Q1 FY2021 Earnings Call Transcript – Sep 2, 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 Q1 FY 2021 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 Neerav. Hello, everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the first quarter ended June 30th, 2020.

I am joined here today by Kulin Lalbhai – Non-Executive Director, 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 first quarter ended 30th June, 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 all of you, I am happy to be here with you to take you through our Quarter 1 results and also share an update on the current state of the business. Q1 was the most challenging quarter in the history of the company and also for the retail sector as a whole. Our operations were shut for the entire month of April and for the first half of May. The second half of May saw a gradual opening up with most channels scaling only from June onwards. With a drastic fall of 88% in sales, the focus in the quarter was to minimize losses through a significant reduction in cost and to release cash from gross working capital. Our cost reduction program was a 360° one, which included rent negotiation, cut in discretionary expenses, a significant reduction in opex at both retail and central level and organizational cost reduction. Due to the strong push on cost, we were able to reduce that cost by 63% compared to Quarter 1 of last year. Moving forward, the cost optimization efforts will continue through the rest of the year as well, so that our cash losses are minimized. 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. In addition to cost reduction, the company has also reduced its gross working capital by 130 crores. By controlling inwards, we were able to reduce inventory by 45 crores and we reduced our receivables by 85 crores. By re-purposing our Spring Summer 21 inventory for Autumn Winter 21, we have been able to cut our Autumn Winter buys by close to 60%. We have also brought in a flexibility to vary our buys by 20% within the season. Through deep cuts in inventory for AW 21 and flexibility in our supply chain, we hope to reduce inventory by at least 250 crores by the end of the year compared to the inventory position at the beginning of the year.

I would now like to talk about the sales trend that we have seen post opening up. As I mentioned before, the first real month of sales was the month of June where we achieved 25% of last year's monthly sales. As we neared the end of June, we were able to open up 70% of our store network and put in place all the safety protocols to ensure safe shopping and a safe environment for our team. I am happy to share that we have seen a consistent improvement in our sales achievement each month. As we stand at the end of August, we are at 45% achievement of last year's revenue. With a reduction in localized lockdown and a good momentum for casual products where the company has a strong presence, we expect this trend to improve by 8% to 10% each month going forward. If I look at the channel wise growth, online has seen the highest traction with a 30% year-on-year growth in the month of August. High Street stores have already achieved 60% to 70% of last year sales while malls and departmental stores are still lower, but are improving sequentially.

We are seeing a big change in the category mix post-COVID where casual wear, inner wear, easies which is the slip-on footwear and do-it-yourself beauty are seeing strong traction. AFL has a strong presence in these segments, which is helping the company in achieving month-on-month improvement in sales. Our T-shirts and Polo sales in the adult business, our kids wear business and our beauty business, Sephora, have already achieved 60% of last year's sales in the month of August. Our footwear business and inner wear business, which has been led by the comfort wear offering have reached 90% of last year's levels by the month of August. We believe that COVID has accelerated the move towards an omni-channel future. AFL has been an early mover in putting an omni-channel business model in place and has made early investments in the same. Our brands have been top ranking brands on the online marketplaces and post COVID, we hope to increase our market share. While the offline market was greatly disturbed in Quarter 1, the company worked very hard to pivot towards digital. Our direct to consumer digital business NNNOW.com has seen strong traction since May. The overall business has grown 3.5 times compared to the same period last year. It now contributes close to 20% of our overall online sales.

Some of the highlights for the quarter have been the launch of new features like next day delivery, omni-channel loyalty as well as rapid scale up of the Sephora business online. In addition to the direct-to-consumer business, we have also seen a healthy growth of 20% in the third party marketplace business. This has been made possible by ramping up inventory availability through both stores and our company warehouse, the strong offering that we have in the casual wear category and close collaboration with the marketplace partners. By connecting our store inventory to fulfill online demand, we have been able to add to our offline sales significantly. We expect the momentum in the online business to continue as we move into the festive season. One of our focus areas has been to recapitalize the company so that it can navigate the COVID crisis. With that in mind, the Board decided to increase the size of our rights issue to 400 crores. We are happy to share that we had very strong interest in the rights issue with it being oversubscribed by 40%. Between the rights issue and the proceeds from the strategic investment by Flipkart in Flying Machine, we have been able to raise 660 crores of equity. With this infusion of equity and by releasing cash from gross working capital, the company will be able to reduce debt levels by at least 200 crores and also fund the cash burn for the year.

