Q1 FY2023 Earnings Call Transcript – Aug 11, 2022

CORPORATE PARTICIPANTS

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

Moderator: Ladies and gentlemen, good day, and welcome to Arvind Fashions Limited Q1 FY23 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 Rutuja. Hello, welcome everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the first quarter ended June 30th 2022. I am joined here today by Kulin Lalbhai – Non-Executive Director, Shailesh Chaturvedi – Managing Director and CEO and Piyush Gupta, Chief Financial Officer. Please note that results, press release and earnings presentation had been mailed across to you earlier and these are also 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 first 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.

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 afternoon to you all. Thanks for joining us for the Q1 results. We witnessed a very strong momentum across channels in Q1 building on the strong demand which we had witnessed in H2 FY22. This robust demand reflects the strong affinity amongst customers for our portfolio of market leading brands. Quarter 1 FY23 is our best Quarter 1 result in terms of sales and profitability with revenues growing by 40% over pre-COVID to 920 crores and an EBITDA growth of 52% compared to pre-COVID levels at 94 crores. Sharp execution on the retail channel continued in this quarter as well registering around 25% like to like growth despite our conscious decision to push out the EOSS window for our brand. We registered the highest ever full price sell through in our business across brands in Q1 and lower discounting helped deliver a sharp jump in gross margin of 49.4% for the quarter which is an improvement of 640 basis points compared to the same quarter last year.

The MBO channel witnessed robust demand as well with channel sales growing by 2.5 times pre-COVID. Our investments in omni-channel and marketplace aided strong performance in online channel with sales almost doubling compared to pre-COVID levels and a 20% growth on a significant base in Quarter 1 of last year. Our working capital continues to remain under control with an improvement in debtors led by higher retail channel mix and better collections during the quarter.

We continue to target having inventory terms of more than 4 times in FY23 leading to free cash flow generation. We remain optimistic about the rest of the year with revenue momentum likely to stay strong with a great autumn-winter'22 launch coupled with continued growth in online and other channels and a further boost expected in the festive season. Our focus on expanding adjacencies like footwear, inner-wear and kids-wear across our existing portfolio will remain one of our growth drivers and we are already seeing rapid growth there. Profitable growth will remain our mantra going forward and the focus will be on improving operating margins and a significant improvement in our return on capital employed. I would like to now hand it over to Shailesh Chaturvedi to take us through more details.

Shailesh Chaturvedi Thanks Kulin. Hi good afternoon, everyone. With 40% growth in revenue over pre-COVID Quarter 1 FY20 and 52% growth in EBITDA, Quarter 1 saw very strong execution of brand promises of our market leading brands with the consumers. It was very heartening for the industry that finally after 2 full years, we saw a full season starting with season launch in February'22 to start off with end of season sale in July and now launch of the new season in August'22. Till now in the last 2 years we have seen COVID impacting one part or the other or the bulk of the season but we are finally happy to see finally a full season. This full canvas of season also gave us opportunity to execute our work in online and offline world, resulting in very strong business KPIs. The scale of 920 crores in Q1 is nearly 600 crores higher than last year's Quarter 1. This was possible because all major channels, be it retail, online, trade – they were all firing. We saw 100 crores revenue gain in retail channel alone in this quarter over pre-COVID Quarter 1. We saw 100 crores revenue gain in online in Quarter 1 versus the pre-COVID Quarter 1 FY20 and the trade channel also grew close to 80 crores. We saw multi-channel growth in this quarter resulting in 600 crores higher revenue than last year leading to 920 crores NSV in this quarter.

Retail has become a large channel for almost half of our company's revenue and this has been pushing our GP percentage higher because retail channel has a higher GP percentage. With very high-quality focus and systematic execution, we saw retail KPIs improve, like-to-like store growth of 25%. I must say our stores have never looked better. April'22 and May'22 saw 50% growth over pre-COVID periods, while June growth reduced because we decided to postpone end of season calendar to July to limit the number of weeks in a year under sale and improve our margins through lower discounting.

Online continued its growth momentum; it has nearly doubled in Quarter 1 over pre-COVID times. The online business has accounted for 25% of revenue for the company in Q1 and has grown by more than 20% on a large base. And it continues to help us serve demand in a more robust omni way. Majority of our stores are now omni enabled and omni contribute nearly 10% of store sales at the connected stores.

