Q3 FY2020 Earnings Call Transcript – Feb 11, 2020

CORPORATE PARTICIPANTS

- Kulin Lalbhai – Non-Executive Director
- 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 third quarter ended and nine months ended Dec 31st, 2019.

I am joined here today by Kulin Lalbhai – Non-Executive Director, J 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 Kulin, who will share the key thoughts about our strategy and financial performance for the third quarter and nine months ended 31st Dec, 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.

Kulin Lalbhai Thanks Ankit. We thank you for being on the call. I would like to start by taking you through the Q3 performance. While market conditions remain challenging we have been able to broadly execute on our plan of balancing primary sales with secondary sales for our power brands, scale up new categories and specialty retail operations and restructure the operations of unlimited and emerging brands. You would have noticed that power brands have a negative sales growth of 9%, actually the underlying secondary sales have been amongst the highest that we have seen in the last several quarters. We have had good traction in retail sales of our power brands with LTL of 7.6% and an overall growth of 10%. Power brand other than Arrow saw a marginal growth despite corrections in the primary billing channels.

However, we took a sharp correction in Arrow as we had indicated earlier in Q2, in the wholesale channels and institutional sales which led to the overall negative growth. We also saw strong sales in new categories like innerwear and footwear with 30%+ and 60%+ growth respectively. We opened 50 stores across the power brands and expect new store opening momentum to continue in the quarters to come. Our turnaround efforts in Arrow are showing promise and we have seen a sequential improvement in the overall profitability of power brands in Q3. Coming to specialty retail business, both Gap and Sephora are showing strong traction with an LTL of 8%+ and overall growth of greater than 25%. This has also led to good improvement in profitability. We continue to focus on restructuring our

Unlimited business. This includes shutting down unprofitable stores, correcting cost and improving our customer proposition.

Our emerging brands business is being completely moved to a secondary sales based model with strong cash flows and efficiency in capital employed. With this in mind, we have exited billing channels which have long lead time, renegotiated our royalty agreements and closed down unprofitable stores. This has led to one-time costs in Q3 and will also have some one-time cost in Q4, but at a lower level than Q3.

We have been able to significantly reduce working capital as compared to September 2019. Our inventory has reduced by 130 crores and there is a 20 crore in reduction in debtors as well. If we compare to December 2018 levels while inventory is higher by 100 crores as we have prepone our purchases for FY20 for an early season launch. There is a reduction of similar amount in receivables as our efforts to control sales in long lead time channels is yielding results.

We expect that we would further reduce the inventory and receivables by close to 150 crores compared to December quarter by March end. With a large part of the correction behind us, we look forward to a better Q4. For our power brands other than Arrow we expect to get close to double digit EBITDA and mid-single digit growth as our primary and secondary sales get aligned. We also expect a much better sequential performance in Arrow. Our new categories and Specialty Retail will continue their current momentum. Emerging brands losses are expected to come down from Q3 levels and we will complete all the restructuring of the emerging brand portfolio as we exit Q4. As we look towards the next year we are excited about the potential of our strong brand portfolio. Our strategy of focusing on key scalable brands will allow us to invest strongly behind high conviction bets and drive a high operating leverage and return on capital employed.

We expect to deliver high single to double digit growth in our power brands and also achieve close to a double digit EBITDA margin. We will continue to scale up new concepts like Sephora, Calvin Klein, innerwear and Gap and these businesses will drive strong revenue growth with a much improved bottom line. Having restructured Unlimited and our emerging brands portfolio, we expect losses from these segments to significantly reduce. As you are aware the company is raising 300 crores by way of rights issue. We expect SEBI approval within the next week and expect to launch the issue in early March. We are deeply focused on deleveraging with the capital infusion from the rights issue, improved profitability of our operations, significant improvement in our working capital and a range of other initiatives. We expect our overall debt to reduce by 40% to 50% in the next year. With this, let me end my opening remarks and open up the line for questions.

Moderator Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Sagar Parekh from Deep Finance. Please go ahead.

Sagar Parekh So firstly, can I have the debt numbers as of December 2019?

Kulin Lalbhai The debt is close to 1,200 crores. It's 1130 to be exact as we ended the December quarter.

Sagar Parekh So, the debt has not reduced sequentially in spite of 150 crore reduction sequentially in working capital?

