Q3 FY2022 Earnings Call Transcript – Feb 14, 2022

CORPORATE PARTICIPANTS

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

Moderator: Ladies and gentlemen, good day, and welcome to Arvind Fashions Limited Q3 FY22 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 third quarter and nine months ended December 31st 2021. I am joined here today by Kulin Lalbhai – Non-Executive Director, Shailesh Chaturvedi – Managing Director and CEO, our outgoing CFO, Mr. Pramod Gupta who is moving into a group role within Arvind Group, and I warmly welcome our new chief financial officer, Piyush Gupta who has joined Arvind Fashions from his previous stint at Bata Indonesia. 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 will commence the call today with Kulin providing his key thoughts on our financial performance for the third quarter. He shall be followed by Shailesh who will share insights into business and financial performance and key priorities for us moving forward. At the end of the management discussion, we will have a Q&A session. 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. Thanks for joining us today. Q3 was a landmark quarter for AFL where the business achieved bottom-line profitability after many years and also saw very robust performance across the brand portfolio. The highlights of the quarter include a very strong retail performance led by Power brands, continued traction in our online channel, large deleveraging due to the combination of the fund raise and debtors efficiency and finally, the highest inventory turn the business has delivered to date.

Sales for the quarter were up 30% year-on-year. EBITDA improved by 62% due to the strong improvement in gross margin, channel profitability and operating leverage. The retail channel performed exceptionally well. We were able to deliver 40% like-for-like compared to last year. While the market sentiments were positive, this performance was possible due to the timely launch and detailed merchandise planning, as well as very strong retail execution. The business was able to open 60 new stores and the momentum is likely to accelerate in the quarters to come. With strong capabilities we have built on the retail execution, we expect the strength in the retail channel to continue.

The MBO channel also showed strong performance. With tight inventory management processes in place, this business delivered strong tertiary growth, as well as good collections for the quarter.

The online business continues to see strong momentum. It has grown 20% year-on-year and has doubled in size over the last two years. It accounts for more than 25% of the overall revenues of AFL. One of the highlights in the online business has been the very strong growth in our footwear business. It has grown 55% year-on-year and U.S Polo has emerged as one of the most successful sneaker brands in the online channel. We are well on track to achieve a 1000 crore business run rate as we exit the year from the online channel.

We continue to see improvement in our working capital turns. Inventory turns have been more than 4 this quarter. With continued efforts on supply chain transformation and stronger processes around inventory management, we hope to improve inventory turns in the years to come.

Our receivables have also seen very healthy improvement. Tight working capital management and the funds from the equity raise have helped us reduce debt by 370 crores this quarter and it now stands at 465 crores. Our reduced leverage has led to a large reduction in our interest cost and has taken our interest coverage ratio to 3.8 times.

We are excited about the journey ahead. With a portfolio of market-leading brands, we have built multiple growth drivers ahead of us. We will grow the retail channel aggressively by expanding into new towns and by also driving up productivity. Our offline wholesale business is well set to grow profitably. The online channel continues to scale powered by new category launches, Omni channel linkages and many other drivers. Our new categories like footwear, innerwear and kids wear also continue to grow rapidly.

While we have multiple drivers of growth, our focus will be driving profitability. As our brands scale, we expect to see strong operating leverage across the portfolio. We also expect our channel profitability to go up driven by internal efficiencies. Our continued efforts on working capital management should help us convert our growth into healthy cash flows. We see this as the beginning of AFL 2.0.

I would like to now hand it over to Shailesh Chaturvedi to take us through more details.

Shailesh Chaturvedi: Thanks Kulin. I am glad to share that in Q3, AFL has become a PAT positive Company. AFL has a unique key powerful portfolio of marquee brands with their unique relaxed and casual appeal that are right in the post-COVID work from home environment.

