Q2 FY2024 Earnings Call Transcript – Nov 8, 2023

CORPORATE PARTICIPANTS

- Kulin Lalbhai – Vice Chairman & Non-Executive Director
- Shailesh Chaturvedi – Managing Director & CEO
- Girdhar Chitlangia – Chief Financial Officer
- Ankit Arora – Head, Investor Relations and Treasury

Moderator: Ladies and gentlemen, good day, and welcome to Arvind Fashions Limited Q2 FY24 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 Arshiya. Hello and welcome everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the second quarter and half year ended Sep 30, 2023. I am joined here today by Mr. Kulin Lalbhai, Vice Chairman and Non-Executive Director, Mr. Shailesh Chaturvedi, MD and CEO and Mr. Girdhar Chitlangia, Chief Financial Officer.

Please note that result press release and earnings presentation had been mailed across to you yesterday and these are also available on our website www.arvindfashions.com. I hope you had the opportunity to browse through the highlights of the performance. We will commence the call today with Kulin providing his key strategic thoughts on our second quarter's performance. He will be followed by Shailesh who will share insights into business highlights and financial performance. At the end of 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 may be 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 and over to you Kulin.

Kulin Lalbhai: Thanks, Ankit. A very good afternoon to you all. Thanks so much for joining us for the Q2 results. Quarter 2 has been a strong quarter for AFL, where we have achieved our highest ever sales, EBITDA and profit after tax. In spite of tough market conditions and a shift in the festive calendar, we grew our sales by 7%, propelled by the retail and MBO channel. The significant improvement in bottom line has been driven by strong like-for-like sales, good full price sell-thru's and improvement in our gross margin.

Our working capital cycle continues to improve with a 10 days reduction in gross working capital days. In quarter 2, we focused on re-energizing our brand through large investments in marketing, where our investments were around 100 basis points higher versus last year. We will continue to invest heavily behind our power brands in the years to come.

I would also like to inform you that AFL has divested its Sephora business post the closure of this quarter. The brand has been diverted to Reliance Retail at an enterprise value of INR 216 crores. With this move, we have completed our portfolio rationalization exercise. Our stated goal has been to build a portfolio focused on high return on capital and strong cash flow. We are very proud of the way in which we scaled up the Sephora business and wish the brand very best for its future journey. With this divestment, we will retire our debt and focus our management bandwidth and capital in scaling up our 5 high conviction brands.

While the current market conditions are challenging, we are optimistic about the prospects in the second half of this year and are hopeful of growth being higher compared to Q2 and H1 levels. Our focus on profitable growth will continue, and we expect margin improvements to continue in the quarters to come.

I would like to now hand it over to Shailesh to take us through the specifics and more details about our financial performance.

Shailesh Chaturvedi: Thank you, Kulin. Good afternoon, everyone. Amidst soft market condition, AFL has delivered encouraging results with a growth of 7% in revenue in quarter 2 despite shift in festival calendar. This quarter's business can be split into two parts. The first part saw the July/August end-of-season sale; and the second part, the fresh season in September.

We had delayed end-of-season sale in June because of good sell-thru's, and then we saw energetic trading in July and August with double-digit like-to-like growth. September business saw a small negative like-to-like because of shift of festival dates to October.

Overall, AFL delivered a healthy 9% like-to-like retail growth with fantastic overall sell-thru's in spring-summer'23 season. With less number of full-price festival days, retail discounting went up by nearly 3%, but we saw very good sell- thru's and managed the inventory levels very well with reduction in inventory by 2 days.

I must also add here, like Kulin mentioned earlier, that Q2 saw the highest ever quarterly sales, the highest ever quarterly EBITDA both in value and percentage, and as well as the highest ever PAT for AFL in a quarter.

Since there was a sense of slowdown, we had prepared our response through various dynamic measures, including product innovation, higher investment in advertising and tight cost control. Premiumization of products for clear differentiation is a key theme here. Arrow pushed business of its premium line '1851' and auto press wrinkle free shirt strongly, USPA launched super premium Polo t-shirt line and higher-quality jeans line, which saw very good sell- thru’s.

