Q4 FY2021 Earnings Call Transcript – June 3, 2021

CORPORATE PARTICIPANTS

- Kulin Lalbhai – Non-Executive Director
- Shailesh Chaturvedi – 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 FY21 Earnings Conference Call. 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 that this conference is being recorded. I now hand the conference over to Mr. Ankit Arora – Head, Investor Relations & Treasury at Arvind Fashions Limited. Thank you, and over to you, sir.

Ankit Arora: Thanks. Hello, welcome everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the fourth quarter and fiscal year ended March 31st, 2021. I am joined here today by Kulin Lalbhai – Non-Executive Director, Shailesh Chaturvedi – Managing Director & CEO, Pramod Gupta – Chief Financial Officer. Please note that results, press release and earnings presentation had been mailed across to you earlier and these shall also be available on our website www.arvindfashions.com. I hope you had opportunity to browse through the highlights of our performance. We'll commence the call with Kulin providing his key thoughts about our strategy and financial performance for the fourth quarter and fiscal ended March 31st, 2021. He will be followed by Shailesh who will share his key thoughts. 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 face. A detailed statement of these risks is available in this quarter's earnings presentation. The company does not undertake to update these forward-looking statements publicly. With that said, I would now turn the call over to Kulin to share his views. Thank you.

Kulin Lalbhai Thanks Ankit. A very good evening to you all. Thank you for joining us for our Q4 results. We as a country seem to be coming out of the worst of the second COVID wave, but as all of us would agree, the last two months especially May has been exceptionally difficult, and we have been doing all that we can to protect the health of our employees and support them through the COVID emergency. We have tried our best to provide wholehearted support to our team in this fight against COVID, including tying up with medical institutions, enhanced financial assistance and insurance covers, tying up with hotels to provide facilities for our employees to self-quarantine and taking special care of front-end retail employees with appropriate SOPs on the working in the pandemic.

Coming to the business performance, the strong momentum gathered in Quarter 3 continued into Quarter 4 as well. The business was able to boast year-on-year growth of 14% over comparable quarter last year. The EBITDA grew sharply by 98% due to the healthy recovery in sales and the various cost measures that have been carried out. This quarter witnessed a strong sales recovery in retail channel of 102% with marginal growth in like-for-like sales as well. The online channel continued on a rapid growth trajectory with a 390% growth over last year. We remain cautious on our wholesale channel due to the COVID uncertainties and achieved 60% of our pre-COVID level billing. This decision will ensure that the inventory levels in the channel are healthy as we come out of the second COVID wave.

Let me share some segment level highlights:

Our power brand portfolio performed very well. US Polo achieved high growth of 25% and a very healthy double-digit EBITDA for the quarter. The two new category extensions of innerwear and footwear saw a year-on-year growth of 30% and 100%+ respectively. Both categories are emerging as winners. Tommy and CK both grew revenues in excess of 25% in Quarter 4 with a double digit like-for-like growth in sales as well as more than 100% growth in online revenues in the quarter. FM continued its rapid online growth by doubling the online business on a large base. While power brands saw a strong improvement in profitability versus the Quarter 4 of last year, the margins were impacted by lower wholesale billing, a slower recovery in the department store channel and the COVID impact in the second half of March. With the increased investments behind the power brands and improvement in the cost structure and a healthy inventory position, we are confident of reaching pre IndAS double-digit profitability in the power brand portfolio as soon as the business normalcy returns.

Quarter 4 is a historically weak quarter for our specialty retail business. However, with the cost corrections and the business model improvements in Unlimited, the quarterly EBITDA loss was 80% lower as compared to pre-COVID levels. Sephora had a very strong quarter with our retail sales recovering to 114% level, and our online sales contributing to greater than 10% of the revenues. One of the areas that did not go as per our expectations was the wind down of the businesses that we are exiting. We have seen higher exit costs on both inventory and store closure and the delay in the GAP exit leading to higher operational losses. While all the brands other than GAP will cease to impact the numbers in FY22, the GAP resolution should be completed in the H1 of the current fiscal.

Over the years, the company has made big investments on the digital side. This includes our proprietary in-house omni-channel tech stack, deep talent and expertise in managing a direct-to-consumer digital business and a product offering that has been specifically made for the online channel.

These efforts have helped us achieve digital revenues of Rs. 700 crores, which accounted for more than 30% of our total revenues in FY21. While the percentage contribution of online revenues will come down once the offline business fully recovers, we expect a large growth in absolute revenues in this channel in the years to come. Our direct-to-consumer part of digital, which includes NNNOW.com, and our marketplace model grew three and a half times and now comprises of 35% of the total online business. Over time, we see the share of the direct-to-consumer business to grow which is strategically important as the D2C business allows a full control over the brand experience online. We have fully integrated our retail network with NNNOW.com and the third-party marketplaces. A substantial part of our offline revenues were contributed by online fulfillment and we see this share growing over time. These omni-channel linkages will help us increase to our productivity and also improve sell throughs and inventory turns.

The improvement in working capital continued with a reduction of Rs. 67 crores in gross working capital compared to December 20. Overall, during FY21 gross working capital has seen a reduction of Rs. 523 crores as we entered FY22 with a much lower level of inventory. The fresh inwards will significantly enhance our freshness and support business growth and better productivity. The sharp reduction of gross working capital and the large infusion of equity have allowed us to reduce our net debt by Rs. 300 crores during the year. The gross debt at the end of FY21 stands at Rs. 943 crores.