The Company is at a very opportune moment to grow these brands profitably. Profitability remains a key focus for us. Q3 was a 1000 crore quarter for the Company registering more than 30% year-on-year growth. With seasonality in the industry, Q3 tends to be the biggest quarter with festival and peak winter business. The highlight of this 1000 crore scale was impressive performance of retail channel. I would like to mention few highlights on our retail performance - strong 40%+ like-to-like growth leading to impressive overall growth in the quarter which is achieved on a very high base of strong festival season last year. The retail contribution to overall AFL revenues went up to nearly 45% which is an increase of 7% in the revenue mix. Retail markets saw robust demand with good Diwali festival season. There was timely onset of winter and there was a buoyancy with travel, all supporting demand in the market. This robust demand was met by a very good retail execution by the team that led to healthy improvements in full price sell thru's. The season was executed meticulously in terms of merchandise appeal and assortment, timely launch with adequate freshness in stores and what really made the difference was strengthening of backend retail processes that delivered sharper execution. In line with unique global retail practices of our international brands like U.S Polo, Tommy Hilfiger, Calvin Klein, Sephora, AFL invested additional resources in backend in buying and merchandising, visual merchandising, loyalty, CRM and service training. This execution ensured that the store launches are of very good quality in the market in a competitive landscape. To ensure that these gains are solid, efficient and sustainable, we will continue to invest behind retail processes and we are confident of continued good execution going forward.

This season also saw new upgraded retail identities for brands like U.S Polo, Arrow, Sephora, Tommy Hilfiger and Calvin Klein. With these new retail identities in place, we should be able to up retail expansion next year. Retail is a high gross margin channel and good growth here has increased overall gross margins up to 46%, a good improvement across recent quarters. Retail performance was also supported by restarting of advertising and visual merchandising investment.

In COVID times, it was not justified to invest, but now we have activated the brand plays. While retail improvements were in place**,** we continued to strengthen our leadership position in online channel and delivered 20% growth. At a revenue run rate of nearly 1000 crore per year, online revenue contributed to 25% of AFL revenue. For online growth, we continued our focus on SMU lines, which have given a big business and we connected 60 more stores with Omni linkages taking the total number of stores with Omni capabilities to more than 800 stores. We opened four more fulfilment centers for faster and more efficient servicing of online orders.

Now, I also want to give you some color on our largest brand, U.S Polo – Q3 was a great quarter for the brand. It recorded a revenue per month in excess of 125 crores with a growth of nearly 40%. It delivered double-digit pre IndAS EBITDA, developed a new retail identity and opened a store in Bangalore with it, launched a new advertising campaign with Bollywood actor Arjun Rampal, and delivered fantastic online consumer sales with improvement in U.S Polo rank at all key portals, including top brand performance at the main fashion vertical. Overall, a good launch-pad quarter for U.S Polo for accelerated profitable growth next year.

The revenue growth from two key channels that we have discussed – retail and online, was 70% of our overall revenue, which was up from 65% in the same quarter last year. These two channels put together grew by 42% signifying a solid momentum and our sharp focus of high priority channels.

Another contributor for 1000 crore revenue was profitable growth of MBO channel that grew 50% over last year same quarter. With clear eyes on right controls and strong processes, we have given the right amount of thrust to the MBO channel backed by the right capabilities in common sales structure and branch structure. We have made sustained efforts this year to reduce debt. With capital raise, divestment of loss making businesses and sharp focus on execution, we have seen sharp reduction in debt levels that have fallen to nearly 465 crores, half of what it was last year at end December.

Collections from the market have also been above plan leading to debtors debt coming down below 60 days, which is a drop of more than 20 days over last year same quarter. As mentioned earlier, we have met our guidance on stock turn performance with turns crossing 4.

Supply-chain project is also underway and will continue to provide the Company with solid sustainable improvements in stock turns moving forward. Stronger balance sheet and significantly lower debt levels have helped us reduce finance costs and these efforts have led to a significant reduction in interest costs, thereby helping us achieve a significant milestone of becoming a PAT positive Company.

With evidence of buoyancy in business, AFL started its investment in future so that the current momentum sustains. The Company has started investing into brand advertising that had been significantly reduced in the last two COVID impacted years and initiated investment into transformation project to support growth and improve efficiency in the near future. It must be reiterated that these expenses are needed so as to ensure recent improvement remains solid and sustainable.

Coming to current market conditions – most markets have opened up. In January, business was impacted by Omicron wave, but recent recovery has been faster. With its stronger balance sheet, AFL expects business to be back to normal by March 2022.

This financial year has seen big transformational changes at AFL. The Company fought two rounds of COVID waves, strengthened its balance sheet through capital raise, saw rapid recovery and good growth of business with sharp execution and stronger focus on brands and has significantly deleveraged its balance sheet.

