that?

Suresh J It is around Rs. 7 crores.

Sagar Rs. 7 crores for Q2 or for both put together?

Suresh J Both put together.

Sagar Okay. So, Q2 would be slightly lower than Rs. 7 crores, right? Because then some part of the payment will flow through in Q3 then?

Suresh J No, it is 50:50.

Sagar Okay. And how much savings would that possibly bring us in future?

Suresh J I can tell you over the remaining period, we have brought down the royalty to the tune of 25% to the original level.

Sagar 25%?

Suresh J Yes, 25% compared to the original level of the agreement level of royalty.

Sagar So, the royalty is down by 75% then?

Suresh J That is right, yes.

Sagar Okay sure. And you mentioned, the store closures for of Ed Hardy and Aeropostale for Q2 was 13 stores, am I right?

Suresh J No, I said 30 stores.

Sagar And how much was the Unlimited loss? You mentioned some store closure costs of Rs. 20 crores - Rs. 25 crores but how much was the absolute loss of Unlimited?

Suresh J Absolute loss for quarter two is Rs. 19 crores what I mentioned was, the question which was asked was across two quarters, what was approximate loss on unlimited store closure which I indicated as Rs. 25 crores.

Sagar So, Rs. 19 crores, the quarterly EBITDA loss for Unlimited?

Suresh J That is right, Yes.

Sagar So, which was similar last year?

Suresh J It was similar last year and if you take first half we are at Rs. 30 crores out of Rs. 30 crores, Rs. 20-25 crores are the store closure loss across quarter one and quarter two.

Sagar Okay, Rs. 30 crores EBITDA loss for H1?

Suresh J That is right, Yes.

Sagar Okay. So, actually your specialty retail EBITDA loss for this quarter was about Rs. 20 odd crores, so, you are saying that GAP and Sephora were EBITDA breakeven?

Suresh J Yes, that is what we said, both in quarter one and quarter two they are breakeven.

Sagar Okay, I thought it was profitable.

Suresh J It is a marginal profit what we have said is, it will remain profitable, it is a marginal profit.

Moderator Thank you. The next question is from the line of Harish Bihani from ICICI Prudential. Please go ahead.

Harish Bihani Yes, hi Suresh. We had set out certain targets for losses, store closure, working capital at the beginning of the year. So, what has changed in terms of our targets?

Suresh J No, we have not made any changes, it remains the same Harish. See, we have the target we took to have around Rs. 200 crore reduction in inventory and debtors, we stand by to reach that number by end of the year and we are more or less in line with the brand losses number. The number which we had indicated is slightly more in the case of Arrow because of the various corrections. When we start taking the correction, we realized that the stock corrections at the channel level is more that we may have to do. But other than that, there is no difference between what we predicted at the beginning of the year and what we are ending up in first half.

Harish Bihani Okay. Unlimited, specifically post this quarter and all the store losses, in the last quarter presentation, we had indicated that post this quarter, we reach at least EBITDA breakeven at the store level or in terms of profit at the store level for most of the stores which will remain open. But in terms of the gap i.e. the overheads. What would that be which will still be a loss and will continue for the next couple of quarters still and we need to gain on the online sales?

Suresh J Yes, that is exactly what we had indicated that once we complete the closure of stores, the remaining stores will deliver a close to double-digit store EBITDA but that will not be adequate to cover the corporate costs. We also rationalized the corporate cost quite a bit. So, that the operating loss because of the corporate costs, also will come down.

Harish Bihani So, it will be a double-digit or how big will this be?

Suresh J See, you have an indication of first-half losses which is in spite of all the store closure. So, we will not be breakeven at the chain level. But our aim is that once we build the online business, we move towards a breakeven level.

Harish Bihani So, safe to assume, 2021 we will continue to have losses in this particular format?

Pramod Gupta Too early to talk about that. But directionally we are making improvement. But too early to say that we will reach breakeven in 2021 itself but this will not be a significant drag on the business that much we are sure.

Harish Bihani So, which other businesses, which other brands or format will be or drag in starting fourth quarter?

Suresh J Nothing, except Unlimited because in emerging bands also more or less we will be through with all the correction and other than that, Unlimited will be reduced level of drag.

