Q4 FY2020 Earnings Call Transcript – July 9, 2020

CORPORATE PARTICIPANTS

- Kulin Lalbhai – Non-Executive Director
- Suresh J – Managing Director & CEO
- Pramod Gupta – Chief Financial Officer
- Ankit Arora – Head, Investor Relations and Treasury

Moderator Ladies and gentlemen, good day and welcome to Arvind Fashions Limited Q4 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 and Treasury from Arvind Fashions Limited. Thank you and over to you, sir!

Ankit Arora Thanks Bikram. Hello, everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the fourth quarter and full year ended March 31st, 2020.

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 fourth quarter and full year ended 31st Mar, 2020. 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 Kulin to share his views.

Kulin Lalbhai: Thanks Ankit. A very good evening to you all. I'm happy to be here with you to take you through our Quarter 4 earnings, details around Flipkart strategic investment in Flying Machine, as well as an overall update on the state of the business.

Let me begin with the strategic partnership with Flipkart; the company is extremely happy to announce the strategic partnership with Flipkart Group for the youth brand Flying Machine. This is a very exciting partnership which brings together AFL strength in building aspirational brand with Flipkart strength in the digital space. Flying Machine is already one of India's leading denim brands with a large share of revenues coming from the online channel but through the Flipkart partnership, Flying Machine's dominant position online will further get cemented and we will be able to build an exciting digital first youth brand, which will not only scale up rapidly in the online space but will also build a strong offline presence. India's youth is now increasingly spending time and money in the online space. This strategic relationship will allow us to leverage Flipkart's reach and deep understanding of customer preferences to position Flying Machine as a preferred brand for young India. With this partnership we hope to significantly accelerate Flying Machine's journey towards becoming of 1000+ crores brand at the net sales value. As a part of this transaction Flipkart will invest 260 crores in Arvind Youth Brands Limited which is a 100% subsidiary of AFL, for a significant minority stake.

Moving on, as is the case with all businesses COVID has had a deep impact on the branded apparel business in the short-term as well as how the market is likely to evolve in the medium term. I would like to touch upon the following on the call today;

1. A brief update on our performance pre-COVID.

2. How the company is handling the challenges of operating new in this reality where I will talk about cost, revenue management and inventory management?

3. How we intend to manage our cash flows and liquidity through the COVID crisis?

4. How we see the business evolving in the medium term?

Let me start with the first; starting with the Q4 results, we were largely on track to achieve our Q4 target before COVID impacted the business. This impact started around the first week of March. The business lost a top line of 300 crores in March due to COVID and that impacted our Q4 EBITDA by 135 crores. Before March, our power brands had delivered us 7% like for like growth in the month of January and February and if it weren't for COVID, if we normalize for the COVID impact, we would have delivered a double digit EBITDA in power brands. Our Unlimited business and emerging brands completed cost restructuring exercise last year and exited from unprofitable stores and channels. This allowed us to reduce capital employed in these businesses by 150 crores last year. With the completion of this cost exercise, we have significantly de-risked this part of the portfolio and set it up for lower capital requirement and cash burn in the future. Our category expansion into innerwear, footwear, kids-wear and beauty is on track and will continue to be a strong growth driver for the company in the years to come.

Moving forward we will focus our energy and investments behind seven winning propositions, U.S. Polo, Arrow, Flying Machine, Tommy Hilfiger, Calvin Klein, Sephora and Gap and ensure that the capital employed and cash burn in the rest of the portfolio is minimized. Since the lockdown was announced, the company has been working overtime to minimize cash losses by drastically cutting down on costs, restarting the business effectively, managing the inventory position and strengthening the liquidity position of the company. In the two months of the lockdown when the company was not able to register any sales, the fixed costs were brought down to 35% of earlier levels by cutting down on all expenses. For the rest of the year moving forward from June, our fixed costs have been brought down by 40% from last year's level. This will allow the business to achieve cash breakeven even at 65% of last year sales. This large reduction in fixed cost has come from rental renegotiation, reducing headcount and operating costs, restructuring our warehousing and supply chain cost and significantly reducing overheads. While some of these cost reductions will be limited to FY21, we expect a structural cost reduction of 120 to 150 crores which will be permanent in nature moving forward.