Kulin Lalbhai Yes, for this quarter most of the release has gone towards also paying down creditors. We have been reducing our inwards, so you know the creditor amount has also gone down. As we further keep releasing cash and with gross creditors coming down, we expect to reduce our working capital of around 150 crores in Q4 and most of that also will go towards paying down our creditors, but once the proceeds from the rights issue will come next year and in Q1 we will see improvement in working capital that is when you will start seeing the debt come down.

Sagar Parekh So, when you say 40% to 50% lower debt for next year. So on is that on this current base of 1100 crores?

Kulin Lalbhai Yes, we are talking about a close to 500 crore reduction in debt.

Sagar Parekh So, 300 crores will come from rights and the remaining 200 will have to come from working capital

Kulin Lalbhai So, as we cut inwards and go through our plans of having better sell throughs, there is a little bit of lag impact and then it will start showing up. So, we are expecting that sort of impact to come from Q1 onwards.

Sagar Parekh And your power brands side, you think Arrow will continue to face challenges going forward or you think bulk of the challenges with respect to Arrow is over now?

Kulin Lalbhai We are actually very confident in Arrow's performance going forward. This was a onetime correction as we were balancing primary and second, but as we move on, we are seeing exciting growth in Arrow. There are multiple initiatives that the company has taken in Arrow. We have really upgraded and premiumized our product offerings. We are upgrading all our top 50 to 70 stores as we speak. A very exciting marketing campaign is going to break out in April and the whole correction of the billing channel is complete. So, we are expecting very strong performance in Arrow going forward. It has already sequentially improved in Q3 versus Q2 and Q4 will be much stronger than Q3 as well.

Sagar Parekh So next year, power brands can show double digit top line growth with what kind of margins can we expect in power brands?

Kulin Lalbhai We are expecting close to double digit EBITDA, but definitely double digit growth in power brands in the next fiscal.

Sagar Parekh And on Unlimited, how many stores are we at right now?

Kulin Lalbhai We have 80 continuing stores that we are going to have post the restructuring that we have gone through.

Sagar Parekh So, restructuring is completely over right in terms of store closure or still there is some?

Kulin Lalbhai There are some tail stores which are closing as we speak in Quarter 4 and we are scaling down our inventory also as we have shut down those stores. So, as we exit Q4 this will be complete.

Sagar Parekeh So, then those 80 stores will have what kind of I mean top line as well as margins at store level?

Kulin Lalbhai See our stable kind of continuing based of stores have just about a double digit store level EBITDA. So, the network which is remaining has that kind of margin profile.

Sagar Parekh But that will not be enough to bring the entire Unlimited in black, right?

Kulin Lalbhai So, we have significantly cut down the overhead cost level also in this format. So, our fixed cost have come down significantly and we are also expecting as our price value proposition improves. We are expecting LTL improvements to come in. So, we believe at the current scale of 80 stores itself is business can move towards breakeven, it can cover its cost.

Sagar Parekh And we were also talking about online channel for Unlimited. How has that progressed?

Kulin Lalbhai That is scaling up very well. We are selling online both through the market place model and through the outright sales model. We have reached strong growth where close to 200,000 units are sold every month. So, it is a run rate of almost 6 crores every month which we have already reached and we are expecting that to further improve next year.

Sagar Parekh This is only Unlimited right?

Kulin Lalbhai This is just Unlimited online.

Sagar Parekh And overall Unlimited in terms of top line how would it look like for FY20 base I mean just to get some sense on margins as well as overall topline how would you look at Unlimited for this year?

Kulin Lalbhai As we exit the year we will be close to 550 crore top line number.

Sagar Parekh And gross margin would be similar at around 40%-45%.

Kulin Lalbhai No, it is closer to 45%.

Sagar Parekh And double digit margins and then so FY21, can we expect Unlimited to be breakeven at EBITDA level or they will still be loss for Unlimited?

Kulin Lalbhai It would be significantly lower losses, but not completely towards breakeven because we are hoping to increase our investments on advertising for the next year. We have kind of been fine tuning the price value proposition and improving the product this year and we want to induce trials next year. So there will be a loss, but it will be substantially lower than this year.

Sagar Parekh So how much is the loss this year?