FY21 was one of the most difficult years in the company's history. However, in spite of many challenges we have been able to carry out many strategic resets which have made us stronger. From a low point of Quarter 1 when revenues fell to 12%, the business was able to quickly recover to

114% by Quarter 4. The strong digital pivot of the digital business moving from mid-teens of FY20 sales to more than 30% of FY21 sales has ensured that our brands remain top of mind to our customers, even when they could not shop in stores. We substantially cut down on inventory and brought it down by around Rs. 400 crores. Having completed this one-time correction, we have put in place the processes and systems to ensure that working capital turns will substantially improve in the years to come. While the business saw very large cash losses in H1 of FY21, the company raised a total of Rs. 860 crores of equity so that we were able to bring down net debt by Rs. 300 crores in addition to funding the large levels of COVID led losses. In response to COVID, we reduced our overall costs by Rs. 540 crores, which is a 40% reduction on the total cost base. We expect a more than Rs. 100 crore of structural fixed cost reduction which will benefit the business in the years to come. With the portfolio rationalization and the strong focus on 6 high conviction brands, once the COVID second wave abates, we expect the bottom line to significantly improve due to the exit of loss-making brands and operating leverage kicking-in in the power brands.

I would like to now hand it over to Shailesh Chaturvedi to talk about the current COVID related challenges and how he sees the opportunity moving forward.

Shailesh Chaturvedi: Thanks Kulin. Good afternoon everyone. I hope you are all safe and healthy in these COVID wave 2 times. Clearly our main focus currently in this round of second wave is safety of our employees and towards vaccination of our team. Three days back we had our first onsite vaccination camp at our Bangalore Office where slightly more than 800 colleagues and even our business associates here and the partners and vendors got vaccinated. And we are now trying to conduct more camps across India. We are also in touch with malls and the department stores to prioritize vaccination of front-end staff which is going to be a very key as we revive the business. The current wave started impacting the business from the second half of March. While most stores operated in the 1st half of April, the Western region Maharashtra began shutting down somewhere around mid-April and by the end of April most of the network was shut down. Month of May has seen the severest impact with almost the entire offline channel being in a lockdown and even online deliveries being barred in large parts of the country. The first week of June has seen many states unlocking with high street stores opening up with limited timing, currently this constraint. We expect a gradual opening up of the network over the next 4-5 weeks. We hope that with the acceleration of vaccination program, consumer sentiment should improve steadily and one area which has been really strong in all this compared to the last COVID wave has been the online channel, as Kulin explained earlier in this call. We saw good pickup in online deliveries in May month also, with uncertainty regarding the pace of the recovery, we have proactively taken required steps to cut costs and balance our inventory in this COVID wave 2.

With the first round of unlock being seen in June month, I am really excited about the opportunities before us. Our six high conviction brands are leaders in their respective segments, and we have clear plans on how to scale them up profitably and we are busy building our capabilities to execute our plans smartly. One good thing about our portfolio is that they have that right work from home appeal and even in the COVID times when the recovery happens, our brands bounce back very strongly, the way we saw in H2 of last year.

US Polo is our largest and the most profitable brand. The key focus for us in US Polo is to scale up the offline network also, including in smaller tier towns, strengthen our new categories like winter wear, kids wear, innerwear, footwear, and further cement US Polo's position as a leading brand in both online, as well as offline channel. I have been working nearly 15 years with Tommy Hilfiger and this JV of Tommy and CK I have seen how strong these global power brands are in India. In H2 last year, both brands Tommy and CK doubled their EBITDA. We will continue to strengthen their leadership aggressively with growth in online channel, accessorization of product categories in both the brands and will increase the local production to improve margins in these businesses. We are also very-very excited to scale up Flying Machine as the online first youth focused brand with introduction of new categories in the online channel such as women's wear, footwear, and accessories in our partnership with Flipkart group.

In addition to online push, we are also rapidly scaling Flying Machine into smaller towns through its unique model called FMX. It's a model meant for small towns. This move into small towns in India is likely to open a very large market for Flying Machine.

Arrow has been going through a full re-energizing with a new brand ambassador Hrithik Roshan. We have a completely revamped product offering, especially on the smart casual and the youth segment, right for work from home environment. Arrow has a new store identity and has a full cleanup on the inventory and market is now hungry for Arrow. With the new season launch in AW21, we are confident of significant improvement in sale and productivity, and we hope to achieve a positive EBITDA in the second half of FY22.

Sephora is continuing to see very strong offline recovery with many exciting new brand launches which are unique to Sephora and improvements we are making in our customer shopping experience; we expect a strong improvement in store productivity once the market normalizes. Our online business is also gaining momentum in Sephora, and we hope to significantly ramp up our online offerings in the quarters to come. The planned journey and the Unlimited business on cost rationalization and on inventory optimization has been carried out fully resulting in a much sharper cost structure and much lower inventory levels. This has ensured that losses are contained, and we are much closer to achieve a breakeven in this business as well. The key objective for us in the current financial year includes, one, significant expansion of our retail network by opening 150 plus stores throughout the country through the franchisee route. Second, digital scale-up powered by category and brand extension, marketplace and NNNOW.com ramp up and further omni-channel linkages and strong relationships with the online portals. Third, strong control on inventory which will allow us to significantly scale up revenues with minimal increase in working capital. Fourth, rapid growth in new categories, like innerwear, footwear and kids wear. Fifth, strong push and sell throughs and productivity in the retail channel through better buying, better planning, and visual merchandising. And finally, sixth, continued focus on cost managed so much required in these times.