We are confident that with the large non-debt fund infusion and strong controls on costs and inventory, the company will be able to navigate this challenging period. While we still face uncertainties in the short-term, we remain hopeful that the sales trends will continue to improve in the quarters to come. The upcoming festive season, winter wear sales, and a normal Q4 will help the company increase its monthly sales run rate. With this in mind, we hope to get closer to an EBITDA breakeven as we exit Q3 and close to a cash breakeven as we exit the year. The structural reduction in cost and strong controls on inventory will help the business generate better cash flows as the market normalize. With a dominant position in the casual wear market and a strong omni-channel model, made stronger with the Flipkart partnership, AFL looks forward to gaining market share in a post-COVID world. We will continue to focus our efforts on scaling our seven large aspirational brands, which will improve the operating leverage and will generate healthy cash flows in the years to come. With this, let me end my opening comments and open it up for questions. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel: Thanks for the opportunity. Couple of questions, you mentioned in your opening remarks that the cost has been structurally down, is there any scope for further dip, what kind of the cost can come back as the revenue recovered to the pre-COVID level. So, just wanted to understand what kind of an variable cost we will have and increase once the revenue recovers?

Kulin Lalbhai: If we look at this year, there are some one-times of cost reduction, so for example in Quarter 1, we had large one-time reductions on the rental side because the markets were closed, we were able to reduce the rentals by almost 60%. As the markets normalize, those rents will also start going up. Of course, we are in constant negotiations and discussions with our partners, but as the market moves towards more normalization by the end of the year those kind of costs would come back. We also had discretionary cost cuts this year, for example, marketing cost etc. which as the markets normalize will also come back. The structural cost reductions have come from removing the inefficient parts of the distribution, so the bottom stores which were not contributing to the bottom line, from differences or changes that we have made to our store operating costs, which are more permanent in nature. We have had a permanent reduction in headcount in some parts of the business, which is the part of the permanent cost restructuring and we have also restructured our supply chain by consolidation of warehouses etc., which is permanent in nature so that would be the kind of permanent cost that we can expect moving forward as we exit FY21.

Maulik Patel: In terms of a number if I want to quantify this permanent cost reduction either in terms of a percentage of the sales or the percentage of the expenses?

Kulin Lalbhai: It would be between 120 to 150 crores of permanent cost removal from the business model.

Maulik Patel: Second question is, as we have seen the recovery and as more number of stores are opening and there is consumer sentiments recovery, what kind of trend internally you are looking in terms of which particular month or if I have to say which quarter you expect complete recovery in your top line?

Kulin Lalbhai: Maulik, it is a little difficult to do very long-term planning in this environment, but as we are exiting Q1, we are close to 50% that we believe another 8%-10% monthly over the next couple of months can be expected. Quarter 4 of course because March was very strongly impacted, the base effect of that would possibly help if one compares to last Q4, but in this environment trying to predict what percentage achievement we would be in Quarter 4, we believe it would be little inaccurate sitting right now, what we do see is that as the markets are opening up and the trend we have seen that wherever the kind of fears or the crisis due to Corona is receding, those cities actually are reviving faster, so we have a view on different markets opening up and with festive coming and the winter wear purchase coming, on Quarter 3 we expect this 10% momentum which we have seen so far till August, we believe that can continue over the next couple of months.

Moderator: Thank you very much. The next question is from the line of Jay Lakhani from IIFL. Please go ahead.

Jay Lakhani: Good Afternoon Sir, I just wanted to know that our online sales are increasing, but can you just tell me that what is the percentage of profit that is generated from online sales?

Kulin Lalbhai: We do not get into channel wise profitability, but what I can tell you is that the profitability is very healthy and in-line with the profitability that we have from our wholesale channel sales, so increase in mix towards online does not impact our bottom line adversely.

Jay Lakhani: What plan actually we have to tackle the online sales that are selling out at higher percentage of discounts, is there anything that we have planned for that?

Kulin Lalbhai: Yes, so that is a very good question. One of the things that we are investing in, is to pivot the online business towards the business where we have much more direct control. So, in the past the business model was very wholesale oriented where one sold the inventory to the partners and then the partners would operate the business. The future of this businesses is where online also operates like retail, that is called where we kind of actually make our inventory available from our warehouses and our stores and we directly kind of manage the business with active merchandising, so more and more percentage of our digital business is where we are getting into much more detailed control and analytics so as to improve the way we run that business, so our belief is that as we get better and better at this not only will we see the scale up in the business, but we expect the net discounting to start going down, in fact we are seeing those trends already. The other big change in the online business model is that now the more sophisticated players are actually looking at analytics and deciding what to make for online and in the future, the online inventory pool and the offline inventory pool will no longer remain exactly the same pool and in online you will create products more attuned to online and thereby achieving a similar rate of sale with lower discounting. So, these are all the new futuristic kind of skill sets that the company is building and in fact even in the growth which we have seen of 20%-30% in the last couple of months, a large part of the growth has come through this model where we actively kind of manage the merchandising and availability of inventory from our own side.