Kulin Lalbhai We actually do not get into that level of guidance, so we might not be able to share that number with you.

Sagar Parekh And lastly on the CAPEX side till now how much have we spent and what is the remaining amount on in Q4 and for FY21?

Kulin Lalbhai So far, we have kind of spent around 75 crores and we will be spending another 10 to 12 crores for the rest of the year.

Sagar Parekh And for next year?

Kulin Lalbhai Next year should not be very high, in fact it would be slightly lower than this year somewhere between 50 to 75 crores.

Moderator Thank you. The next question is from the line of Gaurav Jogani from Axis Capital. Please go ahead.

Gaurav Jogani Sir, my first question is with regards to the cost of depreciation and interest which has increased meaningfully Q-o-Q, so can you highlight the reason for this year?

Kulin Lalbhai On the depreciation side, because of IndAS we have had kind of a onetime higher depreciation because of life of certain assets. We are not expecting that to continue in the quarters to come. As far as interest cost is concerned Q3, Q4 would be a little elevated, but we are expecting it to correct from Q1 with the proceeds coming in and the working capital improvements of sequential improvements quarter-on-quarter kicking in. So, we are expecting that to materially change from Q1 onwards.

Gaurav Jogani Can you quantify the one-off impact in depreciation expense for this quarter?

Kulin Lalbhai It is around 11 crores.

Gaurav Jogani And sir with regards to the debt profile that you mentioned that is around 1,130 odd crores and you did your efforts was able to bring down that 150 odd crores in working capital, but then you used to pay off your creditors, so what could the profile look like at the end of March 2020?

Kulin Lalbhai As I mentioned the overall quantum of debt will remain similar in these two quarters while the net working capital came down. There were obviously cash losses in Q3, those losses will come down significantly moving forward. Secondly, we used that to retire creditors and with the lower inwards the overall creditors level has come down. So that is why in Q4 you would not see a meaningful reduction, but after that you will see a meaningful reduction.

Gaurav Jogani So, March 2020 can we expect the same like 1,200 crore odd debt to be there?

Kulin Lalbhai The rights issue will be completed as I had mentioned by March end so that will make a positive difference and then as I had mentioned we are aiming to mobilize another 200 crores from the business as the year progresses. So that is when you will see a meaningful change.

Gaurav Jogani So, if the rights issue say hypothetically goes by March end then it will be 300 crores plus the 200 crores you are saying by the inward mobilization or else it will be the same.

Kulin Lalbhai Correct 300 plus 200 we are expecting debt to go down by close to 500 crores next year.

Gaurav Jogani My next question is with regards to the power brands you mentioned in your opening remarks that ex-Arrow, the power brand saw marginal growth was that right?

Kulin Lalbhai Yes, that is right.

Gaurav Jogani But how is the overall because you had mentioned that it was a very good quarter with a very good secondary sales growth, how are you seeing the power brands going ahead in the seasons to come?

Kulin Lalbhai Let me just explain where this dichotomy is coming from. Actually, if we look at the customer offtake which is the sales for retail, key accounts and online. The actual sales to customer is double digit for our power brands. The impact of the lower billing in our wholesale channels is what is kind of creating this anomaly of an overall negative growth. What is changing in the quarters to come is that this negative impact is going away because it is a onetime correction where we are matching primary to secondary. So already in Q3 that impact is less than Q2 and in Q4 it will be significantly less than Q3. So that is when the primary growth or the number which you see the reported number will actually move towards the underlying number which is the customer offtake.

Gaurav Jogani Should not this be back to normal in Q4 because if I remember it correctly, we started this entire process from the Q4 last year?

Kulin Lalbhai It really started from Q1 and we had indicated to the market that it would continue in Q3 and the impact would be less which is why there is a sequential improvement and we had said, it will be much less in Q4 and we will be moving much closer to our historical average and that's why we are saying in Q4, we are expecting close to double digit EBITDA and mid-single digit growth (ex-Arrow). So you will see this kind of happening because

Arrow is not 100% coming back to the growth rate, but for all the other brands it is coming very close to historical rates by Q4.

Gaurav Jogani Sir, when you are saying double digit EBITDA you mean double digit EBITDA margin right?

Kulin Lalbhai Yes margins.