Now, we look forward to the next financial year where AFL will gain operating leverage from bigger scale and internal efficiencies.

With that, I would like to now open the floor for question-and-answer.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Sagar Parekh from Deep Financial Consultants. Please go ahead.

Sagar Parekh: Good afternoon sir and congratulations for good set of numbers and good to see we are in black finally. I actually missed the U.S Polo number that you gave. Can you repeat that number? And you said 40% growth for the quarter for U.S Polo?

Shailesh Chaturvedi: Yes, U.S Polo grew by 40%.

Sagar Parekh: Okay and what is the absolute revenue number.

Shailesh Chaturvedi: We don't give exact number, but our run rate that I mentioned was at 125 crores per month kind of a run rate with a 40% plus growth.

Sagar Parekh: Okay, but we can't extrapolate this.

Shailesh Chaturvedi: I'll just repeat some of the comments that I made on U.S Polo. So, I mentioned that Q3 was a good quarter with a monthly run rate of 125 crores, a growth of 40%, a pre IndAS double-digit EBITDA margin and then there were a lot of other milestones like new retail identity & opened a store with it along with improvement in rank in the online portals. So, overall, it was a very-very good quarter for U.S Polo.

Sagar Parekh: Right and if I just add that then what we would have done about 370-380 crores kind of revenue from U.S Polo for the quarter so which means that we are at about 37-38% of contribution towards sales. U.S Polo would be such a large portion of our sales, right?

Shailesh Chaturvedi: U.S Polo is the biggest brand and the number one focus for us.

Sagar Parekh: Right and in terms of this 40% LTL growth that we spoke about for the quarter, could you give us some color in terms of how different brands have performed in the retail channel.

Shailesh Chaturvedi: We don't prefer to give brand-wise color, but we can say that all of our brand did well because the demand was so strong and while it's like-to-like number, overall growth was 60%. Overall, the festival season was very good and as I mentioned earlier, our execution in terms of season launch, assortment etc. was good. Most brands did really well this time.

Sagar Parekh: Okay, got it. My last question would be on the minority interest. If I look at the P&L, your minority interest profit number seems to be very large. So, basically the maximum profits that would have come would have been from either Tommy, CK or Flying Machine. Is that the correct reading?

Shailesh Chaturvedi: Yes, you're thinking in the right direction.

Sagar Parekh: Okay. So, which out of the three would have been contributed to the large minority interest?

Shailesh Chaturvedi: While, we don't share brand-wise details, but this would be from the PVH JV as that is contributing to minority interest.

Sagar Parekh: Okay, got it, thanks.

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

Nishit Rathi: Hi, this is Nishit here. Just a couple of questions. I missed the channel break-up you shared. Could you just help me with the channel break-up, which is how much is retail, how much is MBO and how much is digital and LFS.

Shailesh Chaturvedi: So, if I look at the contribution, the biggest gain in the Diwali festival season is all from the retail and the retail contribution for this quarter went up to around 45%. Online is at close to 25%. So, between these two focused channel that is online plus retail, we have done nearly 70% of our revenue, which is up 5% over last year same quarter. So, these two channels have done well. MBO also has grown very well. In department store, we haven't recovered fully yet. Part of that reason is that we haven't supplied stock to department stores adequately. We have been very-very tight on inventory; we were having anxieties about Covid wave 3. So, that's one area where we need to up our game and that we plan to do in spring-summer'22 season.

Nishit Shah: Just a followup – so 70% retail plus online, and if you were to think of it pre-COVID, if you were to just compare it pre-COVID, what would this mix be like?

Shailesh Chaturvedi: So, if I breakdown online, it has doubled in the last two years in absolute revenue terms. It has gained significant share of overall revenue mix. As far as retail is concerned, currently around 45%. While Q3 retail mix tends to be a little higher because of the festival, but even if I take early 40's as a steady retail number, it is also higher than what used to be in the past. So, both these channels have more than fully recovered.

Nishit Shah: So, basically, the biggest drag, which currently also continues to remain a drag is the LFS channel, right? Because earlier also you were saying that started to come back and grew this quarter.

Shailesh Chaturvedi: That channel is coming up steadily and has now reached almost 90% of the pre-COVID levels. I think our servicing, delivery of stock has to improve, and we have been extremely paranoid about the inventory control. Retail has done really well and hence, a better performing channel eats up the inventories. However, we are very confident that in spring-summer, we will see bridging that gap also. So, it's not like a very large drag or so. It's at 90% of pre-COVID level.