Moderator: Thank you very much. The next question is from the line of Nihal Jham from Edelweiss Financial Services. Please go ahead.

Nihal Jham: Thank you so much and Good Evening to the entire Management. Sir, two questions from my side, first specifically on inventory when you are targeting a 250 crore reduction, we only thought that ideally the inventory that will be on our books at the end of March'21 will be in a way help us for the sales for the year ahead, so with that context and I was expecting obviously FY22 to be normal. So, is such a high reduction in inventory possible?

Kulin Lalbhai: The inventory which is there at the beginning of the year was also inflated because we had a big sales plan in the month of March where we were going to sell that inventory to the market and there was a shutdown and if you remember that is why the March revenue saw a drastic fall and that's why there was large buildup in inventory, so what we are saying is that, one, large part of the correction has happened because we have adjusted the buy for Autumn Winter, so the spring summer goods which got stuck, they have been repurposed for Autumn Winter to a large extent and we have been able to cut the Autumn Winter buys by 60%, so that readjustment contributes a large amount towards this overall 250 crore reduction. The second thing is that with online sales and all scaling up the way they are, we generally believe that a lot more efficiency is coming in the way we can manage the inventory movement, so between these two impacts, we will be able to release this 250 crores.

Nihal Jham: That is helpful, Kulin. I will just take two more questions on the online side, now with the kind of focus that you have shown earlier and now as you are speaking of, is it that incrementally going forward what you see is that for say most of our portfolio excluding Power brands you would want them to focus on the online side and potentially the store openings may not be as high as they were in the past, just thinking aloud, is that what Arvind Fashions is also thinking at this point in time?

Kulin Lalbhai: For us, the store expansion has always been largely the Power brand because the opportunity for them to grow into Tier-2, Tier-3, Tier-4 is much larger, so I would agree with you in saying that as we restart the network expansion, a majority of it would be in Power brands but in format of ours like Sephora where we have seen very strong traction, we would continue that network expansion as well, so I do not think we are compromising the offline opportunity in any way, we are just saying that the online opportunity is a very important one, the company is prepared to ensure that whatever are the skills of tomorrow required to win in online, we will invest ahead of the game and ensure that from a market share perspective, we have the highest market share in that channel, but it will not come at the cost of the offline expansion, which is another clear thing that will continue as more and more cities open up to EBOs.

Nihal Jham: Just on that specifically for GAP and Unlimited, these two brands I was specifically looking at ex-Power brand, what would be the thought ahead?

Kulin Lalbhai: In GAP we have actually stabilized the store format. So, as and when the markets open up, we may not be doing very rapid expansion, but cautiously we would look at all the opportunities. In Unlimited, what we are very clear is, with 70 stores we have, prove that the model can deliver double-digit store profitability and till then we would not be investing behind network expansion that we are clear about.

Nihal Jham: That is helpful, last question from my side. From the online sales, would the share of revenue mix be similar to how it is for the overall company or there are one or two brands who dominate much higher?

Kulin Lalbhai: There will be some variances because some brands have a higher percentage online, I would not be able to go into all the details, but it is not very lopsided that only a few brands are powering the entire growth, it is across the group that we have seen strong opportunities, with some segment seeing a delta of say 10%-15% additional digital market share. It is also a function of what the offline scale of the business is, brands which have launched a little later tend to have a higher online mix because they grew from day one with a lot of online, so there are a lot of factors which go into it, but online is not just dependent on a few brands doing very well.

Moderator: Thank you very much. The next question is from the line of Sagar Parekh from Deep Financial Consultant. Please go ahead.

Sagar Parekh: Sir, Good Afternoon, my question is firstly on the cash flow for the quarter, so if I look at the debt number from March to August, it has reduced by about 200 crores and we are saying that we were 660 crores as fund infusion during the quarter and as you said in your opening remarks, there was about 130 crore reduction from working capital, so that is about approximately 800 crores of cash inflow, and broadly our cash loss for the quarter would be approximately about 130-140 crores, if I just add back the depreciation, so why is our debt down by only 200 crores?

Kulin Lalbhai: In Quarter 1, the entire market kind of froze, there was a buildup that happened on the creditor side as well, so there was a stretch creditor because there was an operational period of April-May where things had frozen, there was nothing coming from market partners and in that same sense, company was not able to pass on fund flow to the creditor side, so the gap that is there is gone towards normalizing all the creditors. There is still some stretch receivable etc., that will kind of get unwound in the months to come, but it is to normalize the working capital cycle beyond funding the cash loss and retiring debt.