Let's talk about the marketplace; with strong investment in fulfillment capabilities across India, with higher degree of online specific product in marketplace and with bigger assortment for our brands, marketplace business has grown by 50% in Quarter 1. Our GP percentage of 49.4% is the highest in recent times. Over the last couple of quarters, we have seen a jump of around 4% in GP due to sharper execution, focus on like-to-like growth, better full price sell through and after accounting for commensurate increase in the variable cost in channel like retail a good part of this gain flows into EBITDA margin. You see, our EBITDA margin has gone up by 1.5% in this quarter versus the pre-COVID Quarter 1, FY20. This has resulted in PBT positive performance for the company. This is the third straight quarter of PBT positive performance at AFL.

Our focus continues to remain to grow the business at 12% to 15% annual rate net-off COVID and we remain focused on strong, sustainable, consistent and profitable growth of business. On the brand front, our uniquely powerful portfolio of market leading brands has gained momentum further post-COVID. U.S. Polo Assn has become an even higher ranked casual brand in India and is galloping towards the top rank here. Tommy Hilfiger and Calvin Klein have also performed exceedingly well in terms of reduction in discounting, increase in full price sell through and have delivered double digits pre-Ind-AS EBITDA. This portfolio of U.S. Polo, Tommy Hilfiger and Calvin Klein is a very powerful set of brands in the market and is delivering very healthy profitability and growth for AFL. Another good news is that Arrow is EBITDA positive. With market revival post-COVID and improvement in supplies to different channels, Arrow has gained scale and is delivering fantastic business KPIs. We've also seen in the market revival of weddings, festivals, business travel and celebration of special occasions which augurs very well for further strengthening of Arrow business especially its profitability.

As the business continues to generate cash even with impressive growth ahead, we expect our net debt levels to remain close to the levels we ended last year at. At June end, our net debt was 427 crores. With continued tight control on inventory, business remains in the zone of 4 stock turn. With improvements in margin, we have seen return on capital employed move up in this quarter to a high single digit percentage and we will continue to step up efforts to take this ROCE to higher level in future. Thank you and over to Ankit.

Moderator Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Nishid Shah from Ambika Fincap Consultants.

Nishid Shah Congratulations to the team on the good set of numbers. Now you have got an incremental — as I think you mentioned in your remarks incremental — 600 crores of sales have come. Now if you look at your gross margins, in your industry the gross margins anyway should be substantially higher, then it is not translating properly into the operating margins as well at the net level. My second question is when you benchmark and look at the competitors, some of the competitors who are slightly bigger than in size to you — I'm referring to Page Industries — they have an ROCE of 67% and operating margin of 20% and all. So, where you do benchmarking and where are we needing to improve to get to that kind of industry leading numbers in terms of profitability and efficiency?

Shailesh Nishid, very interesting question, coming to the scale and the margin; compared to COVID impacted last year's quarter we've grown 600 crores but then also there's a delta of close to 120 crores in the EBITDA and in a weaker quarter called like Quarter 1 which in our industry tends to be low, we have done 94 crores of EBITDA at 10.5%. There is a definitely improvement in the margin scenario. Compared to pre-COVID also our EBITDA margin has gone up by 150 basis points. It's a journey, we are not closer to some of the benchmark companies that you mentioned but if you look at last three quarters, we have consistently improved our margins, our KPIs and from a loss-making company, in the last three quarters we've become PBT positive and I'm sure this journey will continue and take us to the heights that you are mentioning Nishid.

Nishid Shah Yes, Shailesh, just taking over from there and I'm glad you mentioned that, actually if I look at your annual run rate and Page Industries annual run rate, the difference is only about 1,000 odd crores. I'm sure you and Kulin both are cognizant of the fact that there is a huge gap in terms of where Page Industries is in terms of market cap of 54,000 crores and where we stand today in terms of a market cap of almost 4,000 odd crores. I'm saying top line is coming, you guys have done a wonderful job. Now is it that we are now going to focus on the efficiency parameters and also on the profitability aspect. Another thing is, if you look at the working capital days, they have a working capital days of 36 days. We still have to improve on the working capital and improve our inventory turn. So, would you like to expand on that?