We also launched very successful capsule collection with Muhammad Ali in Flying Machine. Tommy Hilfiger and Calvin Klein continued its strong journey in super-premium segment with fantastic growth and profitability.

This quarter saw one of its kind mega events in our top brand U.S. Polo Assn. We launched our famous Legends campaign in Bombay with a global standard even in presence of Mr. Michael Prince, the Global CEO of USPA brand. Taking the brand idea of twinning forward, we showcased two legendary pairs twinning in USPA. One pair was with brand ambassador Arjun Rampal with his fashion model contemporary Milind Soman, as legends of fashion modelling. Given the brand's association with sports, we chose the second pair from tennis, the legendary Lee-Hesh pair of Leander Paes and Mahesh Bhupathi. This Legend event received enormous media coverage just before the season and was followed by impactful national media releases. We also launched our first brand website from our company as www.uspoloassn.in and also tied up for USPA women's wear line with upcoming star, Palak Tiwari. Similar efforts were also seen in Arrow where we released campaign with Hrithik Roshan, which was a directorial debut for the famous actor. We also promoted flying machine brand regionally in North. USPA brand also saw first time mass-media campaigns for adjacent category like footwear and innerwear, which were received extremely well by consumers and trade fraternity. We have continued to focus on our growth drivers like store expansion, premiumization and wholehearted marketing investment and development of adjacent category. We have made significant progress on build up of adjustment category in USPA brand, also in Tommy Hilfiger and Calvin Klein businesses.

In USPA, adjacent categories are now more than 25% of revenue, and this business is growing very profitably in double digits. Both Tommy and Calvin Klein has a very wide range of accessories, including watches, kids wear, innerwear, small leather goods, etc. And this business is nearly 20% of retail business, is growing in high double digits.

Based on success with these brands, we have now started focus on adjacent category for other brands, including recent launch of Flying Machine footwear and small leather goods in Arrow. We increased advertising spend in Q2 by almost 100 basis points to keep our brand salient and to fuel growth. Despite this near 100 basis point increase in advertising, our EBITDA has grown in Q2 due to tight control on overhead and efficiency in sourcing and are decisive focused on building profitable scale of our 5 marquee brands.

Adjusting to other income in Q2, our EBITDA margin has expanded by more than 150 basis points in Q2 despite higher advertising and despite soft market conditions. H1 saw EBITDA margin expansion by 100 basis points to 12%, in line with our guidance. We continue to keep tight control on balance sheet items and Q2 saw a 10-day reduction in GWC with 8 days reduction in debtors and 2-day reduction in inventory.

Overall, inventory freshness has remained strong, helping our gross profit, which has gone up to 49.5%, an increase of nearly 5% year-on-year because of efficiency and sourcing and higher share of retail channels. We are confident that consumer will continue to vote in favor of market-leading brands and look forward optimistically to the second half of the financial year.

Ankit Arora: We can now open it up for question-and-answer session.

Moderator: We will now begin the question-and-answer session. The first question is from the line of Mr. Himanshu Nayyar from Systematix.

Himanshu Nayyar: Congratulations on a great performance. Sir, to start with, if you can let us know what explains the significant difference in growth trajectory in the power brands and emerging brands. And within emerging, is it Calvin Klein, which has been driving this significantly higher growth?

Shailesh Chaturvedi: See, in emerging brands, you are right about Calvin Klein, the super-premium segment has a higher energy. And both Tommy and CK are doing very well, and Calvin Klein is part of the emerging brands. So that growth is because of Calvin Klein's fantastic performance.

Moderator: Sir, are we connected?

Himanshu Nayyar: Yes, I am. I think we lost the management.

Kulin Lalbhai: Let me take that question. This is Kulin here. I think, as Shailesh was saying, Calvin Klein is driving the emerging brand revenue. In the case of Power Brands, one of the impacts this season is because of festive shift. So a lot of our wholesale bookings has moved a month. And that is why for our wholesale channel, quarter 2 has a slightly lower growth compared to quarter 2 of last year, where the festive impact was a positive impact in Q2 for the wholesale channel. So that's one of the reasons why Power Brands is having a lower revenue print compared to Emerging Brands.