Harish Bihani And other than Unlimited, we were trying to reduce cost in terms of overheads and any other costs overall at the company level. So, where are we in that journey and what could be the cost saving?

Suresh J No, I think we have taken significant action to reduce costs. So, most of the action in terms of absolute savings will start occurring from quarter four because some of the restructuring costs and all we are incurring in quarter three as well. But absolute reduction will happen from February onwards.

Harish Bihani Okay. Is there a ballpark number that you would want to assign?

Suresh J See, I can say in terms of the percentage around 20-25% kind of a cut in corporate cost.

Harish Bihani: 25%?

Suresh J Yes.

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

Maulik Patel On Arrow, the institutional business was around 10% - 12% of the Arrow revenue, if I am not wrong?

Suresh J Yes, Maulik.

Maulik Patel Yes. And now it is zero?

Suresh J Zero, Yes. It will be maybe 0.5% to 1%. But it has significantly come down. I mean, it is hardly anything now.

Maulik Patel And you mentioned that there was also a correction in multi brand outlet channel for the Arrow also, correct?

Suresh J Correct. Yes.

Maulik Patel So, that there was a growth in retail format and department store?

Suresh J Yes, in terms of the retail format growth, I was talking about the current quarter. So, current quarter there has been a growth. But Arrow's market share in a relative position has remained the same, which is an indicator that Arrow growth is in line with the department store growth.

Maulik Patel Okay, I got it. Within the other three Power brands, we have seen the growth rate has come down to probably low single-digit?

Suresh J See, I think we had indicated that you know, we are taking correction in terms of the channel stocks even in other brands. So, in spite of that, we have had a growth and top of the entire market situation, I am sure that you know you are well aware of. So, given a very difficult market situation and the correction we had planned in spite of that, we have been able to achieve the growth.

Maulik Patel Okay. And this margin which has come down to around 5% - 6% at overall Power brand level, that also look to be seen into the context of the decline in this institutional business entirely or there is more to that?

Suresh J No, actually I had indicated that one of the highlights of quarter two, the three Power brands back to growth and their EBITDA margin is overall double-digit. So, the drop in the margin of EBITDA is largely driven by Arrow.

Maulik Patel Okay, so from 12.5% to the 6% kind of a number is largely because of the Arrow 10% revenue is not there.

Suresh J Correct, yes.

Maulik Patel Okay. And on this rights issue, will Multiples, which is a private equity, which is a 10% holding will also participate?

Suresh J Yes.

Moderator: Thank you. We will move on with the next question that is from the line of Vinod Bansal from Franklin Templeton. Please go ahead.

Vinod Bansal Hi, sir, just one question remained there, I stick to balance sheet and on debtors. We have stopped billing to these long lead MBOs. Any payments that we are still pending from them or we have received all the money that was due to them let us say at the beginning of the year?

Suresh J No, as Pramod was mentioning, our ageing has substantially improved in the case of debtors. So, there is absolutely no problem in terms of getting the money back. It is our control.

Vinod Bansal No, I understand that, if I may repeat the question. What I meant is, let us say there was Rs. 100 crores we had towards certain MBOs whom we are not supplying anymore in the last six months or a part of it, that Rs. 100 crores, if that is, have we received the entire money or part of it. Some color on that would be useful.

Suresh J There is an absolute drop in debtors that is in spite of the fact that our online sales, which is also a credit sale also has gone up substantially. So, there is absolutely no bad issue as far as MBOs are concerned.

Vinod Bansal Anything outstanding?

Suresh J I mean what we were looking at was people who were late payer, we were not looking at people who are not paying. So, therefore, nothing that is remaining substantial on that account.

Vinod Bansal Okay. And sorry, if it is a very basic question pardon me on that. This whole booking of one-time fees that you pay to the brand for closing it, where do you book in the cost of goods sold or it comes in other opex items?

Suresh J Depending on the item. In the case of royalty settlement, we book that as a royalty item. So, for example, we close a store and then we are liquidating stocks, that will get booked under stocks.

Vinod Bansal This sharp gross margin contraction that we have seen last two quarters. Is it entirely because of these liquidation sales for the stores you are closing?

Suresh J Yes, largely liquidation.

Vinod Bansal The entire 600 bps worth impact you saying?