Shailesh Yes, so I won't talk about a specific industry player because their realities are their realities and ours will be different and the level of discounting in underwear business versus our fashion business is different. I would definitely agree to what you said that, would your focus remain on profitability? I think if we have to say a single mantra for us to take our margin model for Power brand to a double-digit EBITDA in next 12 to 18 months is a single-minded agenda that we have. The ROCE improvement, we've done ROCE positive and now breaching single high digit. What we have promised we are delivering and it's a journey, step by step we will continue to improve our profitability and that's a single objective. Also, on stock turn, we have improved our stock turn from 3 to close to 4 now and that's the journey again that we will keep an eye that improving stock turns from beyond 4 will be a target for us and we will work hard towards that. I couldn't agree more with Nishid what you are talking about in terms of stock turns, in terms of the margin model, that will remain our focus. We've made good progress. We are very pleased with our performance in Quarter 1 and we'll continue to work hard towards that.

Nishid Shah I can see there's a substantial improvement. All I was saying is that we need to improve on the profitability aspect. Now the last question is on the Sephora. We have discussed this in the past, is there any progress on the

Sephora on the online side or are we going to focus only on the in-store side?

Kulin Lalbhai In Sephora, the business is doing very well now. I mean the offline business is currently performing exceedingly well post-COVID. The segment also is doing well. On your question on online strategy, we are still working with our partners on how we should plan that out. For the time being we are in the process of expanding the retail network and the like-to-like productivities are going from strength to strength and as we work and get clarity on the other side, we will roll things out.

Moderator The next question is from the line of Pritesh Chheda from Lucky Investment Managers.

Pritesh Chheda Our growth versus Quarter 1 FY20 seems to be different from what peers have reported. We are on a slightly lower side, whichever peers we can compare with the April space, so is it to do with the end of season sale timing issues for which the growth looks different? That's one question. My second question is, the pre-Ind-AS margin if you could give some comments there and at this revenue scale of 900 crores which means an annualized number of 3,500 crores. If I recall in your past presentations, at about 800 crores of sale or 700-800 crores of sale in our power brands, we were already at about 8% pre-Ind-AS EBITDA margin. Why is it that margin number looks lower even if we have achieved 900 crores and if you could guide us on the pre-Ind-AS margin direction for the company?

Shailesh As far as the growth is concerned our growth is close to 40% over the Quarter 1, FY20 and across the channels the revenue has fired very well. Now if I look at the retail numbers for this quarter, in April compared to the pre-COVID, we grew 50%, in May again we grew at 50% with very good LTLs of almost 35%. In June that 50% growth came down close to 15%

because we pushed the EOSS is out to July and because of that June growth came down but our margins and discounting also came down significantly and because of that we recorded full price sell through's which are very important for the margin model in our business. So, the growth is robust and EOSS had an impact on the June number but that was planned by us. We saw similar things done by many other players in industry.

Pritesh Chheda My question was, we grew 40%, peers have grown 50%. Is there any reason for this 10% differential where the tailwind for everyone was a similar tailwind? There any reason for this differential 10% we being lower?

Shailesh I think we've been doing well across the channel, online has grown on a higher base. I don't know which player you're referring

Pritesh Chheda Madura is (+50%), Kiran is (+50%).

Shailesh I've seen the related parts of these companies which are comparable because some of these companies you have mentioned have many businesses which may not be directly comparable, they do have some businesses which are directly comparable and our numbers are quite in tune maybe better than some of them. I don't want to say specifically but, yes, the EOSS is probably the only reason otherwise we have done quite well.

Pritesh Chheda On the margin side, if you could help us understand.