Himanshu Nayyar: Understood. And secondly, if I look at the minority interest number, even that seems to have moved up significantly. So does this imply much higher profitability in Tommy, CK or maybe a reduction in losses in a few of our other tail brands as well?

Kulin Lalbhai: Shailesh is back. Go ahead.

Shailesh Chaturvedi: We lost the line for a moment. The minority interest is largely linked to Tommy, CK business. And the Super Premium segment has done well. These brands are market leading brands and their profitability has gone up. So that's exactly the reason that you mentioned, Himanshu.

Himanshu Nayyar: Okay. And final question would be on this transaction that we have done, exiting Sephora. I believe we would have already got in the consideration. So I mean, are we looking at now -- I mean advancing our debt reduction plan as to what would be our guidance be now in terms of becoming debt-free?

Girdhar Chitlangia: Yes, you are right. The objective that we are heading towards is to reduce the debt, use almost the entire proceeds to reduce the debt. And as we speak, the end quarter net debt was INR 476 crores. And as of now, we might be around INR 260 crores to INR 270 crores of net debt.

Moderator: The next question is from the line of Mr. Shreyans from Svan Investments.

Shreyans: Congratulations on a good set. So my first question is, from what we understand is Q1 and Q3 are retail heavy quarters, and Q2 and Q4 are wholesale heavy. And you also mentioned that there were some postponement in wholesale sales in Q2. So what I'm trying to understand is why have our other expenses gone up so much because since it is not a retail heavy quarter, we would have expected some gross margin benefit to flow through to your EBITDA.

Shailesh Chaturvedi: See, if you look at the other expenses, they are in line with the retail channel. In this quarter, the retail channel has grown more than 15%, while you're right in a sense that this is a more wholesale quarter. But even in this, because of the good performance in July, August in EOSS, the retail contribution has gone up, the revenue share by 4%. And the retail channel has grown more than 15%. And the similar increases is in the commission and other variable expenses come below. So our other expenses, if you will look at is that out of INR 60-odd crores increase, nearly the INR 45 crores increase has come from the variable, which is commission plus royalty plus supply chain costs.

And also, there is an increase in advertising this time because we took a decision to invest heavily behind advertising. So the balance increase in other expenses is going into the increase in marketing cost.

Shreyans: Okay. And my second question is, sir, when I look at your emerging brands. So obviously, we've done very well on the revenue bit. But just on the margin side, I wanted to understand, Q-o-Q, I think last quarter con call, you had mentioned that Aeropostale and Ed Hardy losses are mostly behind us now, and CK obviously is doing well. So margins should sustainably be at the levels that we saw in Q1. So I'm just trying to understand, Q-o-Q, we've seen some de-growth. So what is the reason for that? And how should we look at this number? Is it going to be that variable, 11% to 6% and then again, 6% to 11%?

Shailesh Chaturvedi: Emerging brands have really done well in quarter 2. The EBITDA margin has gone up by almost 3.5%. The way I would look at quarter 2 is that emerging brands have done well in sales and also the EBITDA has grown really well. Now our business is highly seasonal. And really is not right in many ways to compare quarter 1 to quarter 2.

I think the focus should be on comparing quarter 2 to last year's quarter 2 because this quarter has a EOSS and other peculiar aspects of the season. So the way I would look at it is that emerging brands continue to do well, 2 reasons. One is the good performance of Calvin Klein and second is the clean up that you mentioned. So that benefit come through. And we will hope to even in this uncertain market conditions, we hope that emerging brands continue to do really well the way have done in quarter 1 and as well as in quarter 2.

Shreyans: Okay. And sir, my last question is, so how do we define a power brand or an emerging brand? What is the thought process when you put out CK in an emerging brand? Because CK, when it is doing so well, I think it should be a part of a power brand and Flying Machine should rather be an emerging brand. So just wanted to understand how do you bifurcate these brands when you think of power and emerging?