We have taken all precautions to restart our operations safely keeping the health of our employees and the safety of our customers as the topmost priority. The company has been quick to restart the business was the lockdown has come to an end. We have opened 800 out of our around 1300 standalone stores while high-street stores have reached 60% to 65% of pre-COVID level, malls continue to underperform with 15% to 20% of pre-COVID sales. Department stores sales are currently mirroring that of mall stores while multi-brand outlets are tracking a little lower than the high-street stores. The online channel has performed extremely well for us where we are already at 1.2 times June'19 numbers, with a 3 times growth in NNOW.com and marketplace business. At an overall level for the business, we have reached 30% of our normalized monthly sales run rate. The company has also adapted its product offering to mirror the current requirement. We are seeing a much higher demand for casual clothing with a specific focus on T-shirt, Polos, Comfort Wear, Easies which is a part of footwear and work from home clothing. Since the company's brand portfolio is dominant in the casual space, we have over indexed these categories for the next few quarters and hope to gain market share for the same. We have also launched reusable masks in U.S. Polo and Flying Machine which have been received very well by the market.

Our inventory position has been impacted by extremely low sales since March. Since a large portion of our SS20 inventory was not exposed to the market and is not seasonal in nature, we have repurposed the large portion of the inventory to be launched in Autumn-Winter 20 season. With this repurposing we have been able to cut our autumn-winter buy by 60%. We have also brought in flexibility to vary our buys by 20% within the season. Through deep cuts in inventory for autumn-winter and flexibility in our supply chain we hope to end the year with lower inventory than our March end position. The company has experienced cash losses in FY20 due to restructuring of the business and now due to the COVID crisis, the company will see further cash losses in the current fiscal. In order to strengthen the balance sheet of the company, the board had decided to increase the size of the rights issue from 300 crores to 400 crores. With the cash infusion of 660 crores into the Company through the increased rights issue and the formation of the strategic partnership with Flipkart, the company will be able to reduce debt levels by a couple of hundred crores as well as fund the cash burn for this year. Purchases of inventory for SS20 and the cash burn due to COVID has resulted in a stretch creditor by a few hundred crores but with this infusion taking place, we expect to regularize the creditors. In addition the control over further purchases for autumn-winter season will reduce inventory levels and release cash. With a large non-debt fund infusion and strong control on costs and inventory we are confident that the company will be able to navigate this challenging period.

While there is quite a bit of uncertainty in the short term due to COVID, we believe that the company is well-positioned for the future. With the market seeing a significant skew towards casual wear post-COVID, strong brands in the casual space will benefit in the medium term which will give Arvind Fashions an opportunity to gain market share. With Sephora the company can take advantage of the increase in demand for beauty brand as do-it-yourself makeup will gain traction. AFL is also well positioned to take advantage of the new normal work from home culture with its comfort wear and home footwear range. The early investment in technology is helping the company rapidly scale up NNOW.com and the marketplace sales which are now at 3X levels of pre-COVID. Post opening, fulfillment of digital sales is contributing to more than 20% of our overall store revenues. We have also introduced new digital capabilities in our store like shop the store from home, home delivery, kerb side pick-up and shopping by appointment. Our brands have a strong position on third-party online platforms which will benefit the company as more sales pivot towards the digital channel. Our strategic alignment with Flipkart will enable a significant scale up of Flying Machine.

With all of this, the company is ready for a step change in the scale of its own dot com an omni-channel initiative and a strong double-digit growth in overall online revenues for the years to come. AFL's early entry into small towns will become an advantage as small town markets are less impacted by COVID. With the small town expansion story intact, the company plans to start store expansion at the appropriate time. COVID is likely to change the competitive dynamics of the apparel business and stronger brands are likely to gain market share. With seven large aspirational brands which will be the focus area for scale up over the next few years we expect a significant improvement in operating leverage and cash flows for the business. With this let me end my opening comments and open it up for questions.

Moderator: Thank you very much sir. Ladies and gentleman, we will now begin the question and answer session. We have a first question from the line of Manoj Baheti from Carnelian Capital.

Manoj Baheti: If you can help me understand how you are seeing cash flows during FY21, like around 660 crores kind of inflows you are getting and you also mentioned that the debt reduction will be couple of hundred crores, so balance 400 crores cash flow, do you think it will go mainly for the loss funding, for reduction in operating creditors? So that is my first question, I will comeback with second question.