Shailesh What happens in the margin between the post IndAS and pre IndAs, there is a difference of close to 4% and we've discussed this in the previous calls also. The difference is around 4%. Now ours is seasonal quarter, the EBITDA margin differs based on the level of wholesaling, level of discounting. It's a very seasonal industry and Quarter 1 tends to be the weakest quarter in company in terms of the margin. In the historically also

Quarter 1, we are very happy with our margins in Quarter 1 because this is historically the best margin in Quarter 1 and if I look at the remaining part of the year as we get into the festival season, our margins would be higher because it's a seasonal business and if we are at 10.5% post IndAS then there will be many quarters likely to have a higher EBITDA margin and we are improving our EBITDA every quarter and whatever the number you took, you will see hopefully a higher percentage than that in this year itself. We are very confident of delivering, also I think if I would say midterm 12 to 18 month period for our power brand portfolio we have a clear objective of reaching double digit EBITDA in our brands. We have a slightly weaker EBITDA margin in Arrow, its EBITDA positive now. But it's a journey ahead on that brand to improve to double digit. But U.S. Polo, Tommy Hilfiger, Calvin Klein, these are all in that zone of pre-IndAS double digit EBITDA margin and the whole portfolio will move forward and also seasonally you'll see higher EBITDA margin as we go along in this year.

Pritesh Chheda Just clarifying, when you had a 900 crores sale and it was a pure full price sale, yet you could not achieve your earlier pre-IndAS 8% EBITDA margin, any comment there? I hope you got the question. Why seasonality is the answer here when the absolute number is 900 crores?

Kulin Lalbhai I think Shailesh was answering it, 900 you cannot look at in an absolute sense. Every quarter will have a different channel mix and channel profitability also changes in our business. Historically Quarter 1 is a quarter where there is no wholesale billing. It is a pure retail only quarter, so you cannot take a quarterly revenue as a benchmark. When you look at it from an annual sense what you are saying that logic would hold. As the other quarters come in when the channel mix changes, you will see the bottom-line profile changing.

Pritesh Chheda In your business if you could give the hierarchy of margin profile in an EBO, so what EBO is the lowest vis-à-vis the wholesale?

Kulin Lalbhai We don't get into channel level discussion but historically retail in Quarter 1 is not the highest productivity retail quarter. Retail in Quarter 3 for example will be very profitable during the Diwali season. You have to look at it quarter specific. If you look at our historical performance over many years, you will always see Quarter 1 is cyclically the lowest bottom line quarter in the year because of the channel mix and the kind of sale pattern you usually have in Quarter 1.

Pritesh Chheda So, Quarter 1 is more retail and less wholesale, that's how it is.

Kulin Lalbhai The retail is also a summer season versus the festive.

Pritesh Chheda I will take it offline. I was unable to understand specifics.

Shailesh You can connect with Ankit offline he will give you more color on the channel wise.

Moderator: The next question is from the line of Riddhesh Gandhi from Discovery Capital.

Riddhesh Gandhi We are a reasonably a premium band that we have, so I'm assuming on those the gross margin should be reasonably high. Again, just following up on the question of the previous participant, just wanted to understand structurally what is it that isn't allowing us to earn EBITDA margins in line with other retailers despite having done so well on the revenue front, despite not discounting. Is there something structural? Is it the royalty which we will pay to the brand? Is it the kind of location where our stores are? Is it that our overheads are for a reasonably higher organization? Is it that we're overspending on advertising just want to understand because something is structurally off with regards to kind of profitability even at this level of revenue?

Shailesh Yes, like we said that the Quarter 1 we do largely retail business and there's no wholesaling, the primary billing that we do for the season beginning in February-March or Jan-Feb or in July-August where there is a full margin etc. Retail expenses in the first quarter tend to be on a higher side. So, Quarter 1 has a kind of products we sell, the average selling price of that product versus what we sell in the festive season or in winter season per piece billing. The productivity of retail also is little lower towards this part of the summer season than in the remaining part of the year. Eventually the sales density tends to be little lower in the summer season compared to the winter season or the Diwali season. That kicks in a little higher margin as we go along. You will see in a Quarter 2 and Quarter 3 because of the seasonality you'll see a higher margin for us. If I look at our entire performance, if I look at the GP, increase in GP on an average around 4% in the last 3-4 quarters we have seen. Part of that in retail channel, there is a commensurate variable cost because we have to pay the franchisees commission. The entire gain of retail in GP doesn't necessarily flow into the EBITDA but it still delivers a good EBITDA. The second thing in this quarter I can only see that we had one-off employee expenses of around 7 crores because until last year — we used to have a March ending annual appraisal cycle — which has now become July, so the new salaries come in July which used to happen in April. There's one-time performance bonus & retention that we paid out which will not happen in future. If I remove that 7 crores then EBITDA would have been slightly higher. So, other than that, structurally we are in a phase where our GP and our EBITDA margins are going up.