Gaurav Jogani So, you did mention that you have taken some steps in Arrow. You have also exited the institutional channel in Arrow as well, so now what are the new initiatives that you are taking that gives you the confidence that the brand will come back again?

Kulin Lalbhai See what I said, one, is that this whole wholesale channel correction is going away and the way the wholesale channel work is you take forward booking. So, we actually we have a very clear idea of where this channel will go six months before the numbers actually come into the P&L. So, based on the way there is a demand growth happening in wholesale and now that the correction is over, that big swing would happen in a channel like MBO channel. So that is one, which would be the main component of why the Arrow numbers would significantly swing. The second, is the efforts which we are doing in underlying health of the business which is the way we are upgrading products, stores and marketing where the initiatives are showing a lot of promise. So, based on you know one-time correction which is happening in MBO and these fundamental changes which we are doing in the brands, we are very confident of a very strong turnaround in Arrow.

Gaurav Jogani And sir, one last bit on the emerging brands piece. So, I do understand that you have actually exited the four brands that is Gant, Nautica, Elle, Izod. In this quarter also we have seen some corrections, so when do we expect this particular business to behave normal, I mean get on track basically?

Kulin Lalbhai So, as we exit Q4 we are expecting this on a fundamental basis, we are in efficient business which is not going to lose significant money at all and even Q4 the remaining corrections which are left would be completed in Q4 and the quantum of losses would be much lower than what you are seeing in Q3.

Gaurav Jogani Sir, can you highlight like what all correction is now remaining in Q4 in the emerging piece?

Kulin Lalbhai See the same themes are there. One, there are still inventory liquidation where we have been closing down stores. So, when you shut down stores there is old excess inventory which needs to be liquidated. So, there are losses because of that. Secondly, we have renegotiated our royalty so that we do not have very onerous growth required over the next tenure of all these brands and that required a onetime sort of payout in this particular year. So, as we exit this fiscal that entire restructuring would be over and because of this we would be left with largely now profitable stores and a secondary based wholesale business. So, because of that as we exit Q4 it should be a clean business which is not having unexpected sort of losses.

Gaurav Jogani So, sir if I understand it correct now, will the focus of this particular the emerging brands piece would more be a wholesale oriented and less of the stores?

Kulin Lalbhai Yes, so we have just shrunk down the retail. See the retail business is the one which had heavy capital requirements and it also can swing things significantly. So, to de-risk the business we had said that whatever online is there or whatever stores are there would be limited and we will run them efficiently and then the wholesale business is a capital efficient business which we are running on a pure secondary basis. So, with key accounts it is not the MBO kind of business, this is the way we run department stores which is completely on a secondary basis where whatever you will see is the customer sales and not any billing sales. So online and shop-in-shop is what we mean by the wholesale part of the strategy. So that is scaling up well for these brands.

Gaurav Jogani So, sir just one last bit on this the emerging brand bit. So you had mentioned earlier that you have negotiated the royalty and there was some payout, so can you please quantify the amount with regards to the additional cost that is coming for the royalty renegotiation?

Kulin Lalbhai We cannot get into that level of specificity, but what I can say is that bulk of the negatives you are seeing right now are one offs in the emerging portfolio.

Gaurav Jogani Sir, you had quantified the royalty negotiation in the last call and hence I wanted the number?

Kulin Lalbhai We can take it off line.

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

Manoj Baheti I have three questions. So first one, just wanted to understand like what is the reason for paying creditors like if the business was enjoying x number of credit days from our vendors, is it something like those creditors were supported by some kind of non-fund based limit from bank which we are now liquidating that is one. Secondly on the cash flow itself like you mentioned 500 crores kind of debt reduction over next year, 300 crores is coming from rights issue?

Kulin Lalbhai Sorry can you repeat the second question?

Manoj Baheti So you mentioned 500 crores kind of debt reduction over next year, 300 crores coming from right issue and 200 crores by way of working capital reduction, so my question is like when we are expecting like almost all the pain-points are getting done by Q4 and we are expecting good amount of grow double digit margins, so means I believe that the business will also start contributing in the cash flows from the cash profit, so we have not factored in that because right now also we are also factoring one timers only right issue and working capital correction. The sustainable part is the recurring cash flows from the business, so next year can we expect like some cash flows from the business also going to the debt reduction?