Kulin Lalbhai: Yes, so as I mentioned a couple of hundred crores will go towards debt reduction and the rest will go to fund the cash losses and normalize the creditors. As I have also mentioned we have brought insignificant controls on costs, so that will also help us manage the overall cash loss for the year.

Manoj Baheti: Out of this 400 crores it will be mainly towards cash losses or it will reduce operating creditors also because I believe we have like almost 1000-1200 crores of operating creditors also in our balance sheet, right?

Kulin Lalbhai: So I will explain, see what happened is in the first part of the year we had a SS20 season which we had fully bought before COVID and then the first few months have been the highest COVID losses and the business was shut down. So because of the combination of these two things there was a stretch creditor which got created. At the same time we have a stretch receivable because we also did not receive any cash from the market. Now the good news is that as the business is opening up the receivables are also coming in and now with the infusion coming in, we will be able to normalize the creditors and manage whatever is the cash loss for the year along with that we believe we'll be able to bring down the debt by few hundred crores.

Manoj Baheti: Secondly, are you disclosing that what is the percentage of stake which Flipkart is going to get; you mentioned it is like significant minority stake?

Kulin Lalbhai: Yes we don't be able to share any information beyond that. It's a significant minority stake in the Flying Machine.

Manoj Baheti: Just one more question, it is slightly longer-term like once we are back to normalized business situation, how do you see our Sephora brand as well as innerwear category emerging over next 2 to 3 years?

Kulin Lalbhai: I think Sephora is a very-very exciting business for us. Even last year it saw not only rapid growth but very strong like-for-like sales and therefore a much better profitability and we have started the online journey also a year back in Sephora where we have started scaling up and post COVID we are seeing a very-very high jump in the online sales which shows that the brand pull is very high. So we do believe this brand will move towards the 500 crores mark not only through store expansion and productivity increase of stores but also with a step change in the online business, because we believe beauty as a category online is set for an explosion and prestige beauty which is the higher price points are now seeing more and more traction. So I think the future strategy for us in Sephora is not only continuing the store expansion we have been opening anywhere between 8 to 10 stores a year but also really doubling down on the online opportunity which is looking very exciting. Innerwear also last year was a great year for where we not only expand reach but we also re-launched our comfort wear and we believe comfort wear will be a very-very large part of the overall innerwear opportunity for us in U.S. Polo and as the market open up we are seeing that essentials are actually doing very well. Online has dramatically grown on the essential side both for comfort wear and innerwear and even the MBO channel is slowly coming back to life. So whilst there is a short-term impact of COVID on all the off-line part of the business, we believe the innerwear since it's an essential product should bounce back faster.

Moderator: We have next question from the line of Tejas Shah from Spark Capital Advisors.

Tejas Shah: Just one question from my side, in this environment when everybody is actually fearful at least in the urban centers, fearful of the COVID and trial based purchases are actually taking hit across categories. So, wherever we have opened stores what is our reading on the same our consumers taking risk of getting into trial rooms or it is largely as you said that very standard purchases like innerwear are going right away and other things are not happening?

Kulin Lalbhai: Tejas, let me try and add a little flavor to this generic statement that off-line is under pressure; now if you really try and de-average this, we are seeing a change in the way the consumer is behaving in different channels. So for example, for standalone stores, consumers are perceiving standalone stores as being safer, so very quickly we got our standalone stores coming back to 60%-65% sales level whilst malls opened one entire month after high streets and we have only had 3-4 weeks of trading. But we are seeing that malls are taking a lot longer because possibly the perception of risk is higher. So, in MBOs and standalone stores, the customers are coming back quicker than in large format department stores and malls and in online, we are seeing that not only has the overall sale gone up but there is a change in also the mix where a lot of organic traffic is coming which means there is paid and organic traffic in online, lot of organic traffic is coming online which means that there are people possibly who have the need or want or desire to buy clothing and they are choosing online, proactively going online to search for the brands they love. So that again points towards perception of safety. Now coming to the product side again, there is a lot of nuance. There are some categories which are seeing a lot of weakness. So if you look at formal wear, it is much weaker today significantly weaker than casual wear and within casual wear also there is a nuance, so India has always been a very shirt intensive market, we call it woven. What we are seeing for the first time is that T-shirts and Polos which is round-neck T-shirts and Polos are significantly in volumes going above that of woven. So even within casual because people are working from home and people are not having to go to office, I think the knit wear and the real comfort wear is really growing. So what we are also doing is we are adapting our offering and because we are already very-very strong in the Polo and graphic tee and comfort wear category, we are going to double down on that and scale up. So we believe the perception of risk will keep changing but it is important as the company to focus on the channels where the customer's perception of risk is lower and the categories where the demand for the product is higher.