Riddhesh Gandhi I completely appreciate that the first quarter seasonally is the weakest quarter. I understand that the EBITDA will go up in Q2, Q3 which are obviously stronger. Even though it's the weakest quarter and I'm saying compared to almost all retailers who we are seeing, we are still materially lower despite being on a reasonably high revenue.

Kulin Lalbhai Just explain one thing structurally in this business, it's a very high operating leverage business. Now we have a portfolio of six brands. Each of them are at different levels in their journey. If a brand is typically nearing an 800-1000 crores turnover, basically it is a brand with a high operating leverage and correspondingly the profitability is high. Three of our brands are already in a high double digit pre-IndAS profitability which puts them broadly in line with market profitability of large established brands. We have got a couple of brands which are still scaling up. So, Arrow has been in a turnaround. It had gone into negative EBITDA actually, come back into positive EBITDA. But the journey for it to get into double digit EBITDA is still a journey which will take little bit of time. It is about rescaling the brand and Shailesh mentioned a lot of positives in the KPI but it's still a little bit of a journey. We have seen the beginning of that journey and that journey is not complete. Similarly Flying Machine and Sephora are still in terms of sub-scale, they are also getting into their journey of moving towards double digit profitability. So, large established brands have achieved the double-digit profitability and the maturing part of the portfolio is scaling up and overall, the company is also scaling up which will bring operating level. It's a point in time in our journey where we will continue to see the benefits that will come from some of our brand scaling up and the company overall scaling.

Riddhesh Gandhi Got it understood. I think that's extremely helpful. The only thing I think which incrementally would actually help us and I know you don't disclose the brand level details. But the reason it would be helpful is, it will help us to actually understand the journey a lot better where we can see what has happened with other brands which you guys owned. How those numbers have shaped up and how your other brands are tracking as well in this similar direction. It gives us also the comfort that we are heading at least ultimately in the right place and it isn't being hidden in all of these other aspects.

Kulin Lalbhai I think Ankit can also explain some of this. Generally, the way operating leverage behaves in our business is something that definitely should be understood and I think Ankit can also shed some light on this separately with you.

Riddhesh Gandhi Okay I will reach out offline. And, all the best!

Moderator: The next question is from the line of Yash Mandawewala from Mandawewala Family Office.

Yash Mandawewala Can you talk through the gross margins for this quarter, how much of it is just a one-off due to maybe EOSS being pushed to the subsequent quarter? If we take a medium-term view, where do we see really the gross margins on the portfolio as a whole ending up?

Shailesh Yash, the way our channel mix is varying and the retail is becoming stronger where our execution is sharper. There is a genuine regular around 4% odd jump in gross margin in the recent quarters. This quarter yes, pushing of EOSS would have also helped but that's one- time, next year onwards we will not gain in that. We are definitely in a situation with better focus on our sell through with lower discounting. Our GP has gone up by 4%. Now in some of the channels there is a variable cost below GP like in retail because the kind of franchisee commission, the employee cost, so entire that 4% doesn't flow into EBITDA back even if it's a higher scale. But in some channel, it comes in. Basically, there is a sustained, genuine increase in GP of around 4% odd. I think that should continue in terms of the progress into this year in next few quarters.

Yash Mandawewala Basically, whichever quarters the retail sales are high the GPs will look higher but the other expenses will make up for that. What does this commission piece look like that we give to the franchisees as the percentage of sales. How does that line-item work?

Shailesh That's a channel to channel. In our books if you see there is a term called other expenses, where a large part of this operating expense sits and that's 297.1 crores item in the June P&L. That you can track and see how the other expenses and a lot of it is the channel expenses below the gross margin that goes there.

Yash Mandawewala Right but that's a variable.

Shailesh It's a variable. The franchisee commission is linked to sales. A part of it is variable and some part where suppose we have our own staff etc. and like in department stores. So, that becomes a large part of variable franchisee commission. There is a royalty component that comes which is also a variable link to the sales.

Yash Mandawewala Just next on Arrow, you mentioned we have breakeven for this quarter EBITDA breakeven. So, this is pre-IndAS EBITDA or this is sort of post IndAS?

Shailesh Pre-Ind-AS EBITDA.