Nishit Shah: LFS is 90% of pre-COVID level?

Shailesh Chaturvedi: Yes.

Nishit Shah: Okay, and MBO, what would that be pre-COVID?

Shailesh Chaturvedi: We have grown in MBO channel also over pre-COVID. Also, I must emphasize on the MBO channel that we wanted it to be very tight on the trade channel in terms of process control, discount control and profitability. So, we have been very-very sharp on execution with the MBO channel and we are very happy that with the tight controls and processes in place, the MBO channel has now started to grow. Also, one of the reason of that growth has been our new sales structure. So, we have combined our sales structure and we have opened branches. So, we are going closer to the market, new branch in Delhi, Mumbai, and in Bangalore. So, we are building new capabilities to service MBO channels with tighter controls and better profitability.

Nishit Shah: I think that is great to hear because in a way what you are saying is, it was always a very profitable channel, but it had some challenges on the cash flows. But now you have much better control with cash flow and it has started growing again, right? That is the right way to think about it?

Shailesh Chaturvedi: Yes. We are quite happy with the progress of MBO channel and it will remain a low teen percentage in terms of revenue mix. The bigger pieces will the online and the retail, which will be almost like 70%. But in that low teen number, MBO should grow with a higher profitability.

Nishit Shah: Perfect. Shailesh, this quarter, our other expenses went up by almost 75 odd crores and you did allude to the fact that you started reinvestments in the brands. So, I would love to get some color from you. How should we think about other expenses and what percentage of other expenses will be variable cost like royalty and other costs, which will increase with sales and what percentage is fixed, which will give you some kind of an operating leverage going forward in the future?

Shailesh Chaturvedi: Let me breakdown into two parts. One, part of the increased expenses are variable like you rightly said because as the business as grown really well this year to a 1000 crore topline with a 30% growth over the same quarter last year. Obviously, the variable linked expenses like franchise commission, royalty to the licensor, and wherever we have a minimum guarantee rental, etc., so all that goes up because that is linked to the sale and we are happy to give that because we are getting higher sales. The other things are more sort of discretionary to a point where we believe we need to invest behind this for sustaining the current gain. So, we have seen a very good upswing in our business, but we want to ensure that these gains are solid and sustainable. Some of these costs are largely the marketing expenditure and in the last two years, we couldn't advertise much and it was not justified in the COVID sort of time, but now when we saw the evidence of good improvement from September and October, then we decided to up the brand play because now we want to focus on these 6 brands and grow profitably with them. Take the example of U.S Polo. where we signed with famous Bollywood superstar, Arjun Rampal, and we did a campaign with him starting with end November, including with the winter jackets, and that led to very-very good upswing in the business of jackets this season. So, we have had to increase advertising so that these gains remain sustainable in the next year. Also, there were small expenses on the transformational projects that we have done on supply chain that we are committed to increase our turns beyond 4, and we have a supply chain consultant working with us to help us take this whole project of increasing stock turns going forward. The way I would look at it, once we get our higher scale and when once we don't have COVID in our lives, and once these marquee brands grow the way they have grown, then the scale will bring in operating leverage. So, it's a call we needed to take to invest into future so that these gains remain sustainable and solid, and we do a brand play in these times.

Nishid Shah: Any possibility of quantifying some bit of it, or you think that's not possible?

Shailesh Chaturvedi: I would say the transformation projects will continue for a year, but I can tell you that if we had not done sort of a brand play and just kept advertising at a very basic sustainable level, we would have saved Rs. 10 crore or so. So, in this quarter, we spent that kind of money higher to invest into the future.

Nishid Shah: Sure. That was very helpful. Thank you so much and all the best.

Moderator: Thank you. Next question is from the line of Mythili Balakrishnan from Alchemy Capital. Please go ahead.

Mythili Balakrishnan: Thanks. A couple of questions. I just wanted to understand, in online, how much of it is coming from our own site versus marketplaces?