We are also strengthening some of our key capabilities in the team so that we can better execute our strategic plans. We are building a centralized sales function for the first time to get economies of scale across our brand. We have hired a new Chief Revenue Officer who has joined us recently. This common sales structure will allow us to improve our market coverage and also give us efficiencies. We are also parallel strengthening our supply chain function which we want to transform and have hired a new supply chain head with a mandate to improve inventory velocity across the entire system and thereby improve turns which are very important. We have also brought in many senior industry leaders in the last three months across our brands who have deep expertise in our industry domain, so that we can work towards energizing each of our six high conviction bets towards a strategy of profitable growth.

We have bold plans, and I feel confident that with our uniquely strong portfolio of brands and a very capable and energized team, we will be able to steer Arvind Fashion towards a very exciting future. Thank you.

Moderator: Thank you very much. The first question is from the line of Nishit Rathi from CWC.

Nishit Rathi: My first question is actually on the balance sheet side. It's good to see that the turns in the second half specifically both on the inventory and debtor side showed a good traction and from whatever you are saying, it looks like there is still some room for improvement. So, would love to understand, how should we think about inventory turns and debtors? What is the normalized levels and what are the key drivers which will take us there? And, I have a few more I will ask after this.

Shailesh: As far as the inventory turns are concerned, it's like a top priority for us going forward. As we gain our scale both post-COVID or in terms of NSV and EBITDA, the key priorities is how to improve our stock turns. Now, during COVID times the whole business slows down, and inventory lies in the closed stores or in the warehouse, so it slows down the turn, but what we have done is that we have gone last year you will see our GWC reduction of Rs. 523 crores. We have gone hammer and tong in terms of reduction in inventory. Also, we have tightened our processes on buying and make sure that there are a lot of disciplines on that. Also, I'll briefly just mention that we want to start a transformation project on the supply chain, and we have hired a domain expert who is coming with a mandate to increase the stock turn. So, the whole idea is to improve stock turns and move towards a model which is more demand driven than forecast and push model driven the way the industry has worked in the past. So, there's a lot of focus going forward to improve the stock turn and we are making sure that the discipline on inventory, discipline on the processes and also the new expertise on supply chain that we are trying to achieve to reach much higher level of stock turns than we have. Also, one thing that is going to enable us is that our inventory levels are quite low as such right now and there's a need for fresh goods and typically fresh goods tend to move faster and give you a better margin also. So, I think the way our inventory position is today, once the COVID subsides and we move forward, I expect to have very good velocity on movement of goods in our business.

Nishit Rathi: Shailesh, if I have understood it right our inventory which is roughly around 100 odd days plus or minus, you are saying the turns could come down and the gross margins going forward could also see better improvement because of higher fresh full-price sales. Is that understanding correct?

Shailesh: Let me break down your question into two parts. One is about the turns and other is about the gross margin, right? So as far as the stock turns are concerned, like I said earlier, that there is a lot of emphasis to increase the stock turn. So, there's no way we would want stock turns to come down. There's a good opportunity for us to increase the stock turns going forward and it's a very important mandate for us and that's our key focus area. Second part is gross margin. Like I said earlier that inventory levels are now at historical low. Of course, currently COVID is again hitting us but once we come out of the COVID, we are expecting and this work from home our brands are very well placed, our inventory levels are quite low and as we start filling in the channel again in a few months again, gross margins would kick in at a higher level because gross margin have a direct correlation with the freshness of the inventory. And as we pump in more fresh merchandise into the market, into different channels, we expect our gross margin to be at a very healthy level.

Nishit Rathi: The second question is on the digital sales. So, you said around Rs. 700 crores was our digital sales and of that 30% was roughly your direct-to-consumer sales which is both marketplace and NNNOW.com. So, I have two questions here. Question number one that I want to understand is, in our terms of trade, is it similar or better or worse off in terms of our digital sales, do you get better margins with better turns or is it similar margins or slightly lower? And the second question is with respect to both NNNOW.com, are we losing money there and marketplace model, if you could just explain what exactly are we doing there? These are the three questions with respect to digital.

Shailesh: Again, let me go one by one. Online revenue last year of Rs. 700 crores, 30% contribution growing at healthy pace. So, these are all very good numbers for us to take into the next year. We are proud of the scale where we have risen, it is market leading position. That also helps us to get good margins because we are very large player in this segment. And we have not just one model, we have multiple model from our own D2C, NNNOW.com to our own marketplace and also, we have a very good business relationship with the large portals where we do a large business with them also on online business. So, our margins, online business is not dilutive, it is accretive. Its margins are as good as many other channels. Also, we have a very specific plan to improve the margins in the online business this year. Traditionally, online has been more of a discounting play and channel to sell old goods, but the focus now is shifting to what is known as SMU. These are specially made merchandise unit which are like online for online. So, what happens is that we use the consumer analytics of the online players, including our own NNNOW.com and we design SMU products which are right for this online world at full price, not a discount business. We use the consumer insights and we use our own brand and the product design strength. It's like a good marriage between the two, so it comes out as a play where our margins are very good. And this year the biggest focus is SMU drive. This is a full price business which very decent healthy margins for us, and we want to push that business. Our brands are very strong, we have right appeal in the post-COVID world, and we want to use this appeal in the online world to further improve our margins which are anyway healthy, but they can go up further through this drive of SMU line that we are talking about.