Yash Mandawewala We had just during COVID pivoted Arrow towards having slightly more casual or bit more sporty collection. Now that the offices are opened and formal wear seems to be making a comeback. How are you thinking about the positioning with regard to Arrow?

Shailesh Very good question because Yash what we have seen is that since March this year, the festivals, special occasions, weddings, all those business travel has really increased, if you see the flight tickets and the hotel occupancy has really jumped up. In COVID times when people were only working from home, we modified and we had a strong sportswear collection in Arrow. What we have seen in the Quarter 1 the sell through of its core products which is a formal shirt, formal trouser, they have seen fantastic full price sell-through. That business has come back and that is giving us scale because that scale was not coming during COVID. Arrow is a very strong player in many department stores, is in the top two brands in a competitive space. That business has now bounced back and that is giving sales which is giving the leverage for the Arrow to come back to EBITDA level pre-IndAS profitability. We will continue to work on its formal shirts, formal trouser, suits & blazer. We still have a casual line which is also growing well because demand has been very strong in the Indian market of late. So, Arrow will benefit from the revival of the festive, wedding, special occasion demand.

Yash Mandawewala Also, I mean pre-COVID, there was this institutional channel that it seems Arrow is pretty strong in. Over there, I think there's a structural hit to the profitability with regards to Arrow. How are you guys thinking about how much time will you give this brand to turn around and maybe is there a decision that needs to be made on the future of this brand over the next 12 to 18 months?

Shailesh It's a very leading brand. If you do any consumer research, it's a very priced possession. It's a top consumer brand, Arrow in it's segment is a leading brand. I think the environment became very hostile during COVID because people were not traveling, the weddings were not allowed, special occasions were not happening. Today as the world has come back and started to learn to live with COVID, we are seeing very good traction and buildup of scale. We just finished our booking for spring-summer'23 season, Arrow is really a very highly desirable brand, in fact the sell through of Arrow not just in our stores but with the trade consumers, the sell through's are very encouraging and very market leading sell through's in the industry. So, COVID was particularly bad for this one brand. But, that's behind us and we are building scale in this. SS'22, if I see versus pre-COVID times, there is a big improvement in sell through, big improvement in reduction in discounting. I think it's a brand that we feel very proud of having in our portfolio. This is the only wedding brand in our portfolio. Other brands are casual. We go to customers in the market, it's a very important part of our bouquet that we offer to a trade customer. We are very strongly committed to Arrow and we've seen the work and I think this brand should accelerate.

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

Nishit Rathi This is Nishit here. So, I have a couple of questions. One, I just wanted to understand, so if I'm just doing the math right, Tommy, CK and USPA all turn profitable seem to be doing double digit profitability on pre-IndAS and all the other brands also seem to be making money which is Sephora, Flying Machine and Arrow. So, none of them seem to be losing money. But somehow that doesn't add up in your numbers. So, are you losing money somewhere?

Shailesh No, I mean we did lose money in Arrow in the past but that's behind us and it's now broken even in the Quarter 1 and Flying Machine is also profitable, just that the scale like Kulin said earlier the brands are sub-scale. Arrow had a specific COVID impacted performance. I think with Tommy, CK and USPA continue to do well both in terms of scale and profitability. Now Arrow, Sephora and Flying Machine will need to add their scale and profitability. So, that's the journey for us ahead.

Nishit Shailesh, my thought was that if I take those top three brands they will be maybe 50% of your business as part of my rough assessment and if I give double digit margin, it's kind of there. The only thing is something has to lose money somewhere for you to be at that kind of reported profitability levels.

Shailesh I assure you, like I said earlier we had seen losses in Arrow business but that business has turned around, it is broken even now. The absolute profitability in these brands that you mentioned, Arrow, Flying Machine and Sephora is still very small and when we look at double digit and then somebody's low single digit and you look at the overall portfolio, it does impact the numbers. In a way you are right that our task is to take the profitability of Arrow and Sephora and Flying Machine higher and that's what we are all working on. If you look at the last three quarters, we have consistently step by step improved our execution and we will also continue to improve and Arrow where it was a year back versus now, it's in a much healthier space, Sephora is doing leading like-to-like sales in industry and that business has started gaining scale. I think in some sense I agree with you that what you are indicating to us, leave the math part away, what is the job ahead for us.