Tejas Shah: What is the path ahead for Unlimited from here?

Kulin Lalbhai: So, in Unlimited what we had done last year and shared with you that we had exited ourselves from the unviable part of the business and focused with 70 stores in the three states where the business is doing very well where it has a higher recall. So what we have done is two things, one with the onset of COVID we have taken a very big lens we have put on cost and we have succeeded in dramatically restructuring the cost of Unlimited where the fixed costs are coming down by as high as 30%. The other thing which we have been able to do in Unlimited which we in fact did last year is that we have moved from a seasonal purchase to every two months we look at what is required, and we purchase. So its dramatically increase the flexibility of our supply chain and removed the perennial issue which we had where we would have inventory building up and in fact even in Q4 we saw this new inventory strategy is really successful in release in capital. So even though you have COVID where the sales are at 40% of where it was before, we have seen that with the cost control which we have put in, the overall burn of unlimited will be very significantly reduced compared to last year and secondly, because we will release cash from inventory, we actually hope that unlimited for the year will be cash neutral even though there will be cash losses, the releases cash from inventory should neutralize that. So that is kind of the plan with which we are going ahead in Unlimited.

Moderator: We have next question from the line of Nihal Jham from Edelweiss Financial Services.

Nihal Jham: Kulin, my first question was if you could just elaborate that when the Flipkart deal has happened, specifically why have we only chosen Flying Machine and why have some of the other power brands not been considered as a part of the minority investment?

Kulin Lalbhai: Even a few quarters back and even pre-COVID, the thought was that we want to really energize and scale up Flying Machine because what has happened over the last 2-3 years is we have been able to position Flying Machine in a very-very interesting sweet spot, where it is being perceived as a very-very cool young brand and it is the brand in our portfolio which has by far the highest percentage of its sales from online. Since, it is mirroring the place where the youth purchase. So, as a strategy also in our group it has been built billed as a digital first kind of strategy. So when we decided to scale up Flying Machine and getting investments to scale it up, we were very clear that we want to get a strategic investor and even within that for us our relationship with Flipkart Group is very deep. In fact Flying Machine performs extremely well on both the quarters already, so in a sense it was a very-very natural fit that if we want to create a very-very disruptive business model. What are we trying to do with FM – it is not just that because your partner scale will come – we want to run this business very differently because in the future I think brand can behave very-very differently in the digital world where data and insight can be used to really micro-target customers and then create products that customers want. So, the vision behind this partnership is that if we can really start working very differently where all this rich customers data and insight is mined and then we create a very disruptive supply chain to become very flexible in providing the customers with what the customers want real-time, then we will end up creating a very futuristic different sort of business and that is the hope or the ambition with Flying Machine.

Nihal Jham: Absolutely, just a specific thought I was having when I look at seven brands or specifically the power brands. U.S. Polo is definitely the most well known brand in our portfolio. As you have highlighted earlier also, has among the best return ratios and it has a casual wear focus portfolio. So would a tieup there have helped us get a higher infusion and also drive the growth of that brand which is already well-known and successful even more?

Kulin Lalbhai: U.S. Polo is already a very successful brand online. U.S. Polo is also a much broader brand where it is straddling youth, middle-age and even right up to age of 40-45. So we're intending to broad-base it and make it kind of available across channels in a balanced way, so its growth strategies are little different but even if you look at within U.S. Polo there are categories where we are working in a very disruptive way to grow online. So for example, footwear in U.S. Polo has been a huge success and more than 60% of our growth in footwear in U.S. Polo is coming from the online channel. So when we thought of creating this idea of a disruptive new digital first brand, currently we as a board felt that Flying Machine is a very-very good candidate and that's why we chose Flying Machine as a platform.

Nihal Jham: The second question was that Arvind Fashion has been a company which has been casual wear focused and as you mentioned also post-COVID this trend has definitely increased currently till work from home continues. What I want your thoughts on is that do you structurally believe that formal wear as a category growth rate has stunted or it will de-grow and if that is the case then do you want to then reposition your collection in Arrow going forward?