Sagar Parekh: Okay, so this 130 crore reduction is just purely inventory and receivable?

Kulin Lalbhai: Yes.

Sagar Parekh: So the creditor days, you would have paid the creditors of approximately 300-400 crores?

Kulin Lalbhai: I mean there is the difference in the number you are seeing has gone towards normalizing that, yes.

Sagar Parekh: Okay, because the difference in number is pretty big, so that is why I am just confused?

Kulin Lalbhai: No, but that is the only difference. It has gone towards normalizing the creditors.

Sagar Parekh: Okay, so by the year-end when we say that 250 crores working capital reduction so that is just inventory plus receivables or that is on a net?

Kulin Lalbhai: That is just gross working capital.

Sagar Parekh: Okay, so by the end of this year, how should we look at the debt number for March'21?

Kulin Lalbhai: As we said, beginning to March '21, at least 200 crores reduction, there are some unknowns as we have all been discussing that it is impossible to exactly model Quarter 3 and Quarter 4, which is why we cannot give an exact range, but at least 200 crores debt reduction.

Sagar Parekh: So we have already reduced debt by 200 crores as of now?

Kulin Lalbhai: It would be somewhere around the August end number, it can be higher and lower a little bit based on some of these things that will play out in Quarter 3 and Quarter 4, the sales curve is still something we are not 100%

sure about, but we feel that it should be at least 200 crores reduction from the beginning of the year.

Sagar Parekh: Right, so basically on a 1000 crores debt number for the year, we would still be looking at the interest cost, so at the moment are you finding it challenging in terms of paying the interest cost or because the moratorium is now over?

Kulin Lalbhai: No, as I mentioned we are well placed right now on our cash needs, so there is no challenge.

Sagar Parekh: Okay, so we will be able to fund our interest cost then?

Kulin Lalbhai: Yes, and all the cash losses and everything and end the year with a reduced debt.

Moderator: Thank you very much. The next question is from the line of Vimal Sampath, an Individual Investor. Please go ahead.

Vimal Sampath: Good Evening, I just wanted, we have top end brands like Calvin Klein, Tommy, and mid brands like Arrow, US Polo, and then we have Sephora Unlimited, can you just give, you said that in August you have reached 45% of August'19 levels, so if you can give not the brand wise, but just the category wise position – how has premium/mid-level/value done?

Kulin Lalbhai: The more important kind of way to look at it is I have seen the category mix which is what I gave as a broad direction, which is the casual parts of the categories like Polo, T-shirts have actually been 15% higher than the average in the adult business and certain businesses like kids and beauty are again at around 60%-65% level which is 15%-20% higher than the average and then innerwear and footwear for us has been the outperformers at already 90% to 100% of last year, so I think that lens is a little better because I do not think the trends are very clearly split by price point. The trends are more clear from a category lens.

Vimal Sampath: I am a shareholder for a long, long time. We had brands like Ruf & Tuf, Excalibur and New Port, which would be ideal for online now, so are we trying to exploit anything on those brands or what is?

Kulin Lalbhai: Brands as you may know, those brands got housed as private labels in Unlimited in the past and Unlimited has connected its private labels to online, so we are seeing good strong traction from the value business also in the online channel, so that is it is something we are focused on.

Vimal Sampath: Right, because we can really do well in that low value category. Are we planning sell this to Reliance as there was an article in between regarding that?

Kulin Lalbhai: I cannot comment on market speculation, but what I can share with you is that as a part of our overall online, the Unlimited portfolio is also a part of that and it is showing very healthy growth.

Vimal Sampath: Since we are owning those brands, just as we have been able to encash on Flying Machine, maybe two years down the line if we grow this, we can monetize these brands also?

Kulin Lalbhai: Correct, so we do believe in the value segment story, I think the sub-Rs. 1000 price point is a large price point online and with Unlimited every six months we have 4000 to 5000 options across the eight to 10 private labels, so we are currently getting access to that opportunity through that platform.

Moderator: Thank you very much. Ladies and Gentlemen, that was the last question for today. I will now hand the conference over to Mr. Ankit Arora for closing comments.

Ankit Arora: Thank you everybody for joining us on the call today. If any of you have any more questions, please feel free to reach out to me and I will be happy to take them offline. We look forward to speaking with you again next quarter. Thank you.

Moderator: Thank you very much. On behalf of Arvind Fashions Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.