Shailesh Chaturvedi: This was done in the past when Calvin Klein was still a small business. And you are very right that in last 2-3 years, this business has really outperformed, is one of the coolest brand in the country. And it's really grown in scale and in terms of profitability. And there'll be a time when we will soon probably classify it as a power brand.

But we are still following for transparency of analysis and for you to sort of see the data in the right perspective. We still kept Calvin Klein now with Sephora's exit, which was also part of emerging brands. We will re-look at the portfolio and we will soon come back with some new thought process.

Shreyans: Sure. And sir, just on the Power Brands bit. Last quarter, we grew about 1.5%. This quarter, we grew by about 5-odd percent. So from our understanding, we are doing pretty well in USPA and Tommy, so consol basis, our growth has been slightly lower. So just wanted to understand what has been the growth rate for Arrow and FM, if you can just help us understand the trajectory there?

Shailesh Chaturvedi: See, look at Power Brand business in the light of 2 things. One is there is a softness in the market, which impacts all the brands. Second is a shift on the festival dates where last year, the Diwali was earlier and September saw lot of festival dates and billing. And now festival season has moved from quarter 2 to in October. So all the brands got slightly impacted.

There's no brand-specific data here. And when I look at the number of Flying Machine and Arrow or U.S. Polo, there is a decent growth in the current market condition in all the 3 brands and all the 3 brands got a little bit impacted because of the change of the festival calendar, and some of it will get captured in Q3, and some we'll have to fight the slowdown in the market condition.

Moderator: The next question is from the line of Mr. Priyank from Vallum Capital.

Priyank: Congratulations team for the fantastic performance. My question is on Arrow, sir. If you can help us qualitatively, how has been the operational performance on Arrow. I reckon we have taken a lot of steps to improve the profitability over there. Are there some more strategic steps left for us to get this brand to double-digit EBITDA margins?

Shailesh Chaturvedi: Let's look at Arrow in 2-3 parts. One is that during COVID, it became a loss-making brand. And we did a lot of effort post-COVID from change in merchandise to marketing with Hrithik, to new retail. And we made a lot of efforts to grow the business. And last year, there was a swing in EBITDA of almost INR 80 crores in Arrow and it broke even, and it's been now profitable brand for last 3, 4 quarters.

This quarter also has remained profitable. Now in the current market slowdown, Arrow has continued its growth, its grown high single digit in revenue. Also, its EBITDA has grown. I was looking at the EBITDA number, this quarter, EBITDA is the highest in the last 8 quarters for Arrow. So there is a continuous progress in the Arrow business.

Now it's still in the early and the low single-digit EBITDA profitability in Arrow. And like I said in the previous investor call, now our whole journey is to build the scale further and take it to the 10% EBITDA, which could take 2 years or thereabouts, our guess is and based on the market conditions.

I think if I have to say one thing that we need to do now to take it to that level would be opening many more stores because it's subscale brand still. And we need to expand its EBO reach and also grow a little more online share. So I think it's about scale, and then the sale leverage will come. The KPIs on sell-thru's and gross margin and many other KPIs are really green, and we need to now scale up the brand.

Priyank: Got it. Very clear. And kudos to the team for taking a decision on Sephora. My question would be since you have taken this strategic decision, when can we expect such strategic decisions for other few brands because we are now clear on our communication that we want to focus on the 5 core brands. When can we expect any such decisions which are other brands, which are yet continuing few losses for us?

Shailesh Chaturvedi: Let me say upfront, we are extremely focused in energizing these 5 brands and make them big-scale profitable brand. So we have no plan now for any further action on any of these brands. The single agenda is to energize these brand profitability, scale up them to a profitability that we've been guiding and grow the company at a certain scale and with a certain profitability. So we don't have any other action on card, and we are very committed to building AFL into a bigger and more profitable company through these 5 brands that we have.