Kulin Lalbhai Sure, let me try and answer both your questions. The first you know what I mean about creditors is when you cut inwards. So, what we have been doing is we have really been sharpening the way we buy. So, we have had in most of our brands even though we are growing we have been focusing on increasing our full price sell throughs, which means that we are ordering less. When you order less, it means that the total creditors amount goes down. So usually that creditors come and funds the business, but when you cut your orders that goes down immediately while the cash generation from the new buys happens over the entire season. So that leads to an upfront anomaly, it cuts down the availability of creditor funds you have, that is what I was trying to explain.

Manoj Baheti So, inventory goes down and creditor goes down so both goes down?

Kulin Lalbhai You know both go down and then in negates but what would then happen is as the season progresses and your inventory start getting liquidated of that season that is when the cash flows, additional cash flows come which is what I was saying that in Q3 and Q4, that cut has come but the positive impact will come with a little bit of a lag. You are very right in saying that there is an expected significant amount of improvement expected in the profitability of the business next year and it will generate positive operating cash flows, but we are also expecting to grow in a healthy way so there will also be a healthy growth in net working capital, but net-net of all of that because of a better profitability and the new way that we are managing our inventory and our supply chain, we believe that the business will release that kind of cash between working capital and a better profitable business.

Manoj Baheti So just to elaborate it further, like means if all our incremental growth or EBITDA margin if it gets passed in the working capital, when the business will start generating cash flows for shareholders for like working capital reduction and rights issue it will be one time, but on a recurring basis despite of getting double digit margins and good sales growth, are we expecting some kind of cash flow release post working capital?

Kulin Lalbhai No that is not correct. I think the business is very close to reaching that sort of operating leverage where the incremental EBITDA will go and actually lead to free cash flows. Some of the decisions we have taken I think that free cash flow generation is much closer whether we are able to achieve it next year itself, if not definitely the year after because the overall scale and EBITDA of the business has reached a point where you know the cash generated will not all go into net working capital. It is just a question of reaching that mark and post that the business would be generating because per se you know our business is now quite a capex light business. We are talking about a 50 to 75 crore capex that is a very asset light kind of model. So, there is no reason we will not be able to kind of deliver on this. I think the challenge in the past has been that the receivable cycle and the inventory has been the overhang, but the level of focus with which we have attacked these you are seeing now the change in momentum on that and we believe that because of these initiatives that we can drive the business into a free cash flow generating business very soon.

Manoj Baheti So next year we can expect some kind of cash flows from the business if double digit margins and growth materialize?

Kulin Lalbhai So that is what I am saying we will be very close to that. Next year is that inflection point there is a real possibility we can tip over that as well where it would go into FCF, but we are very close to that point.

Manoj Baheti And secondly just wanted to understand you mentioned that on power brands in Q4 you are expecting double digit margins from around 6% kind of margins in Q3, just wanted to understand if you can give us a broad breakup like where this kind of margin improvement will come whether it will come from gross margin improvement or whether it will come out of cost cutting or whether it will come out of operating leverage, so just wanted to understand a broad level breakdown of journey from 6% to double digit margins?

Kulin Lalbhai One of the biggest impact is the Arrow turnaround because we have had a massive negative variance coming because of the MBO channel. So if I were to put it very simplistically, the biggest component is the impact of the primary to second billing going away in Q4. More so in Arrow, but even so in little bit in the other brands.

Manoj Baheti So mostly because of Arrow losses which might have been there in Q3?

Kulin Lalbhai The MBO channel is a high profitable channel. This is a channel where we have had the inventory corrections which took away the profitability and as we have reached Q4, we are hitting the fundamental underlying profitability of the MBO channel most seen in Arrow, but also slightly in the two other brands and fundamentally there is always operating leverage. So as that anomaly of MBO goes away, the underlying operating leverage improvement is also going to become visible across all the brands.

Manoj Baheti It is mainly on account of inventory correction which is mostly over in Q3?

Kulin Lalbhai: That is why you know we have had secondary and customer sales which has been healthy, but our net sales that you see have been negative and the EBITDA has gone away largely because of that trade channel correction and as we move out of this fiscal year that would be completely over.