Kulin Lalbhai: I don't think formal wear will ever go away but formal wear is changing and if you really look at even other formal wear brands, they are kind of re-positioning or using dress-up casual as a growth driver. So for us also we have significantly repositioned or changed the product profile and the look and feel of Arrow Sport. What we have also done which we feel is a very exciting future ready strategy, we used to say that formals also need to become cool, neo-formals or formals for the youth is different from classical formal and that's why we have positioned Arrow New York which is another sub-brand of Arrow to go up to go after the young, digitally native professional in the late 20s. So even that product range was completely re-ideated and re-launched towards the end of last year. So with these two kind of things in mind we believe that Arrow has enough growth drivers and I am not a believer that formal will go away. It is going to be definitely—it's already—a very large market but we have to reinvent formals.

Nihal Jham: When you speak of NNOW.com obviously earlier when it was a part of Arvind, we knew that initially the setup involved certain expenses to put website up and going. Currently is there a burn that happens in operating this website or its breakeven?

Kulin Lalbhai: No the margin model of the business has significantly improved, so there is no burn. In fact in moving forward we want to build an exciting high-growth and profitable business with NNOW.com, so it's not a burn anymore for the business.

Moderator: We have next question from the line of Ayaz Motiwala from Nivalis Partners.

Ayaz Motiwala: I have two questions from my side; one is you highlighted upon certain facts on mall base and large-format retailers not scaling up as well as standalone stores or MBOs in your opening comments and you also talked about the cost control and rental was one aspect of it. So my question to you is, is this going to transform the way retailing is done, are we going to see malls are being replaced by the online channel over time and is this the way forward from a company like Arvind which is very forward-looking and does things at the cutting edge?

Kulin Lalbhai: Yes, first of all I would like to just call out that it has been four weeks since malls have been opened up. I would not go as far to kind of write an obituary to anything. It's very difficult to predict how things will progress because we don't know how we will be able to bring this disease under control. Just some statistics to share with all of you; China which has brought COVID under control is actually now positively comping on apparel as a category. Europe which has brought COVID under some level of control has almost got lifestyle back to 80% of original level. So the category does bounce back, of course the caveat is that the disease has to be brought under control. So I think the next 6 months are uncertain because we don't know how COVID would pan out. I think malls globally have also reinvented themselves because they are now less about just shopping but they are experience centers and human beings are going to continue to yearn for experiences. So any well executed physical retail which is experiential is here to stay, densities of off-line retail may change over time. So in the past if a city like Delhi required 30 stores, in the future it might require 15 stores with omni-channel built on top. Now almost 20% of our store revenue is actually fulfilling online demand, so the world is changing but I don't think any particular format necessarily has to completely go away. We will have to see what will be the channel mix 5 years from now, COVID has actually accelerated the trends which were there which is increased digitization but it doesn't mean that digital will replace experiential retail which is what a great mall provides.

Ayaz Motiwala: And so as a side question, would you say that in terms of your plans on store opening which you have on a constant basis, is that going to be re-looked at and malls that are already being revisited as a part of the cost control program which is my second question following but how will you evaluate?

Kulin Lalbhai: Yes,, so what we had already started last year as a retail strategy is to say that in urban India we want to invest behind very aspirational and experiential retail that is why we upgraded a lot of our stores and if you look at Quarter 3 and Quarter 4 for us in Power brand, we got our like for like sales back up to 7%+ and that is the focus that in urban India one should go for iconic, very experiential retail whilst parallely we have been expanding the network more in Tier II, Tier III where we believe there is a lot of room still for expanding the retail. So in urban India we are going for experience and maybe in fact the number of store count will come down but the opposite is the case in Tier II, Tier III, Tier IV where we expect the whole expansion story to continue for a very long time to come. Because of COVID what might happen is some of the long tail stores which were borderline profitable or were unprofitable possibly shutting them down would become a little accelerated, so as a part of our structural cost reduction, we have taken a call to shut down another set of stores post-COVID. So I think that's the only thing which is changed in COVID which we are taking a little harder view and anything which is on the borderline or not making sense from a profitability perspective in retail we would shut it down.

Ayaz Motiwala: Can you elaborate on the second part of the cost control; you said about 120 to 150 crores would be a structural reduction in the cost base with the combination of rental reduction, store closures etc., can you just elaborate a bit more on the efforts being taken by your company on that front?