Priyank: Sure, sure. Just a quick question on, sir, how much would be EOSS as a sales composition in trailing 12 months, if you can help us? And how has that been trending as a percentage of sales over the last few years?

Shailesh Chaturvedi: Our sell-thru's have been very good. So we do probably industry-leading sell-through in our season, and last summer season was good. Now if you want any specific information on the sale data, etc., we can get back after the call and you can connect with Ankit on this.

Priyank: Perfect, perfect. Last question from my side, and then I'll get back in the queue. Our channel checks have suggested that large formals market leader has stopped participating in the trade channel aggressively. And the competitive intensity has been slightly lower on the formals and on the wedding wear side, especially on the men's wear. So just wanted to get your sense, would we be gaining market share? Would we be gaining shelf space in the MBO channel in the coming quarters? Is that the strategic thing that we are also looking towards it?

Shailesh Chaturvedi: Let me just say simply that MBO has been a good performing channel for us, even this quarter has grown more than 15%. And we have expanded distribution in MBO channel with all our brands. So in that sense, we would have surely gained market share.

But one more thing I have to say is that all the growth in MBO, we have been very, very tight on the hygiene of the business. And we have really kept focus on profitable growth. We don't want a situation where the debtors or ageing of inventory becomes a problem. So we are very focused on the quality of sale and that's very important with the MBO channel and our governance on the stock held and on the debtor is very, very critical for this channel. So we are happy at this point with the hygiene in MBO channel, the growth have been good and also the standards have been maintained.

Moderator: The next question is from the line of Mr. Ankit Kedia from PhillipCapital.

Ankit Kedia: Sir, 3 questions from my side. First is we have seen good growth on retail and MBO channel. What is the decline we are seeing in online and LFS channel because these 2 channels also account for more than 1/3 of your revenue. And given that the other 2 channels have grown by 15%, clearly, these 2 channels would have seen a high single-digit decline in the system.

Shailesh Chaturvedi: Ankit, like we said, there is an impact of the festival calendar. And in the couple of channels that you mentioned here that shift, like, for example, take online, a lot of big portals have shifted their tower events which happened last year to September to October this year. And we have the October numbers that some of those businesses have recovered in October.

So in that sense, the shift of tower dates and also the Puja festival in East or the Diwali dates across the country, that shift has impacted the department store. But we feel very comfortable that the department store, our market share and our growth are good. And also online, there is a little bit of destocking in that channel, so that we're keeping an eye on. But our focus has been building our B2C business - our B2C business where we do the marketplace and through our own website NNNOW, we are building.

And we have seen 65% growth in Q2 in our own control where we offer the pricing and experience and the assortment. So we are really building our own muscles on B2C side, which is showing very good growth. We are building our Omni network stores, which is also in a very encouraging state. And one, in many ways, this quarter is not really comparable to last year quarter in some of these channels because of the shift of the festivals. And also, yes, we also admit that there is a bit of a softness in the market. And because of those 2, you may see that there is a small decline. But if I look at medium term, we will feel confident of these channels.

Ankit Kedia: So if I have to add September and October together, and obviously, last year Diwali was also in October, now it's pushed through November, how has been the early trends in the market for October and early November, if you can help us understand that. Because a lot of the other retail companies are knocking off some softness, but even green shoots in the demand are leading to Diwali?

Shailesh Chaturvedi: See, I can say that as we see the current, there are still many days to Diwali left and the peak – weekends are still ahead, weekdays ahead. But whatever the days that we follow, the business has been sluggish and maybe it's because of cricket or otherwise.

Moderator: Participant, please hold on. The management line has been disconnected. I'll try to reconnect back with them. Please hold on.

Shailesh Chaturvedi: Ankit, I was talking about Diwali being a little sluggish still now. And we are hoping that the second half of the Diwali calendar might pick up, but let's see.

Ankit Kedia: So some of full year guidance, which we used to have of 11% to 13% growth. Is it possible that will be toned down to high single-digit growth? Including Sephora because Sephora will not be there from November, but adjusting for Sephora?