Nishit Rathi: Sorry to interrupt. Turns on the online business, are they similar or better or are they slightly worse?

Shailesh: Online turns are very good. For example, what I just mentioned SMU it's made to order, immediately we ship out, get our money-in, so extremely fast turns. Also, we have unique manufacturing processes like flexi production where we can do small runs on a very flexible manufacturing where there's no inventory and low depth goods get shipped out to the portals or sold through NNNOW.com. So, it's a very fast turn business. So overall online is a faster turn than average. So, it's better from a cash conversion standpoint. Coming to NNNOW, it has reached a good scale, the most important metrics is the positive unit economics and it has reached that level. We are breaking even on that, however, still remains an area of investment for us. We will continue to invest behind the whole experience of NNNOW and we will support it through more and more differentiated merchandise as we go along. And the last question I think you asked was on the marketplace. We have built large capabilities in last one year, COVID accelerated to make us do it even faster. So, we have built large number of warehouses which are fully equipped to do B2C billing, and we have five odd warehouses right now and we are looking at further strengthening that capability so that we can service marketplace orders closer to the demand, faster probably at a lower logistics cost. So, marketplaces is a business which has really grown significantly. We do, as you rightly pointed out 35% from D2C, but that percentage is going to increase as we go along. And it's very important because it gives us a chance to influence the consumer experience in online world in a very direct way and that remains our focus going forward.

Nishit Rathi: Last question from my side, this Rs. 400 crores enabling resolution, can you throw some more light on that, as to how are we thinking about it because at these prices to dilute any further will be like very painful for investors like us.

Kulin Lalbhai: Let me take that question. We have gone ahead and done an enabling resolution and we intend to have this as a rotating enabling resolution which we are going to do every year. We believe that in any uncertain environment like the one we live in, having a resolution in place is a good idea. As before, we have always maintained that we will be proactive in ensuring that the business never has any want of capital, but at the same time, I would also like to share that as of now there is no immediate fundraise plan in front of the board, but we felt that just looking at the uncertainties that we are facing with COVID wave, it is important to have the flexibility and have the resolution.

Moderator: The next question is from the line of Sagar Parekh from One-up Finance Solutions.

Sagar Parekh: Thank you and congratulations on a decent performance. Firstly, on how should we look at the debt for FY22, net debt figure? So, I believe we are at about 920 odd level for March 2021. Secondly, if I look at your FY21 cash flow, your interest cost is about Rs. 249 crores that we have paid during FY21. If I even average out the total debt for the year FY21, it would be approximately about Rs. 1000 to Rs. 1100 crores on an average. So, I am not able to reconcile. So basically, are we saying that the interest cost for the year was at 25%?

Pramod Gupta: This Rs. 225 crores of interest cost include IndAS 116 interest on the lease liabilities.

Sagar Parekh: I am just looking at the cashflow statement which says the interest cost is about Rs. 249 crores.

Pramod Gupta: Let's break down the interest cost between two components. One is the interest on borrowings and then the other one is the interest on the lease liabilities, which is under IndAS that long-term leases are capitalized. You take out Rs. 72 crores out of Rs. 225 crores, that leaves us Rs. 153 crores. While our year end borrowings are a little over Rs. 900 crores, we started the year with much larger borrowing and before the fundraise in the month of July'20, the borrowing unfortunately went up further. Also, during the first quarter during COVID period in order to bring in a certain amount of liquidity and keep the operations going, we also had to take higher debt. Therefore, one is to look at the year-end level and other is look at the year beginning and the buildup of the borrowing that happened before the fundraise happened and subsequently, our debt levels came down.

Sagar Parekh: So, actual cash interest cost is about Rs. 150 odd crores is you are saying?

Pramod Gupta: Yes, 153.

Sagar Parekh: So, that also is about 15% odd kind of, even Rs. 1000 crores assuming average interest cost for the year.

Pramod Gupta: Therefore, we started the year with Rs. 1250 crores and that went up a little bit higher until the month of July. So, we do have a higher level of interest in the first four months of the year and then it gradually came down.

Sagar Parekh: And how should we look at the debt levels for FY22?

Pramod Gupta: FY22 we should be looking at approximately similar level of debt level as end of March 2021.

Sagar Parekh: So, debt will not go down. I was expecting the debt number to go down because you will have some rights issue money coming in and plus assuming the cash flow for the year would be positive now given the fact that our demand is likely to bounce back

Kulin Lalbhai: There are two things, one, we are expecting a very-very significant ramp up in revenue between what we achieved last year and what is kind of the business plan for this year. So, it is disruptively higher growth rate on a base because the business is scaling back after a COVID disturbance. But in spite of that the working capital will not dramatically go up. It would go up somewhat. Secondly, there are some COVID uncertainties, at least in the first quarter which are going to impact the business and we will see how the COVID unlock happens and how quickly we move back. But because of those, it is on a conservative side I think we believe that the debt levels should be similar.

Sagar Parekh: And on the interest cost, given the fact that now this 153 number should come down because I believe 153, since you mentioned that it was 1250 at the start of the year, and then we had some additional debts, so that's why the interest cost is on a higher side, but this Q4 interest cost number, can I multiply that by four to get the interest cost for FY21?