Nishith: And Shailesh how should I think about it? Because historically on the con-calls, I had the belief that any brand that reached a scale of 300 to 400 crores started giving extremely high ROCEs. But that number seems to have gone up. What is the new level for you for us to just understand? At what scale do these three brands start giving you double digit kind of margin or what mix change for you to kind of start getting those kind of margins?

Shailesh I think I would say the answer for a double digit would be two parts, not just scale. Yes, scale is very important and it gives you the leverage and your fixed cost get apportioned. But I think it's also the efficiency. This is also about the sell through, it's also about the discounting level. You can be a very big brand but with high discounting and still be loss making. I think the whole rigor of executing right from merchandise assortment to the right retail standard, to right growth in the stores or online discounting. We have to work on both the sides, its scale yes, I agree with what you're saying but there's no answer to that at this scale you will 100% become profitable because you will have to marry the scale with the efficiency. You could be a 400 crores brand profitable, you could be a 600 crores brand loss making. Somewhere we have to find both scale which is important from a leverage point of view but also efficiency. That's why you see our entire discussion is on sell throughs, launching season properly, reducing discounting. A lot of our effort is actually going in last 3-4 quarters that you've seen is to improve our KPIs on the execution. That's what we are doing a fairly decent job of. That's what we'll have to continue doing, so that every brand in the portfolio of power brand becomes a double digit pre-IndAS portfolio in next 12 to 18 months.

Nishit Okay, that was my third part which I just wanted to understand. So, you're saying that in the next 12 to 18 months you see your entire power brands portfolio moving towards that close to double digit margin, right?

Shailesh Yes, that's our stated objective and we are working hard towards that.

Nishit My last question because I was unable to understand, so you have Rs. 300 crores worth of other expenses. In that you said a lot of it is also variable which is the commissions that you must be paying and royalty you must be paying. So, can you just give us a sense what percentage of it is fixed, so that we get a sense of when you actually get operating leverage and how does it happen?

Shailesh Nishit, we can slice it for you and connect with you later because we don't have a ready data to provide right now. We will do the math and share it with you.

Nishith Sure.

Moderator The next question is from the line of Sagar Parekh from One Up Financial.

Sagar Parekh My question is again on the pre-IndAS EBITDA margin only. You all have sliced and diced everything. Just on a 3,600-4,000 crores top line base for this current year, we would still not be reaching double digit kind of pre-IndAS. So, given the mix of brands that we have for annually at 4,000 crores what would be like the pre-Ind-AS EBITDA that we can achieve and at what level of sales can we achieve double digit kind of pre-IndAS EBITDA number?

Shailesh Sagar, what we have stated and we keep giving our guidance is, that this year we will be in the high single digit EBITDA at the overall portfolio level. A lot of our brands are already pre-IndAS double digit. We mentioned some of those brands and some brands are not like we just said the names clearly. So, that's what this year's journey is. What we also committed is that we continue to improve our GPs, continue to improve our contribution and EBITDA margin so that we reach in 12 to 18 months the whole power brand portfolio which will be double digit. That's our plan and we are sticking to it. That's our guidelines and we are working hard towards that.

Sagar Parekh And just one suggestion, actually I know generally you have mentioned in the call that the pre-IndAS EBITDA is about 400 bps lower than the reported EBITDA. But if you can, in the presentation, you give the breakup of EBITDA between power brands and emerging brands. This practice you used to do it earlier, in case if you can possibly do it again in terms of giving us pre-IndAS EBITDA number for power brands and emerging brands separately, it would be really helpful and it will be taken positively by the investor community in general because otherwise in the call a lot of time gets wasted on asking the same questions about what is the pre-IndAS EBITDA margin breakup etc. That's just the suggestion from my side.

Shailesh Sure. We noted your suggestion Sagar and our team will connect with you and we will definitely work on that.

Sagar Parekh I've already spoken to Ankit about this. In case you all can apply this from next quarter onwards, if you can give pre-IndAS EBITDA margin breakup for different power brands and emerging brands separately that would be really helpful.

Shailesh We'll definitely consider your suggestion.

Moderator: The next question is from the line of Pulavarthi Saikiran from Pulavarthi Advisors.