Shailesh Chaturvedi: See, no, we have a certain sales guidelines, 12% to 15% in medium term and is based on a certain set of growth drivers that we have. And I spoke extensively today also about adjacent category. Second growth driver is our store expansion. We opened 46 stores. And in the first half, we opened 91 stores. It's on track.

Our like-to-like growth are very healthy, 9% in this quarter despite slowdown. That like-for-like growth also is working. And digitalization, I say

B2C and Omni linkages are working, B2B online is a bit slow in the short run.

So most of our growth drivers, including premiumization of brands and categories, new categories, all look very green to me. And they're all firing. The market is a little soft. So in this medium term environment where we are looking at growth of between 12%, 15%, I'm sure we'll have some quarters of very, very high growth. And we will also have some quarter where the growth may be low.

But we are very confident that in the medium term, we will continue to grow at 12% to 15%. And I also believe that H2 could be better than H1 because we have more festival dates and we have wedding dates and winter season coming in, let's see. It's uncertain, but that's our sort of optimism cautiously. So we believe that in the medium term, the growth drivers, we will stick to our guidance.

In the short run, we will see because markets are very uncertain, and we are still looking at growth. But I also want to qualify one point here is that we've been very, very focused on the quality of growth. So look at our profit growth is always higher than the sales growth. So we have always looked at growth, whether the MBO channel, I said with high governance, we want to focus on quality of growth. We want to ensure that our profit growth is higher than the sales growth. And we are still very confident that the medium term, we will meet our guidance. There will be some good quarters and there may be some slow quarters.

Ankit Kedia: Shailesh, on your comment on store openings. If I look at last year, you opened 175 odd stores, but the net opening was only 5. This year also, we are talking of gross opening of 91 stores. Can you just help us what is the net store addition happening? And are the store closures behind us now?

Or there is still rationalization happening of loss-making stores in the system?

Shailesh Chaturvedi: At any point of time, in a physical world, there is always churning down of 3% to 4% of the stores, and that will continue at any point of time. It's sometimes higher, sometimes lower. So we are at a normal stage right now. I don't have exact data right now, but we can connect with Ankit on the store closure, etcetera. But I could say that we are now a regular pace, there's no extraordinary even happening currently.

Ankit Kedia: Shailesh, just a feedback. There are more than 20 retail companies listed, and you are the only ones who don't share with us channel-wise revenue, neither do we get overall retail number of stores the company has today. I'll appreciate if disclosures can be marginally improved. It will help us analyse the company better.

Shailesh Chaturvedi: Ankit, that's very, very good suggestion. Thank you for that. And both on the channel wise and on the store count, we take your feedback, and we will come back with those details soon, Ankit. Thanks for that feedback.

Moderator: The next question is from the line of Mr. Himanshu Nayyar from Systematix Group.

Himanshu Nayyar: Just had a couple of questions on Flying Machine. So whatever efforts and measures that we had taken to sort of energize Arrow seem to be now giving us good results. But do we have a similar level of confidence on Flying Machine also ramping up and turning around both in terms of scaling up as well as profitability?

Shailesh Chaturvedi: Flying Machine is maybe a season behind Arrow in terms of the energy that we are putting. We started in spring-summer'23 in the last season with a very new imagination of the brand. We launched a new logo, a new propeller, new font for the brand, new advertising. We are very focused on selling to the Gen Z customer in a damn hot way. And the effort has just started 1 season. I'm happy to report to you that there are some green shoots while still very early in the recovery and you look at Arrow also has been -- many, many season, it takes time in this environment with uncertainty to grow.

But I can say that we have seen a lot of green shoots in terms of better sell-thru’s in Flying Machine, and that sort of helps us to reduce discounting. So it's very early days still Himanshu, but we believe we are going in the right direction, the way we went in the right direction with Calvin Klein earlier or with Arrow and now with Flying Machine, and it's our own brand, and we are very, very committed to scale it up to its logical scale, we're very ambitious on this brand. Just that it's a very early stage of re-imagination of this brand, and we'll keep you posted as we move the brand forward, Himanshu.