Kulin Lalbhai: One thing we have done is, we are trying to make our overall business more efficient, so we have seen a 20% reduction in our headcount in head office and that has come from a combination of, of course we exited some businesses last year which allowed us to restructure and we have brought in a higher level of automation in the business which has again helped us to become much more leaner, so when we were faced with the COVID issue we were able to really do a lot of soul searching on this and become very lean. So one piece is around headcount, the other piece is around the store network, so there are two pieces to this. One piece is as I mentioned there was a cohort still of stores which was adding a negative contribution, so now in a normal market you always feel that with some amount of focus and investment you will be able to turn around that that cohort. We have been able to now take a decision to close those stores and that also is a structural saving because it will make also the whole working capital model better if the store network is a little healthier. And lastly store opex also is a big item in businesses like us, so we have really revisited our whole playbook in terms of how to really tighten store expenses and there also we are expecting a 10% reduction. And lastly on supply chain, we have already started a project last year where we were consolidating our entire warehouse base and making it much more automated and best in class and that also will bring in a significant saving. Luckily we had started that project three quarters back and we will get the benefit of it moving forward. So with all of this, this is a very critical piece which is we want to bring a cost reset which is not just for this year. This year's cost reduction is more here and now, re-negotiating rentals and this and that. Some of that would come back next year but what we are talking about the 120 to 150 crores is cost which has gone away from the system.

Ayaz Motiwala: Just to clarify, I may have heard it wrong, so I want to take the right note down. You said fixed costs are brought down by 35% or brought down to 35%?

Kulin Lalbhai: No, brought down by 35%.

Ayaz Motiwala: And then you said currently to 40%?

Kulin Lalbhai: Correct. So I will explain, when we were in complete lockdown those two months, we actually brought cost down to 35% of original fixed cost. Moving forward from June we will be at 65% of the original fixed cost and once COVID goes away because of the structural fixes we will be at 85% from next year of original cost, so that's kind of the clarification of that.

Ayaz Motiwala: And you said you are now running at 40% and you said you can breakeven at 65% of the last year sales probably?

Kulin Lalbhai: Yes.

Ayaz Motiwala: So just this linkage to 65 seem to be some magical number 65%-70%; listening into some of your mall owners and their conference calls, it sounds like they not promising but they think that you can get to that sales volume number at which their old agreements kick in or as such. So like you remodel your whole cost structure to breakeven at lower levels of 65%-70%, what does it do to rentals in that context? Does it get linked to sales at a lower level or how does that happen going forward?

Kulin Lalbhai: Broadly the same principle has applied that during the complete lockdown there was almost a complete waiver of rental and then in this period where we are below 50% broadly that is kind of rental concessions that we have in the market and it's tough to predict Quarter 3 and Quarter 4. If Quarter 3 looks like Quarter 2 then people will possibly around August sit down and figure out what needs to be done. So it's difficult to peg exactly how Quarter 3 rentals will look like or Quarter 4. I think in the spirit of survival and getting through this phase, everyone has to do something that works for everybody in a partnership model and that's what I am happy to share that so far that is what has happened. So it's been the deep partnerships which we have with the malls, have allowed us to find a middle ground which works for everybody.

Ayaz Motiwala: Lastly Kulin just an observation but the COVID crisis has pushed you all to do like this thing the structural cost reduction in some sense? Did it need such a bolt out of the blue for all of us to get to this program or it's an ongoing program like you highlighted some of your other cost control programs?

Kulin Lalbhai: See to be honest we have gotten into a strong cost mindset even since last year but whenever a crisis of this proportion comes along, it forces you to put things on a completely blank sheet and build up. So I feel that sometimes these crisis allow you to think very differently and force you to think differently and it's our duty as management to really come and try and deliver something looking at the challenge that is before us. So yes I would say perhaps what you are saying is true that, that does tend to happen.

Ayaz Motiwala: I really appreciate your answers and thank you very much. I wish you all the best, I hope all the sales come back and we all can go to malls and start buying stuff from your stores.

Kulin Lalbhai: We are hoping to, we are looking at our friends in China and Europe and wondering when India will reach there.

Moderator: We have next question from the line of Vaishnavi Mandhaniya from Anand Rathi.