Pramod Gupta: Broadly yes.

Sagar Parekh: So how much was the interest costs for Q4 then excluding the lease liabilities?

Pramod Gupta: It was around 34.

Sagar Parekh: So, 140 crore should be the number then?

Pramod Gupta: Yes, you can assume that.

Moderator: The next question is from the line of Priyam Khimawat from Infinity Alternatives.

Priyam Khimawat: Just looking at your presentation, we have done around 64% recovery for our power brands. So, assuming that we reached around Rs. 2,500 crores revenue mark for power brand, we earlier used to do around double-digit pre-IndAS margins. So, assuming that we reached that maybe in second half this year or next year F23, what kind of EBITDA margin are we looking at? Will it be substantively higher considering the cost reduction which we have done, or will it be in the similar range? Just want you to understand that from you.

Shailesh: We look at this year into two parts, H1/H2. So, we are starting unfortunately with COVID wave 2, this first quarter will get impacted. We also have some pending final nos. to be done on the GAP business that will get done in the H1. In H2, we expect the EBITDA to bounce back in that proportion. Well, power brands are already delivering good EBITDA. Even in the last quarter if you see the power brand EBITDA is fairly good, towards high single digit, and it should continue its improvement journey as we bring in more and more fresh goods where the margins are quite good for us. So, as we grow the digital business, as our costs efficiency kick-in, more fresh inventories go into the market the EBITDA the margin should be better.

Priyam Khimawat: Just to put my question in another way, like we have done around (+500) crore savings in cost this year. So, how much of that do you think is sustainable? Because at the start of the year we were telling that around 150-200 crore of the cost reduction is sustainable on an annual basis. So, just wanted to understand that.

Shailesh: If I really see the cost elements, so there was rental saving, supply chain, and manpower cost saving. So, definitely there's 100+ crore kind of saving is structural, and it will go forward. Some of the costs as we scale up the business significantly hopefully in the second half of the year will come back. So, the rents will not remain at concession. If the business bounces back that rent will go back to its contractual amount. Little bit of employee also we will have to hire to support the growth. So, definitely a significant portion of the cost saving is structural, and it will accrue and will go forward whereas some we will need to add back the cost. I don't know if that answers your question.

Priyam Khimawat: Okay understood, fair enough. And just another question. Our FY20 rentals were around 400 crores, actual rentals without this IndAS impact. What kind of concessions were we be able to get this year and what is our actual rental outflow to landlords this year? If you could just help me with that number.

Shailesh: There are two forces happening right now because that will make it difficult to put a number to the rental right now, because the first quarter COVID impact, our discussions are in progress with our partners landlord. We have already written letters to them seeking help and they will get resolved soon, but we don't know the exact number, we can't comment on that. Second part is also that there is a plan for growing the business through the franchisee network. So, there is a possibility that we will convert some owned stores to franchisee stores as we ramp up the business forward. So, I am unable to put a number to the rental for this year.

Priyam Khimawat: That's for FY22. I was just trying to understand from FY20 to F21 which is the last year which we have done.

Pramod Gupta: We will take back this question and Ankit will come back to you with the numbers.

Ankit Arora: Yes, Priyam, I will come back to you on this.

Moderator: The next question is from the line of Dhruv Shah from Ambika Fincap.

Dhruv Shah: Congrats on decent Q4 performance. I just have two broad questions on two of your brands. One is Sephora. How do you plan to ramp up now? Because seeing your competitor doing a really good growth, what are your plans in Sephora going ahead?

Shailesh: Sephora is a brand which is really known for its shopping experience. And we saw in the month of January and February this year, Sephora recovered business the fastest. So, there is a very strong consumer pull for this brand and we expect that post-COVID, Sephora will continue to grow rapidly. We are upgrading the shopping experience even further; they are very good already and Sephora is a leading brand in most malls. So, we want to up that game further. Second thing we want to do is that we have a very strong line of launches of exclusive brands. And that's very important in this beauty segment. There are 5-6 very-very strong mega brands which are in the pipeline. In fact, 1 or 2 we had to delay by a couple of months because of the current COVID wave. But that exclusive pipeline of these brands in the beauty segment will help Sephora further. Also, we will explore whatever the possibility to expand the geography of the Sephora business in India as we go along. And lastly, online is very important. We have seen a good traction with Sephora in our own marketplace and in our own NNNOW.com business. We started it recently and in a very quick manner it has crossed the double-digit contribution for Sephora. So, this online journey will continue to grow, and it will help the Sephora business grow. So, the excitement at the store, launch of exclusive brands, online linkages, and the growth that we are planning, all these will take the Sephora business forward.

Dhruv Shah: My next question is on Unlimited, are we planning to close any further stores or are we done with the realignment, restructuring? And now onwards this year you will see a breakeven and from next year probably you will see some EBITDA positive?

Shailesh: There was a big drive to rationalize the business. We closed down a large number of not so profitable stores. At the current distribution network, it is quite healthy. Unfortunately, currently COVID is impacting the pure retail, it is impacting more, but as we come out of the COVID I think Unlimited is very cost-efficient model now. Also, Unlimited has built its private brand expertise further, and also, built the online channel with omni capability in the last 6 months. So, Unlimited is in a very healthy and efficient way that is why you see in the last quarter, losses were 20% of same quarter last time. So, it is in a fairly efficient stage when normalcy returns. We expect Unlimited to be close to breakeven in the normal times. Currently COVID is impacting most businesses, but as we talk about normal times, Unlimited has reached a fairly good degree of efficiency.