Suresh J Yes, correct.

Moderator Thank you. The next question is from the line of Manoj Baheti from Carnelian Capital. Please go ahead.

Manoj Baheti Hi, Suresh. I have couple of questions. First is like, just to take forward the question from previous participants. I am seeing that your debt level in the balance sheet has gone up vis-à-vis 31st March 2019, it has gone up by Rs. 300 crores. And if I look at like PBT plus depreciation, which is a non-cash cost, it is just Rs. 130 crores kind of cash loss. So, what explains the balance increase in debt?

Pramod Gupta As you can see, there is also certain amount of increase between inventory and debtors also, which is a seasonality related increase that happens and therefore, I think one way of looking at it is vis-à-vis March another way of looking at it is vis-à-vis the last year September and therefore, there is a seasonality involved and I agree that you should be looking at PBT minus depreciation, but also the other part of it is that you do have some CAPEX. So, it is not that a CAPEX is nil. So, so therefore, when you look at the seasonality related increase plus for the capex, that broadly explains the number.

Manoj Baheti What was the capex?

Pramod Gupta It was around Rs. 45 crores.

Manoj Baheti So, 130 plus 40 rest is explained by working capital increase. So, almost Rs. 130 crores working capital increase?

Pramod Gupta Yes. So, that is why I said you should be looking at it vis-à-vis the last year comparable number.

Manoj Baheti Okay. And what is the plan for debt reduction? Like if I see other than rights issue, from two years to three years' perspective, what is the plan for debt reduction?

Pramod Gupta Let us talk about this year itself. At the beginning of the year, we had talked about the fact that we will be taking down our year end position of inventory and debtors put together will be approximately Rs. 200 crore lower than the March 2019 number and we are still on track of that. And therefore, there that means the reasonably sharp reduction vis-à-vis the levels that we stand today and also, we are expecting that, the amount of cash losses we have had in the first-half you know, we will not have the same situation in the second-half. So, with a combination of reduced inventory and debtors and not burning the operating costs as much as we have ended up burning in the first half, the combination of the two will help us reach a significantly lower level of debt as compared to now.

Manoj Baheti Just to clarify Rs. 200 crore reduction compared to 31st March 2019, that is the target, right?

Pramod Gupta See, basically the way we look at it like that is we will reduce inventory and debtors. Now, whether that can I will use entirely to reduce the debt, or we will deploy some of it to reduce the creditors and get some operating benefits. That is our allocation call that we will take. But we will basically make sure that we make the cash available and then we can talk about how to utilize the cash.

Manoj Baheti Right, sir. Sir, I have one more question which is on 31st March balance sheet there is provision for refundable liability of Rs. 204 crores and it has gone up significantly vis-à-vis 31st March 2018. And in assets, current assets also there is a returnable assets of almost Rs. 230 crores. If you can explain that.

Pramod Gupta Yes, that is essentially our inventory that is lying with our SOR customer, sale or return customers under IndAS 115 which was implemented, you know last year. There is requirement to sort of treat your sales with third parties on a sale on return basis as returnable asset. And then that is what we had accounted for. I know it creates confusion in our balance sheet. So, we are discussing with the auditors whether we should continue with this accounting treatment or should just treat this as an inventory because for all practical purposes is in inventory form.

Manoj Baheti Exactly, so in fact if I take your inventory, it is it should be Rs. 986 crore plus to Rs. 229 crores?

Pramod Gupta We look at my inventory as both put together, we do not look at my inventory at Rs. 986 crores.

Manoj Baheti So, that means that if I compare inventory to cost of goods sold, it is almost one-year kind of inventory we are running?

Pramod Gupta Why do you say that?

Manoj Baheti So, if I see, vis-à-vis cost of goods sold.

Pramod Gupta That is 180 days.

Moderator Thank you. Ladies and gentlemen, that is the last question. I now have the conference over to Mr. Suresh for his closing comments.

Suresh J Thank you, everybody, for joining us on the call today. If you have any more questions, please feel free to reach out to Ankit. We look forward to speak with you again next quarter.

Moderator Thank you. Ladies and gentlemen, on behalf of Arvind Fashions Limited, that concludes this conference call. Thank you for joining with us and you may now disconnect your lines. Thank you.