Shailesh Chaturvedi: The way we look at our business is how much of our online business is servicing consumer directly where we have a full control on experience, from merchandise assortment to the pricing, to the delivery, etc. So, we call that as the direct-to-consumer business, whether it comes from our own website, NNNOW.com or from a portal like Myntra. This business is almost like 30% of our overall digital revenues. This is where we build a large marketplace with its own inventory, its own fulfilment etc. Also, we started last year in big way on omni linkages and we have more than 800 stores now that are linked through omni, and then there's an online-offline networking happening there.

Mythili Balakrishnan: Got it. In terms of EOSS start, when will this start and also could you give us a sense of how much of the sales would be full price?

Shailesh Chaturvedi: This year, there were two reasons we delayed the EOSS and the industry also delayed the start of the EOSS. Point #1 was because of the COVID wave 2 in the April-June quarter, the launch of the end of season at that point of time in July started late. So, the fall holiday season started a bit late. So, there was no need to discount which used to be typically mid-December when EOSS used to start. So, industry saw the need and we all saw the need to not discount at that same date calendar because we had fewer weeks of full price this time. Second reason and the bigger reason was that we saw very-very buoyant demand in the market like I mentioned during Diwali. Winter season had set-in on time and was of good intensity. We saw a lot of travel that helped retail upswing. So, we delayed the launch of EOSS. To answer your question, what you really saw that most of the business in October-December quarter barring the last week of December**,** most of the business would be full price in this quarter.

Mythili Balakrishnan: Got it. I also wanted to get a sense from you on the payable side. We are sort of at this 1000 crore number and its sort of high. So, I just wanted to get a sense from you that do you see this coming down as we sort of payoff some of this or you think that this is the level at which your vendors would be comfortable with?

Shailesh Chaturvedi: Actually, our payables have come down as a size of the business and there has been a steady progress and we had a meeting with our vendors in this quarter. We took them through what the new AFL with the new improving balance sheet was looking like. So, I would say that payables situation has improved significantly and we're comfortable with the current levels. I would also ask Piyush add some color.

Piyush Gupta: Now, the payables are, to a large extent, correlated with the turnover and its linked to new season buying which is relevant for Q3. Important is how many days of payables right now we have. We have less than 100 days which is very reasonable and we should maintain the current status.

Mythili Balakrishnan: Got it. My last question is on Arrow. It's a brand, which has sort of struggled and it is like in the past. We have sort of relaunched it and tried some different technique**.** So, just wanted to get a sense of what has been the market response.

Shailesh Chaturvedi: This year, product received very good response for Arrow. The growth over the last year has been good, but I would still say that Arrow will take some time. So, there is a lot of improvement in its profitability, but the way the brand is structured in COVID, we have been very-very tight on the inventory, we expect it to reach its logical conclusion in the next financial year. We are happy with the progress, but there is still a lot to execute and do better on Arrow.

Moderator: Thank you. Our next question is from the line of Pritesh Chheda from Lucky Investments. Please go ahead.

Pritesh Chheda: With our Company there have been more than two rounds of capital raising that has happened, and we have run the business in a certain format. Incrementally, how do we see the capital allocation or the capital side of management by the Company, and when we are looking at the working capital cycle, the key part there is obviously the inventory. So, we have reached 4x inventory turns this quarter. How do we see these inventory turns moving forward, let's say, a couple of years from now? And, a couple of years from now, what would be our strategy on the capital structure side?

Shailesh Chaturvedi: So, I'll take the question in two-three parts, start in the reverse order. Inventory – we are very happy with the progress that we've made on the inventory turns. We had guided that by end of this year we should cross 4x and we have already achieved that in this quarter. We also have a supply chain project going on with an external domain expert, part of a transformation project that I mentioned where we want to grow the stock turns further in a more sustainable, solid way. So, we are committed to high stock turns and improving stock turns, and that will be at the heart of our working capital strategy to make sure that, the inventory in the market is very fresh, which helps our like-to-like and the overall growth. The second part of the capital structure, our focus has been on these high conviction brands. We have rejigged our portfolio and focus on these marquee brands which is very well suited for the post-COVID times. The idea is profitable growth of these brands so that these businesses throw cash. Even in this quarter, these businesses has thrown operating cash flow. The whole idea now, going forward, is to grow with these brands and expand with the cash flow generated from these brands. So, the idea would be to have a very disciplined capital structure focused on debt level, on inventory turns, and growing the business by profitable growth of the fantastic portfolio brands that we already have.