Vaishnavi: So just looking at the group wise performance, so comparing it to the normalized performance for Q4, so for power brands like last year in Q4 we had a 14% EBITDA margin which fell to I think around 10.2% and for the full year from 12% to 6.9%, right? So for Q4 if we said that in the first 2-3 months at least we had a good 7% or so like-to-like growth then why exactly is the de-growth in the profitability so sharp? Is it because of Arrow or is it because of the other power brands?

Kulin Lalbhai: Yes, as we had said when we had shared the Q3 result with you that we were expecting profitability to just come back to about double-digits for this very reason that we had one more quarter of the correction in Arrow to be with us. So per se, we were on cost to achieve what was our guidance in Quarter 3 because the Arrow correction was something we knew and was going to happen.

Vaishnavi: So largely led by the Arrow correction?

Kulin Lalbhai: Yes and that too it's specifically the correction in the trade channel. So that's been the reason why that was the same thing that we had mentioned in Quarter 3 and Quarter 4 that the correction in the trade channel in Arrow is the main reason of difference.

Vaishnavi: So going forward how should we see the margins in power brands playing out then with the cost reductions?

Kulin Lalbhai: See in the very short-term because of COVID it is very difficult to give a guidance on growth or for that matter exactly predicting when double-digit EBITDA comes back but because we have done a very deep cost correction this year which will help us manage our burn for the year; second half of the year things will progress and things are moving up but this structural piece which I talked about of cost that would definitely help us moving forward even in power brands because even if we come back to 80% of original level we could see a good profitability. So definitely the cost cuts will help us as we move forward for the bottom line in power brands.

Moderator: We have next question from the line of Vinod Bansal from Franklin Templeton.

Vinod Bansal: So couple of questions, one staying on the cost part for 35% to 40% cost reduction. We had about what 1850-1900 crores costs in this fiscal'20. 35% would probably be 650 crores; could you break it down into your various cost heads? So how you are looking to reduce it say staff cost, how much will you look building in the rent and how much the other opex, in terms of savings?

Kulin Lalbhai: It would not be possible to go into every cost head break off this year but broadly as I mentioned out of that 600 crores, around 150 which we are expecting to be structural. The other bit came from obviously this year because COVID has been a very deep impact, we have a significantly large savings also coming from rental which is something which would continue for this fiscal but is unlikely to spillover to the remaining fiscal and of course during the lockdown period we really tightened our belts where all costs were brought more to a minimum including things like marketing etc. which is why this year is a much larger saving than what we would expect as a structural saving.

Vinod Bansal: So that I understand directionally. I am trying to just see how strongly built this number of 650 crores is. So let's talk about rentals, have you already signed agreements or got into an agreement if not signed about the kind of the renegotiations you are doing?

Kulin Lalbhai: So whatever, when we are saying we have brought our fixed cost down by 40% for this year, this is based on agreements which are signed. There would possibly as I mentioned some changes that could happen if Q3 works a certain way, so if there is any further reduction we would bake it in but this is based on what we have on the table.

Vinod Bansal: Could you throw more light on the numbers we achieved, so what was the range?

Kulin Lalbhai: So as I said we broadly had a rental waiver during the shutdown period and whilst the sales are below 50%, broadly rentals are 50% of where they were and some people have given an indication of certain cuts for the second half of the year. Those are still kind of we have only baked in a part of that but that possibly could be in the vicinity of 25% for Quarter 3.

Vinod Bansal: So if in second quarter if sales are below 50% of normal, what kind of waiver are you looking at?

Kulin Lalbhai: It's around 50% waiver as we speak like in the months of June-July; already these are all confirmed waivers.

Vinod Bansal: So when you say 40% cost savings, it includes the complete rent waivers of first 2 months which is coming along with complete sales loss in the first 2 months as well?

Kulin Lalbhai: Yes, correct.

Vinod Bansal: So it's fair to assume let's say FY22 if you had 1860 crores you would grow in line with sales whatever the recovery comes back but sales as a percentage of cost would still be lower by the virtue of this 125 crores?

Kulin Lalbhai: Yes the 120 to 150 that is what we are saying would be the permanent kind of cost that would go away. What remains to be seen is next year can we come back to 100%, will we come back to 80%, that's still open question.

Vinod Bansal: I am sorry I am staying with the question again; this 125-150 crores sustainable cost savings it's not coming necessarily from rent?