Dhruv Shah: Let me put it across like that Shailesh that when Kulin says that whatever ramp up you are saying, is Unlimited a part of that or you just have focus on six brands and Unlimited is not part of your ramping up plan?

Shailesh: What we do is that we do one step at a time. In Unlimited, our focus was to restructure the cost base so that we don't lose money and it reaches a breakeven. And I must say that Unlimited, the new team did a great job of very rapidly bringing the cost efficiencies, cutting down stores, getting the new business model going, getting the capabilities right on online & omni, the new tabletops & the new pricing methods. We just want to continue for a few more quarters in that space. Also, COVID is not helping right now but we want to be 100% sure that these efficiencies that we have already got and we saw in the Quarter 4 sharply reduced losses, it stays, and we want to see that these are sustainable and then we will figure out our next stage of the Unlimited business.

Moderator: The next question is from the line of Chetan Phalke from Alpha Invesco Research.

Chetan Phalke: I will just continue with the last question, out of total capital employed close to 400 crores is in our Unlimited business. So, how do we ensure that we get to a reasonably okay return on capital employed going forward over there? Can you just elaborate on how we can get there because we haven't been there in the last 3 or 4 years?

Shailesh: I just want to reconfirm the capital employed number and Pramod can just comment on that, then I will take the answer forward.

Pramod Gupta: I think the capital employed would actually be much lower. I would separately like to understand from you as to how the 400 crores number has been arrived at. Because if we were to look at the inventory, and the inventory includes a fair amount of partner brands which are like we account for them as inventory in our books, but there are corresponding creditors, and we have to pay only on the basis of the secondary sales. So, therefore you might be looking at only the gross and not the net.

Shailesh: Let me just add to what Pramod is saying, in my view the capital employed is a much lower number.

Chetan Phalke: Any ballpark number?

Pramod Gupta: We can separately reconcile the number, but it will be significantly lower than 400 crores.

Chetan Phalke: What is the roadmap going forward for Unlimited? Recently there were some news reports that we might just find a buyer for this division, and it might be disposed off to someone. Is there anything like that on cards or are we looking to turnaround the business on our own and go to a 20% kind of return on this?

Kulin Lalbhai: I think what we have clearly maintained is that as far as we are concerned, we want to invest our capital behind the 6 brands. Our Unlimited business we wanted to get to a milestone of achieving significantly better store profitability and as Shailesh mentioned, it is becoming quite a large profitable online business. Having achieved these two milestones, on the first milestone I think we are still perhaps 6 months away. Second milestone of scaling up digital through the private label online route is going quite well. But once we have achieved these milestones, the idea should be how do we create long term value, and we are not looking to put capital employed behind growing in this business. So, we are looking at all the different ways in which we can ensure that the platform which we have created which is now a reasonably scaled and omni channel platform, how we can realize the right value and the next steps in terms of unlocking something out of this. So, we don't have a specific update we can share at the moment, except to say that we have brought it to a level which is healthy, we will continue to improve its profitability and scale it online with the existing network, and we will parallelly look at ways in which we can solve the issue around not putting capital behind it to scale it up ourselves.

Chetan Phalke: One more question. Our inventory correction in Arrow is fully complete now? Can we see fresh inventory spillover given that our retail side is closed since last couple of months?

Shailesh: The inventory correction has been the sharpest in Arrow, and in fact there is a shortage of inventory right now as we speak, and as the market improves post COVID, we plan to fill in the channels very soon for Arrow, and we are hoping that the second half of this financial year Arrow should be in EBITDA positive brand.

Chetan Phalke: Can we see a fresh inventory spillovers in our other brands? Let's say in US Polo, Flying Machine, in other brands? Because the retail side is closed.

Shailesh: What has happened is that we have seen last year also some best practices that we will carry to this COVID wave 2. So, inventory correction is important because we don't want the turns to slow down or the freshness to go down, so we have cut down inwards by couple of 100 crores in this round of COVID and made sure that both on cost side and also on the inventory side, we remain quite sharp in order to fight this COVID wave. So, while we have cut down the inventory, but we will have adequate fresh volume of inventory to supply to the market as the market picks up. Also, the second half is full of seasons, so Diwali this year is 10 days earlier, so we expect Puja, Diwali season to start at least a fortnight earlier than last year, and that also would ensure that the channel etc. starts picking up goods faster and we had a very low level of inventory with the trade channel as we have been very cautious about that channel. So, my sense is that that channel is also hungry, just that currently because of COVID everybody is cautious but once the market picks up, we should be able to apply a very large amount of fresh inwards in all of our brands including surely US Polo which is our biggest brand in the market.

Chetan Phalke: Shailesh Sir, you were mentioning about improving our supply chain drastically and improving our stock turns. So, can you elaborate more as in what are the aspirational stock turns that we are looking at, like say 3-4 years down the line for our power brands?

Shailesh: Frankly for this financial year at an AFL level, power brands would be even better. We were looking at closer to 2.25-2.5 times, which is our first target which we should be able to achieve that and then the journey is to take that number even higher. So, the process is starting, as we speak today, we have made huge progress in terms of inventory reduction, buying control, new discipline on our processes, sell through rigor in the company. And with the new project that I mentioned that there is a whole mandate to push the stock turns agenda forward. And I am sure that our power brands will even excel the numbers that I just gave a hint about.