Pritesh Chheda: Okay. So, when you say that you'll grow from the cash flows of these brands, so we ideally will not see the balance sheet expanding significantly in your next growth phase. Is that the conclusion we should take?

Shailesh Chaturvedi: Focus is like I said is on profitable growth and cash generation from the business and I can request Kulin to throw additional color on this as well

Kulin Lalbhai: Yes. I think that's exactly the way to look at it, as we have been telling that with six high-conviction brands, all of which are positive EBITDA and as operating leverage kicks in, profitable growth will come in, and with the working capital turns becoming tighter, a lot of that growth will lead to cash flows. So, we do not expect balance sheet to expand. In fact, the business should start throwing up cash with this strategy.

Pritesh Chheda: Okay. So, we can see our drawdown in debt as well, as we move forward?

Kulin Lalbhai: Yes. We intend to reduce leverage in the years to come.

Pritesh Chheda: Okay. One bookkeeping question. So, between the reported result that we have, which is post-IndAS, what will be differential between post-IndAS and the pre-IndAS, and the EBITDA level?

Kulin Lalbhai: Actually, it is around 3-4 percentage points.

Pritesh Chheda: 3-4%, okay.

Pritesh Chheda: Where are we on the Flying Machine brand after its brand encashment with Flipkart? Where are we on the Flying Machine journey? One more clarification I want to do, amongst the brands that we own, where do we have a less than 100% ownership now, so Flipkart is one and how about the other brands?

Shailesh Chaturvedi: So, let’s take this in two parts. First is on Flying machine. So, last year, when we did a strategic deal with Flipkart group, it opened a lot of doors for us on the online world. We wanted Flying Machine, which is a youth centric jeans brand and the only established value brand in our portfolio, and with that objective, we went into the partnership and now it's opened doors and with partnership with Flipkart, which is a leader in that segment and Flying Machine is doing really well. Even this quarter, the growth on online is more than 50%. On the big days, as you know, online has a lot of big days and Flying Machine does very good number. It’s a leading ranked brand on Flipkart group portal. In fact, we are very happy with the progress and the mutual learning that we have between us and the Flipkart group. We had a lot of insights on the online business from their side and this business is ramping up. Second question was on the ownership of different brands. So, we have a joint venture with PVH that's an American multinational Company. It's an equal JV where Tommy and CK brands sit. So it's an equal JV between us and then we have relationship with Flipkart group for Flying Machine, where it will get converted into equity next year as currently FK ownership is in the form of cumulative convertible preference shares (CCPS).

Pritesh Chheda: Okay. So, Calvin Klein, Tommy Hilfiger and Flying Machine are the three brands where we would have less than 100% ownership?

Shailesh Chaturvedi: Yes, that's right.

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

Vaishnavi: Hi, thanks for taking my question. Two questions, one is on the working capital front, at least on the inventory, what kind of investments should we see in inventory going forward, especially since you mentioned that inventory was running tight and we didn't supply to LFS?

Shailesh Chaturvedi: So, LFS business also is trending well now and it's the right time to open the tap a little more wholeheartedly. So, we believe we are at stock turns of higher than four and we have a stated objective of ensuring the turns in the near future remain close to four or above. So, based on the size of the business and we expect the business to grow, for the higher scale, the inventory in proportion to the turns will go up, but we're not expecting any deterioration of the stock turns.

Vaishnavi: Okay, got it. With our inventory turns going up and basically freshness in our inventory increasing, better full price sell through and better gross margins, and at the same time online channel contribution increasing to double in terms of the absolute revenue versus what it was pre-COVID, how do we look at the gross margin going forward for the Company?

Shailesh Chaturvedi: The inventory freshness is a double advantage on the inventory turns and also the very big added advantage of having fresh stock in the market which helps in lower discounting, which effectively helps with higher gross margin. Also, retail is a higher gross margin business and there is a thrust to improve that channel mix also. So, if I really look at an example like Q3, where turns are higher and best quarter in terms based on the channel mix. So, with this, we will continue to be in the mid 40's and above. That's our objective on the GP side.

Vaishnavi: Okay, got it, thank you so much.

Moderator: Thank you. We will take our next question from the line of Aliasgar Shakir from Motilal Oswal. Please go ahead.