Kulin Lalbhai: No, in fact it's not coming from rent at all. The only part of rent which contributes are those stores which were negative contribution stores which we have taken a call to shut down which is a part of the retail savings but the bigger part is as I mentioned the opex control also in the stores and then the restructuring of our warehouse, manpower reduction at headquarters and controls on overheads. So these are the four broad buckets for the structural cost reduction.

Vinod Bansal: Also sorry I am clarifying this point again if it's at 65% of your normalized sales you should do a cash breakeven, is that understanding correct?

Kulin Lalbhai: Yes correct.

Vinod Bansal: The cash breakeven includes the interest cost payments also?

Kulin Lalbhai: Yes, that's what we mean cash breakeven, Yes,

Vinod Bansal: What's your implied EBITDA margin assumption in that therefore?

Kulin Lalbhai: So if you look at it we have fixed cost and we have the contribution margin that would come based on a lot of different factors; which channel, what discount etc. but broadly if you look at last year our interest cost was around a 15 crores monthly run rate. You can add that back if you want to do the math but of course interest cost we expected to come down post the fund infusion.

Vinod Bansal: Also during the course of last year we had been shutting down some brands, I think three or four brands; are we done with that exercise completely?

Kulin Lalbhai: Yes we are completely done with that; in fact the write-offs were there last year so they are off the books, the discontinued brand.

Vinod Bansal: For the full year, for the entire period what kind of additional payments we have made to those stores brand owners for the early engagement with those brands, which is a one-time expense which will not happen again?

Kulin Lalbhai: If you really look at the most part of the write-off was because we actually shut down the stores and we liquidated all that inventory. So the component of pay out to brand out of that was very small. Suresh, do we have a broad number on that, for the discontinued brands?

Suresh J: We had paid out 10 crores on the royalty.

Vinod Bansal: So the item you had shared about 68 crores one-time cost in 1Q etc. that was including the inventory liquidation included in that?

Kulin Lalbhai: Yes primarily it is that, the store write-offs and the inventory liquidation.

Vinod Bansal: What is that number for the full year FY20?

Kulin Lalbhai: Suresh, what was that number for last year?

Suresh J: You are basically asking the discontinued brands?

Kulin Lalbhai: Discontinued brand write-off, Yes.

Suresh J: Total write-off is 73 crores.

Vinod Bansal: 73 crores in FY20. I suppose this is a part of loss that will not come back in FY21?

Suresh J: That’s right, Yes.

Vinod Bansal: And last question, we had also started this program of being more disciplined in our receivables days, the channel that was a long lead cycles you had stopped supplying to them. Now that the business has been stopped it’s been couple few quarters, have we received all the money from that channel or some of it is still stuck, they have also delayed the payments for the past business?

Kulin Lalbhai: No, actually that is what we really brought in a lot of control there and if we were to look at a non-COVID period we would have seen a clear improvement, in fact it had already started being clearly visible in the books from Quarter 3 itself that the debtors were coming under control. Unfortunately with COVID obviously there has been a suspension but we are not expecting any significant bad debts there. We are kind of whatever we were feeling are the provisions that were required, we have taken in Quarter 4.

Vinod Bansal: Again I am trying to put it very simple manner the channel to which we stopped supplies during the course of last year, this is pre-COVID, the channels to which you stop supplies for our own doings we didn't want to supply to them because of long lead time, none of that is in the books right now, all has been received? That 780 crores receivables are not included in that channel?

Kulin Lalbhai: Let me try and break it down. There were certain brands which we completely took out of that channel which is the reverse the sale and took back the inventory. That is fully done last year, if that is the specific question you are asking.

Vinod Bansal: No my specific question was this 780 crores does it include any money that is yet to be paid by that channel that doesn't work with us anymore?

Kulin Lalbhai: No what I'm saying is the books have been closed out on the discontinued brands. So there is no further money due out of those discontinued brands from the channel.

Vinod Bansal: Ok. Thanks a lot, that helps.

Moderator: Thank you very much sir. Ladies and gentlemen that was the last question. I would now like to hand the conference over to Mr. Ankit Arora for closing comments. Over to you sir.

Ankit Arora: Thank you everyone for joining the call. If there is any questions which have been unanswered, you have my co-ordinates and you can please reach out to me and I will be happy to take them offline. Thanks everyone for your time today.

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