Manoj Baheti Lastly, I have one more question like if you can quantify how much of your sales is on a returnable basis and also if you can give a brief overview on your innerwear business and how it is scaling up. How do you see this business shaping over next couple of years?

Kulin Lalbhai Out of our total business in the branded side retail accounts for close to 35% of the business and that is on a completely secondary basis which is whatever is sold is the customer sales. So, in that sense there is no receivable, it is only inventory and even our key accounts we operate on a secondary basis. The two channels where we operate on a primary billing basis are trade and online. Online is close to somewhere between 15% to 20% of the business and trade would be around 30% of the business. Now online again is a very real time business, where you have very high visibility. So, the business where we have had the problem of inventory returns has been the MBO channel where as a company we have put a lot of conscious efforts on managing the visibility of that channel. So today we have invested in technology and processes where we have full visibility and control now on the customer sale even in this channel and we have now matched the way we do primary billing based on the secondary offtake. So, all of that work has gone into now balancing out channel so that the whole business can be run on a secondary basis. I hope I have answered the first part of your question.

Manoj Baheti Only one thing if you can cover, in this that how much of our trade is represented by MBO?

Kulin Lalbhai Trade is MBO sorry I am using these two terms interchangeably.

Manoj Baheti Entire trade is MBO right?

Kulin Lalbhai Yes, we call it MBO.

Manoj Baheti And retail is all these like all these large format is true right?

Kulin Lalbhai So that is key accounts. There are four channels, one is retail which are all the standalone stores. Key accounts are all these department stores like Shoppers Stop etc., trade is the MBO channel and then we have online, so, these are the four main channels.

Manoj Baheti And key accounts must be another 15%, 20% done in this case right?

Kulin Lalbhai Yes, it is around 20% yes.

Manoj Baheti So now if you can touch upon my second question mainly on the innerwear category?

Kulin Lalbhai Yes. So, we are very excited about our innerwear business. As we entered the year we had around 7,500 points of sales, as we speak we have taken the distribution up to 13,500 points of sales and you know as we exit the year it will be 15,000 points of sale. We have been seeing very strong traction on US Polo. Even in this quarter, we have grown by 32%. If we actually look at the offtake at the customer end, it is even higher than this number. So fundamentally the brand is showing very good traction.

Historically the bulk of this business for us was the innerwear theme and not comfort wear. We re-launched our comfort wear just in Quarter 3 and the initial response of the re-launch comfort wear is strong. So, we are expecting the comfort wear part of the business to start scaling up very meaningfully, some of which will happen in Q4, but a lot large part of it will happen in the next year. So, I think we are very excited about the way US Polo is scaling up and of course, we have Calvin Klein as a niche business on the higher end side, but I think US Polo with the distribution of 15,000+ points of sale and a much stronger comfort wear line coming up, we are expecting that business to get a big leg up

Manoj Baheti Any numbers would you like to share at this point of time on innerwear business?

Kulin Lalbhai No, I mean as you know this year we have grown at more than a 30% rate and we are not giving a specific guidance for next year, but with comfort wear also coming in, we are expecting exciting growth in that business next year as well.

Manoj Baheti Already this must be 150 crore or 100 crores plus kind of category for you overall inner wear?

Kulin Lalbhai We per se are not giving brand wise very detailed revenue and bottom line so we prefer not to get into that level of specifics.

Moderator Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda Yes just a few questions. In Power Brands when we said that the reported decline is 9% and Arrow is the reason for decline, so some components on how and what pace will be other brands grow combine I do not want individual brand. To what extent Arrow declined is the question? And similarly what would have been the Arrow impact on margin, now you could give it for Quarter 3 or 9 months whatever is comfortable and similarly in Emerging Brands because we have discarded a few brands so the residual brands which is our focus brand and at what pace did they grow and what is the impact of those discarded brand on margin either on 9 month or Quarter 3 whatever you are comfortable with?

Kulin Lalbhai See on the power brands side other than Arrow, the growth was low single digit. So, arrow de-grew by close to 30% and that is more because there was a correction in that one channel, so it does not have to do anything on the fundamental off take in retail or any of those other channel. It is largely because of the trade channel correction that you saw in Arrow.

Pritesh Chheda This is 9 months or this you are referring to Quarter 3?