Aliasgar Shakir: Yes, thanks for the opportunity, a couple of questions. One is on your inventory. So, Shailesh you made this comment that we've been very-very focused on inventory and there was some of the growth in LFS and MBO channel probably given up. So I just want your comments on what measures are we taking to ensure that tight inventory control may not hurt our revenue growth going forward, and I mean, how do you see this panning out?

Shailesh Chaturvedi: That's a very-very good question. You have to see the context of what I was saying that we had anxiety about wave 3 coming in. So, we were paranoid and we didn't know when the wave 3 would hit us etc., so we were very-very tight on the inventory side. In the COVID times, the biggest focus is inventory, how do you manage freshness and how do you keep the inventory under control. So, now hopefully COVID is behind us and now we are looking at a different background completely and as we stand today, recovery is fairly good and we expect that business will become normal by March. In the changed scenario, we will take different calls and while we will still remain very conscious of stock turns increasing and in our business, discounting and high inventory is really the bane of our industry. So, we will always be cautious and prepared on the inventory side, but of course we also want the higher growth and leverage that comes from bigger scale. So, we will take the prudent decision. So, it will be a ball that we will juggle between growth, which we want because it has its own advantages and it brings in profitability and at the same time, we don't want to make any mistakes on the inventory or on the freshness side.

Aliasgar Shakir: Understood, this is very helpful. Just a related question here is, could you just share typically the time it takes for a particular product from order to store, and what is the flexibility you have to manoeuvre here?

Shailesh Chaturvedi: Yes, so it's again a very pertinent question in our industry. So, we work on many bricks. One brick is where we do a seasonal roadshow, booked order for the market, which could be four to five months in advance. At the same time, we also do things like flexible manufacturing that can deliver goods in 45 days. So, we don't have one rhythm like what used to happen in our industry. The whole idea is to be more agile and alert and respond faster to the changing market demand dynamics. So, we work on part of a brick that is fashion that we book in advance four to five months. We also work on a regular basis with our core and essential product, which don't get discounted. We also work on monthly flashes where we bring in monthly collection closer to the season and market, look at what's selling, trending well, where are the gaps, we fill in through those monthly flashes and then especially on the online world, respond to the things, which are selling fast and work on a very fast flexible manufacturing where we can deliver goods faster. So, we work on multiple methods to reach to the market.

Aliasgar Shakir: Understood. This is very-very helpful. One question on your footwear. You mentioned that footwear within U.S Polo has done very well, particularly the sneakers. Can you just share a few things over here in terms of which are the other brands which are doing footwear? How big is overall footwear in our overall portfolio, what is growth trends we are seeing? Maybe if you could also share if we have any specific focus in footwear to have specialized footwear driven EBOs or what is the growth outlook here?

Shailesh Chaturvedi: Footwear is a key focus area. We have a stated objective of growing adjacent categories in these high conviction brands. U.S Polo is the biggest brand. So, we have launched adjacent category like kids, women's wear, footwear, innerwear. Look at another brand in our portfolio, Tommy Hilfiger, it has very large adjacent category from kids to watches to belts, wallets and small leather goods. So, we are very keen to extend the appeal of our focus brands into related categories. Footwear is very-very relevant for casual brand like U.S Polo. We had put investment behind footwear ahead of time couple of years back and we are seeing good traction. U.S Polo sneakers, especially, our leading ranked brand on the online platforms. We are also adding footwear in our stores of U.S Polo because it leads to higher like-to-like growth for stores and also improves the sales density, which all brings in additional gross margin for our retail channel. So, footwear is very-very exciting business. It has doubled its revenue in the last two years during COVID and has improved its rank in online world. So, margins are also good. We are putting adequate, wholehearted investment to grow the footwear category. We are increasing assortment, we have open footwear, we have sneakers, we have, moccasins, etc. So, we're looking at all possible categories that fit into U.S Polo brand appeal and growing footwear business. We can look at other brands also extension, Tommy Hilfiger already has a footwear business, Calvin Klein also has a footwear business. This will remain an area that we'll keep a close eye on, and in the meanwhile, we are very happy with the progress that U.S Polo footwear has made.

Aliasgar Shakir: Understood, this is very helpful. Can you share what would be the size of footwear in the overall portfolio.

Shailesh Chaturvedi: I won't be able to share exact number, but it's really contributing well to the store and and also online, the revenues are very good, making it a leading brand.