Pulavarthi Saikiran First of all congratulations on very good trajectory on the number. I think there is enough of discussion happening at the EBITDA level profitability. If I just change this profitability discussion at the net profit level. I'm just wondering how does different brands look like? Because when we look at the numbers there is a minority interest which is there which is essentially the Calvin Klein and Tommy are reasonably profitable when we look at even the long-term trends this year or last year. As we are suggesting, the other brands are mostly broke even at the EBITDA level. But unfortunately, that is not getting translated at the PAT level. If you can just explain us what is this holding it back? Also, if you can just let us know how this profitability at the PAT level can improve for the next few years.

Shailesh I think it's valid observation. There is a joint venture which is profitable and we have in the AFL very strong, fast-growing profitable brand in U.S. Polo, it's a market leading brand. We have a couple of brands which are sub scale, where the profitability is low and we have discussed, one of that we have turned around, it's broken even now. Some other brands like Flying Machine, Sephora still sub-scale. The whole effort will be to build efficient scale, a profitable scale so that the EBITDA margins go as we said that high single digit pre-IndAS this year and power brand double digit EBITDA pre-IndAS in 12 to 18 months. Once that happens then the profitability comes because if you really see at an interest level or at a depreciation level, there has been a good reduction, our debt levels are under control, depreciation is going down this quarter versus previous quarter also last year you see a sharp reduction in the below EBITDA items. There's no interest cost or depreciation cost worry because its balance sheet has already been tightly managed. I think the PBT level or at PAT level, the gain will continue to happen when the EBITDA goes up and we will continue to manage our interest cost tightly the way we have done and our depreciation. I think it will come back to our discussions on margin improvement and our guidance and our single point agenda is to improve the scale in an efficient manner, so that the EBITDA margin goes up.

Pulavarthi Saikiran I understand but if you look at it, just looking at the same commentary. The Tommy, Calvin and then U.S. Polo are highly profitable and probably in the double-digit margins at the EBITDA level and none of the brands are losing money at the EBITDA level which is also reflected at the EBITDA side. But unfortunately, that is not getting translated to the PAT level. So, are you suggesting that the depreciation and amortization, finance costs are primarily be fixed hence whatever the gross margin expansion happens will flow to the EBITDA hence the profitability should improve at the PBT level. Is it that what you are hinting at?

Shailesh Yes. Like I said below EBITDA the items are already in control. If you look at historical last 5-6 quarters trend, interest cost and depreciation have witnessed sharp reduction and we were not even PBT positive. In the last three quarters, because of all the improvements there in balance sheet and cleaning up of the brand portfolio we've turned PBT positive. It's a third quarter where we become PBT positive. So, it’s a journey and we are committed to it because it will eventually come back to cash generation. We started generating cash and this year also, the business will throw cash. This whole PBT improvement, cash generation at FCF level, this is a guiding principle for us. We are working hard on that and as some of our brands are scaled up in an efficient manner and we continue to keep a tight control on a balance sheet item and stock turns etc. then the cash flow will happen. So, that's the agenda that we are focusing on.

Pulavarthi Saikiran One last question from my side. When you say, Arrow is profitable, you mean Arrow is profitable at pre-IndAS level or at the PAT level?

Shailesh No we are talking about brand pre-Ind-AS EBITDA level.

Pulavarthi Saikiran So, essentially the Flying Machine and Sephora also at EBITDA level they are profitable but below EBITDA probably they might be losing some money. Is it a fair assumption to make?

Shailesh Yes, and they need efficient scale then only the overall game will change for us and that's what we are focusing on.

Pulavarthi Saikiran Last question, in terms of the tax rate, how much accumulated losses we would be having on our balance sheet?

Shailesh I think I don't have a ready answer but I'll request Ankit to connect with you to give you this data point.

Ankit Arora Saikiran I will connect with you offline and we will give you some color on this.

Moderator Thank you. Ladies and gentlemen as this was the last question for today, I would now like to hand the conference over to Mr. Ankit Arora for closing comments.

Ankit Arora Thank you everybody for joining us on the call today. I trust all of your questions would have been answered. If any of you have any further questions, please feel free to reach out to me offline and I will be more than happy to answer them. Thank you so much for your time and look forward to interacting again next quarter.

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