Chetan Phalke: Are there any global benchmarks for the stock turns? Or Indian market is vastly different than the other markets, so we can’t really get there? Any comments on that side.

Shailesh: We know the best practices in this industry. But I think the way we should look at it is that we have our own reality in the country, and we want to improve on that. Our game is what we did last year, and how do we improve it rapidly going forward.

Kulin Lalbhai: If I can just come in here to add. One thing that is happening in this business is that the earlier benchmarks around excellence have been built more around the velocities and turns of largely a physical business. And the reality of the world is that we are moving more and more to a digital centric business. And as Shailesh was explaining earlier, digital is no longer the factory outlet of the physical. We are actually creating both an offering and a supply chain separately for the online channel. And this supply chain can be very-very real time because unlike offline, where products are spread across a lot of retail stores and there is a certain speed at which products can move from the production hub to the warehouse to the store, in digital it is very-very disruptive. So, I think the old benchmarks should not be taken. I think as we build more and more of a high velocity digital centric model, we should keep pushing the paradigm on how inventory turns can keep going up & the omni world will change some of the older paradigm.

Shailesh: I will give you one example to just take forward. Look at the omni linkages, a lot of our stores including in power brands are linked with the online world and there is a large percentage of growth in the store channel is coming from the omni fulfillment. That is another disruptive way of increasing your sell through and the stock movement in the physical store through the omni linkages and that is a completely new linkage and capability in our industry and they all help us to increase the sell through and the movement of our products.

Chetan Phalke: Just one last question for Kulin if I can put that forward. Which brands apart from GAP wherein you are facing exit issues? And what kind of capital employed will get free once we exit all these brands?

Kulin Lalbhai: We exited quite a few brands over the time, right from Nautica, Gant, we had some online focus private labels that we had built earlier, Ruf & Tuf, Newport, these were all the brands we exited, and we had broadly indicated that these discontinued brands would release a little over 150 crores of capital employed. I believe a little under half of that has been realized, whatever is left is largely in GAP which as we mentioned earlier that in H1 of this year, we should have a resolution in that as well.

Chetan Phalke: Kulin, with respect to Sephora, what kind of sales we can achieve in let's say 5 years? And how is the industry positioned, how are we placed compared to Nykaa because I think Nykaa is also coming up with IPO. Can you just give us a brief on how the industry is placed going forward?

Kulin Lalbhai: One thing that I would like to share is that Sephora is a prestige business, the average ATVs are significantly higher, so it is in a sense a little bit of a more premium luxury format. So, there is some correlation between the price points and the kind of distribution and scale that can be achieved. I don't mean to say that the opportunity is not exciting, in fact it is very exciting, because today we have seen that wherever we place Sephora, it has the highest productivity in any mall. So, the sweet spot of that premium customer that prestige customer, that fit is perfect with Sephora. I think whilst India will be today able to possibly absorb somewhere in the mid to high single digit number of stores addition every year, because this format goes to the slightly more affluent malls and the premium locations. I personally feel that as the per capita income goes up over the years, I think the number of stores India will be able to support will significantly keep going up. It is a little difficult to predict the curve there, but it is very clear that the number of cities that can support the Sephora price points will keep growing, and there is premium malls coming in. So that is the answer on the offline side. I think the disruptive opportunity is on the online side. In the past our online offering was first a function of the size of stores which we had. What we have done since the last year, like we have done in apparel, look at online for online and what that means is that we can definitely enhance the offering in digital. The price points obviously cannot go to a mass pricing because that is not Sephora, but there are so many exciting global brands that Sephora has, exclusive brands which have not yet come in India. So, over the next 18 months we have a very exciting calendar and broadly the offering is going to double. So, in online a lot of the sales scale up is directly proportional to how the offering goes up, and beyond that of course, we will be investing more in customer acquisitions, more cosmetics-based feature sets. Sephora is very strong in its global management on digital. We are working with them to bring a lot of those best practices and knowledge to India. So, today it is very difficult to plot out exactly how the hockey stick of digital will go but we will be focused enough that we really expand and scale up the digital and the offline will be a function of the mall supply that comes in in India. Both put together I can see a world where Sephora will become a large force to reckon with, for the simple reason that that 60% of the offering is exclusive, it is unique, between Sephora private label and all of these exciting brands and because it is globally a €15 billion format, it creates some of the coolest cosmetic brands in the world. So that engine of new brands which will keep coming in, will come into India through Sephora. So, structurally opportunity exciting and we are doing what it takes to start ramping up the digital opportunity, but within the price points and the ASPs that Sephora stands for. You cannot suddenly become one-fourth the price because that is not Sephora.

Chetan Phalke: Are we launching a separate website or a separate app for Sephora? Because from what I understand at this point of time we don't have a separate app to do it.

Kulin Lalbhai: We are doing it today through our multi-brand app and we are working with global. The way Sephora works is the digital front end, or the retail store is like the offline retail store, that is a certain SOP structure and the way it works and we would work with Sephora global. If that store front has to come to India, we would have to work closely with them and bring it which discussions and efforts we will be making in the quarters to come.

Chetan Phalke: What percentage of our sales is online in Sephora at present?

Kulin Lalbhai: Right now, it is between 10%-15%, but it is ramping up. The year before last it was negligible, it has become material last year, and we are hoping this year we have quite a bold plan to grow it significantly this year.