Aliasgar Shakir: Got it, this is very helpful. Thank you so much.

Moderator: Thank you. We will take our next question from the line of Prateek Poddar from Nippon India Mutual Fund. Please go ahead.

Prateek Poddar: So, you see the sharp increase in employee costs and even other expenses adjusted for your 10 crores investment, which you called for. Anything to read into it?

Shailesh Chaturvedi: I mean I would repeat what I said. With the evidence of good growth and recovery in September-October, we needed to make upfront investment in the brand play and because we clearly wanted that buoyancy in our business should sustain and we needed to take a strategic decision to invest now or wait, and these brands are very important and we want to invest ahead so that the gains and the traction of these brands sustains and improves in the times to come in the near future. Also, we have some transformation project going on like supply chain I mentioned, we have a domain expert working with us. It's likely to be a 1.5-2 year project to make organization efficient on stock turns. So, these are all very strategically important initiatives and in COVID, our hands were tied, but now we decided as the markets are recovering, we needed to up the brand play.

Prateek Poddar: Got it. So, if I were to analyze this quarter revenue, you have earlier guided high single digit pre IndAS margins on the EBITDA side. That will take some time, now you would need a higher scale to get to high single digit pre IndAS margins?

Shailesh Chaturvedi: I would put down the things in two-three parts. Point #1 is, Q3 revenue is 1000 Crs and it is the biggest quarter. It reflects a sudden scale, not evenly, since it's a seasonal quarter. Second part is that obviously, in the last two years, the scale is impacted by COVID, and we expect the operating leverage on the scale as the COVID goes away. So, we are committed to growing our EBITDA margins and some of our brands are already double digit, I mentioned U.S Polo and Tommy Hilfiger. Early next year our EBITDA margins will improve further. As far as the Power brands are concerned, I'm sure in 12 months, we will see higher EBITDA margin from that portfolio, and as the scale & efficiencies kicks in, our balance sheet has been deleveraged, our interest costs have come down, so there is a lot happening and we're really looking forward to next year where hopefully there'll be no COVID.

Prateek Poddar: Fair enough. Thanks.

Moderator: Thank you. Before we take our next question, we'd like to remind participants to ask a question. We’ll take our next question from the line of Rishikesh Ojha from RoboCapital. Please go ahead.

Rishikesh Ojha: Hi, my first question is what would be our current market share?

Shailesh Chaturvedi: In our industry, it is one of the most difficult questions to answer because it's a very large industry and very large is unorganized, and then there are conversion from unorganized to organized at play at a different price point, different segment. We do get exact precise information from some of the channels, like we get information from department store channel. We do get some data from the malls and in online world. I can only say that our brand portfolio is market leading brands with fairly good market share, but I can't put a specific number for you.

Rishikesh Ojha: Okay, no problem. My second question is that if you could share your margins on NNNOW.com.

Shailesh Chaturvedi: Again, we don’t give out very specific business related, on a particular business, whether it’s U.S Polo or NNNOW.com.

Kulin Lalbhai: I think what we can possibly at this point share is that it’s a positive unit economic business, in fact, it’s a double-digit channel level profitability, but we wouldn't be able to get into very-very specific numbers on it.

Rishikesh Ojha: Okay, no problem. My last question would be what is the return on capital employed we are targeting in a medium term?

Shailesh Chaturvedi: Again, very good question and ROCE is a key north star for us and that’s where the eventual focus will be. So, we're going step by step i.e. reviving channels, Power brand margins and then cutting down on the capital employed and making working capital very efficient, increasing stock turns. Currently, our journey has started from the last quarter where we have delivered a decent ROCE, but we want to see these numbers sustain. Our near-term objective is to reach double digit ROCE and aiming for higher ROCE after and we are committed to it. We are working hard on that and this will take us a year to two years to reach towards our goalpost, but all the efforts on working capital control, improving stock turns, improving margins of our brands, channel efficiency, all are directed towards finally achieving the ROCE target.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the floor back to Mr. Ankit Arora for closing comments. Over to you, sir.

Ankit Arora: Thank you everybody for joining us on the call today. If any of you have any further questions or any questions have been unanswered, please feel free to reach out to me offline and I'd be happy to answer them. Thank you and look forward to interacting with you next quarter.

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