Kulin Lalbhai This is Quarter 3, but it is very similar for 9 months. In Q3, there has been a slight improvement over Q2, but around 30% de-growth is for the 9 months. Can you please repeat your question on the emerging brands?

Pritesh Chheda Similarly, the emerging brands, we have few brand discarded so adjusting for that brand discard, our focus brand within the emerging brand would have grown at what rate and what have been the impact of margin if any on those discarded brand which you have taken, any inventory write down or any royalty adjustment you can say?

Kulin Lalbhai So, the discontinued brands were written off in the first quarter so what you are seeing now does not have any impact of the discontinued brand. So, whatever you are seeing in the Emerging brands is for the remaining focus brands where you are seeing kind of scale down because we have exited billing channels completely in those brands. We are now completely secondary and we have shut down stores. So that would mean that once you are doing that, it would mean that there is a contraction. So, whatever you are seeing in that emerging brands numbers is the remaining brand and nothing to do with the discontinued brands.

Pritesh Chheda So, what is the growth rate of the focus brands within the emerging brands which is Calvin Klein, Ed Hardy and Aeropostale because on a YoY basis the impact of discontinued brand would continue right?

Kulin Lalbhai Again, let me just clarify whatever is discontinued is no longer in the Q2 or the Q3 we wrote if off in Q1 so whatever you are seeing now in the result of Q2 and Q3 are the remaining emerging brands. So, you know the growth rates are there in our reporting. So, they are also de-growing because we have been kind of scaling down retail and the billing channel which is why it is a strategy to de-grow up to Q4 till they are being restructured, but then you will see the growth coming in.

Pritesh Chheda Then couple of questions on the working capital and the capex side, so on a working capital side if you could guide us what would be the net working capital day reduction that we would see in FY21 because currently it is flat because whatever you reduced on inventory and debtor you paid down the creditor so there is no total net working capital reduction. Wwhat it would be next year?

Kulin Lalbhai See we are still closing the business plans of all our brands. So we may not be able to give a guidance on the full networking capital days. As we kind of get into the next quarter, we will possibly be able to share more light on it, but as we said that we believe still with the steps we have taken on our new way of buying and a tighter supply chains, we would be able to bring the days down even beyond what we exit the year at.

Pritesh Chheda And lastly on the capex side, when we are spending about 75 crores this year and 50 to 60 crores next year, is it that we are actually not getting into our own retail space addition and lot of the capex is now done by a franchisee or we are actually eying the online part of doing business and hence the capex numbers reduced and eventually it has to come back. Is that the reading or do you have any other comment?

Kulin Lalbhai So, you know as far as our brand business is concerned it has always been dominated by a franchise led expansion. So, if you look at power brands the majority of the stores open and when we open a lot of stores every year has been franchise investor led. Capex largely goes in what we call specialty retail. Within specialty retail a large chunk of our Capex has been going into Unlimited, but since Unlimited is still restructuring, next year strategy is to get throughput from the 80 stores which is why you will not see a large capex beyond Unlimited. There would be a Sephora and Gap where we have been largely doing the capex. Sephora is covered under the capex number which we are opening as many stores as we can get, the format is doing very well, but there is only a certain number of stores which can open in a year and for brands like Gap also we have now moved the expansion into franchise based expansion. The other reason why capex is coming down is we have had a very strong IT capex cycle especially last year and this year because we had rolled out some very large programs on the IT side those are also going away. So that is also helping reducing the overall capex requirements.

Pritesh Chheda But your aspiration, ambition on Unlimited, is it postponed, or you have changed your aspiration that you will not expand?

Kulin Lalbhai As I mentioned before, even with the 80 stores the idea would be if we can bring this business to breakeven. We have been working very hard to restructure the business, improve our customer proposition. So, the focus is more around how are we upgrading products, how are we running our stores better, how are we getting productivity before thinking about how are we multiplying. I mean that is we believe, the right strategy. We have started to see some improvement that the efforts we have done are paying off as our cost structure has significantly changed. So, the focus we are having for next year is to really get our proposition right, get the store level margins up and get the 80 store network to perform.

Moderator Thank you. The next question is from the line of Nidhi Agarwal from Sunidhi Securities. Please go ahead.

Nidhi Agarwal My first question is that are we done that losses except for Unlimited, do we expect more exceptional items?