Moderator: The next question is from the line of Abhijeet Kundu from Antique Stock Broking.

Abhijeet Kundu: My first question was on US Polo. What would be the salience of kids wear in US Polo and how has been the performance looking at the kind of growth. US Polo can see a significant growth there. So, during the quarter also what we have said is inner wear and footwear have grown by 30%. But if we look at these two, how has been the growth?

Shailesh: In our two brands, mainly USPA and another more premium brand, Tommy Hilfiger, we have a very well-developed kids line, and both do fairly good contribution to the business. As far as US Polo is concerned, it is already a leading player in the kid's business in all the kids focused shops, and it accounts for a fairly close to double digit number in our own stores also. We do large business of boys line in US Polo. There is opportunity to grow the girls line of business in US Polo. We have plans and in fact in the starting comment I had said that we want to grow the adjacent categories and I had also mentioned kids wear. It is definitely a focus area for us because we see a power of US Polo. And the brand pull it has for even kids' line, it is very strong, and we have very strong demand coming from our partners for children's wear. So, you will see increasing energy, you will see a little more action in children's wear from our side in times to come.

Abhijeet Kundu: During FY21, how has been the performance of kids wear in US Polo?

Shailesh: Actually, there are different phases of the children's wear demand, so when the unlock was happening last year in August-September. At that point of time, we saw the kids wear business had come out fast, because kids grow in size, and they change size faster. So, after the lockdown easing we saw across both online and offline, first few segments that picked up was open footwear and children's wear and we did very good business in that phase, and after that it has stabilized to the normal level of business. But as we grow US Polo further in online and further in smaller tier towns in India, we see children's wear will be a key part of that strategy.

Abhijeet Kundu: My second question was on, we have seen a very significant growth in online revenues & digital space. But apart from the partner sites, the sales which are happening on your own website, there is one which normally comes up in the return ratio which typically retailers are trying to mitigate the impact through omni channel. So, how are you planning to manage that?

Shailesh: As far as the return of stock in the online channel is concerned, we see NNNOW.com has a process on return mechanism and the percentage of returns that we were getting from NNNOW.com has significantly reduced in the last 3 months. So, our efforts have been to make sure that return is managed well.

Abhijeet Kundu: What I was trying to get a sense on, see what happens in online revenues a lot of concerns are there on return ratio, typically the understanding is that the return ratios are in the region of 25%-30%. So, till the time its partner website it is fine, but when it comes to your own websites, how are we mitigating return ratio.

Kulin Lalbhai: The way it is managed is that first of all you have to assume that the return is going to come in, because it is a part of the business model, so whenever we talk about net sales in our own business, we actually net it for the return provision. So, it is pre-provided, we would actually only show 65%-70% of the sales as the book sales. And then how do you efficiently manage the return. The world is becoming more and more sophisticated where you try and take the returns locally, reprocess them and get them back into sellable state as fast as you can. We are making efforts to make that journey faster and faster. So, in the earlier model everything would have to come back to the central warehouse, we are now moving to a model where we reprocess it in the state level itself and get it back into retail stores quickly. So, we are still optimizing that, but as far as revenue recognition is always net of the return provision.

Abhijeet Kundu: Then the typical cost, every time it is returned, what will be the logistics cost?

Kulin Lalbhai: When we put logistics cost, it is built in an online model. 50% of the cost is the return logistics cost, even though only 30% returns come, the cost of returns are higher than the cost of forward, and that is also built into the margin model. That is a part of the logistics cost, but the good part of an omni model is that since you deliver from stores, you have a lot more close delivery, and over time we will have a lot more close return, what that means is in-state return and in-state delivery as that keeps going up, the percentage logistics costs keep coming down.

Moderator: The next question is from the line of Nishit Rathi from CWC.

Nishit Rathi: Just two clarifications. You said that you are targeting an inventory turn of around 2-2.5 times, I am assuming that you are talking 2-2.5 times COGS, right?

Shailesh: Yes, COGS to COGS. We have seen sometimes people take sales, but we are talking about COGS. That's the right way to look at it.

Nishit Rathi: I am just trying to understand. You are basically talking of a 4-5 times sales number.

Shailesh: That is right.

Nishit Rathi: That is point number one. Second one was if I understood it right in Sephora, what you are basically saying is we are now going to sell on NNNOW.com, which is our own platform and we are going to have a store front in all the marketplaces, that could be Nykaa, that could be Myntra, that could be anywhere, right? Is that understanding correct?

Kulin Lalbhai: No Nishit, Sephora globally is an EBO format. In some select markets they also do third-party. So, we would work with them to ensure that we keep making Sephora goods available elsewhere. I think the gentleman that had asked the question was to say, in addition to a multi-brand store front would there be a Sephora only store front, and that was the discussion we were having. For third-party marketplaces, in certain markets they have done that. As the markets in India evolve, we will work with our partners to see how we can optimize the availability of that 50% exclusive product that Sephora sells.

Nishit Rathi: But today basically we only sell Sephora online primarily through our own platform, is that correct?

Kulin Lalbhai: We only sell it today through NNNOW.com and the discussion we were having was Sephora.com.

Moderator: Ladies and gentlemen, due to the time constraint that will be 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 further questions which have not been answered on the call, please feel free to reach out to me and I would be happy to answer them offline. Thanks for your time.

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