Kulin Lalbhai So, as I mentioned in the Emerging brands side there would be one-off which are there which would be in Q4, they will be smaller than the number you are seeing in Q3.

Nidhi Agarwal Other than that, are we done?

Kulin Lalbhai Yes, so Unlimited we are expecting the losses to come down as I mentioned, Unlimited would not be possibly breakeven next year, but the losses would be lower, significantly lower.

Nidhi Agarwal And my second question is that we are also hearing that there is lot of inventory in the lot of channels, so we are expecting double digit growth on next year, so what is giving us this confidence of double digit growth?

Kulin Lalbhai I am not sure if I understand that how is the inventory linked to growth. So let me try and answer what are the growth drivers of this business. One clear growth driver obviously is network expansion and in Q3 also we opened almost 50 stores in power brands and we are also opening in Specialty retail. So, one factor or driver of growth is channel expansion. The other driver is category expansion and once again we have given some details to you, there are certain new categories which are growing very well for us like footwear, inner wear and kids wear. So that is the second major driver of growth and the third obviously every year is throughput which is what are we doing to get our LTLs up. There is significant effort happening behind that and you saw a good performance in Q3 as well. So, this business fundamentally has very strong growth drivers and nothing makes us feel less confident about that. In fact, our brands are in the sweet spot of being in the casual wear side where underlying demand is strong. I forget the fourth big driver which is online which continues to grow at a very rapid pace. So, I do not think there is a challenge at all for us in terms of growth drivers for the business.

Nidhi Agarwal But what about the margins because, since there is lot of inventory in the channel which would be sold at lot of discount, so how will you tackle that?

Kulin Lalbhai So, let me explain I do not think it is discounting in the channel which has had the impact in our margins. What has happened is that in certain channel we sell to the channel and we book the revenues and they sell onwards this is only for the MBO channel. Now what had happened for us is we had one time correction where we had more returns coming back from the channels. We have corrected that by putting much higher level of controls and visibility into the actual sale. Once that is now balanced, there will be no P&L or bottom line impact because of this issue going forward. The overall discounting levels of our brands have not gone up and that is not the reason why our bottom line has come down. It is this onetime billing correction where there was a revenue reversal which has hit our bottom line and as I mentioned as we exit Q4 that is over for all the power brands which is why the double digit growth would come back from next year.

Nidhi Agarwal And my last question, we are reading that in US there are more stores close than the new stores that are opened, so how do you see this trend in India?

Kulin Lalbhai Yes, so I do not think the US is a very good market to benchmark I will explain why. First of all, the density of stores by population is the highest in the US compared to any market in the world. What does that mean? It means that it is a very over saturated market and in the world of omni-channel where online and off line co-exist, you must never have over built offline so that is one of the reasons US has seen such a dramatic correction. The second is India is at very different juncture in the S curve where we are not even nearly saturated. I think a better comparison is China. If you look at China, most organized brand will be present in close to 800 to 1,000 cities. In India our power brands are still barely crossed the 250 city mark and you know we are now opening say for example even in one of our brand like a US Polo we would open 60, 70 new stores the large part of these are completely new market where we are opening, where our stores never existed. So, India has so much saturation to go that I do not think America is an example at all. India will develop like China which is an omni-channel world and omni-channel world is very different. So, for example what we are seeing in India is that our customers are first getting added to the brands due to online. So online is feeding our brand in new towns and then we are following up with a store. So, the great news for us is we are not overbuilt. We are growing up in an omni-channel world, we can use online to see the brands and then go and saturate the market in offline. So, you should not be caught in an overbuilt scenario because of the way India is developing as a market.

Nidhi Agarwal And the last question is advertising how much was the expense this quarter?

Kulin Lalbhai See we tend to have our advertising at close to 4% of 5% of our net sales. So that broadly where it has been.

Nidhi Agarwal So, will it change with increase in contribution of online sales?

Kulin Lalbhai No, the way advertising is being done is changing significantly which means the channels are changing. You are spending a lot more on digital and not on offline, but there would not be a substantial change in the percentage marketing as a percentage of revenue, the way you will spend it will change.

Moderator Thank you. Ladies and Gentlemen, that was the last question. On behalf of Arvind Fashions Limited that concludes today’s call. Thank you all for joining us and you may now disconnect your lines.