Himanshu Nayyar: Got it. And the second and final bit was on the Flipkart stake that we sold to Flipkart. So can you provide a timeline as to when that equity will convert it, so that we can know exactly what sort of stake Flipkart would hold in Flying Machine going forward?

Shailesh Chaturvedi: So that event has happened. And it's a significant minority stake that has got transferred to Flipkart group. So that activity has happened.

Ankit Arora: Himanshu, Ankit here, just give you a little bit more details on that. So as Shailesh mentioned, the event has already happened because that was supposed to be done as of based on the financial performance as of March'22. Post that event, Flipkart, of course, has an option to convert those CCPS into equity. So that's with Flipkart.

But from our side, as far as the question is concerned on the percentage number, that's the reason the classification also has changed from CCPS, which is part of other liabilities to equity, and that really defines the entire structure of the transaction.

Himanshu Nayyar: Okay. But we are not in a position to give out a number right now on how much...

Ankit Arora: It's confidential based on the discussions with our partner. You will kind of get to know that number when they exercise that option available to them in a time period defined at their end.

Shailesh Chaturvedi: It's a significant minority, that's what best I can hint it.

Moderator: The next question is from the line of Mr. Jatin Sangwan from Burman Capital Management Private Limited.

Jatin Sangwan: Congrats for the amazing set of results. My first question is around Aeropostale and Ed Hardy. So what was the absolute amount of loss that we incurred on Aeropostale and Ed Hardy? Until how much time will we keep incurring these losses? And what are our strategies to minimize these losses? Or are we also looking to sell these brands?

Shailesh Chaturvedi: So from an operation point of view, Ed Hardy and Aeropostale are now silent brands in our portfolio. We're not producing any goods. We are not holding anything at our end. And like we have guided earlier in the investor call, that we have a certain minimum royalty to be paid for a number of years.

This year, that royalty that we are paying what we call as tail brands, the brand that are not a part of these 5 marquee brands, it's around INR 15 crores, and it will drop to less than INR 10 crores next year onwards.

Jatin Sangwan: Second question is on Sephora. What was the loss due to Sephora in this quarter?

Shailesh Chaturvedi: It's a very minor insignificant number, not material number, I must say. We don't give brand-wise data, but it's not a very large number.

Jatin Sangwan: Okay. So last year, we had around loss of INR20 crores for Sephora in FY'23. So that means Sephora is now close to breakeven, much closer to breakeven for us?

Ankit Arora: So just to clarify, I think you are referring to 2 different numbers. You are referring to a PBT loss of last year versus EBITDA comparison. So that's not the right comparison for you to do.

Jatin Sangwan: No, I'm asking PBT loss number for Sephora this quarter.

Ankit Arora: Yes, sure. So from a Sephora standpoint, the business was closer to about breakeven as to what Shailesh has mentioned multiple times. And of course, because it was a COCO retail business, it was a negative PBT business, and that continued to be in the similar trajectory for the first half of this year as well.

Moderator: Next question is from the line of Mr. Ritesh from Molecule Ventures LLP.

Ritesh: First of all, congratulations on nice margin upliftment in this quarter. Just I have a couple of questions. So we decided to open like 200 FOFO stores this year. Can you give a brand-wise breakup, which brand will have most of the addition or that sort of?

Shailesh Chaturvedi: Yes. The expansion is across the brands. The Power Brand, obviously have a larger number of stores because that's where like USPA leading men casual leader brand, we have a very large number of stores. So we open more stores, but it's across all the brands. And we can, Ritesh, share the details, and we got the feedback from Ankit earlier, and we will keep that in mind, but we will provide the details to you, Ritesh.

Ritesh: Okay. My next question is, what is – what would be our aspirational margin in Power Brand segment? Or should we consider this 13% or 13.2% as base case?

Shailesh Chaturvedi: So let me split, Ritesh, this into 2 parts. Our first stage guidance was that we want to hit double-digit pre-IndAS EBITDA and grow EBITDA every year in the short term between 100 basis points to 150 basis points based on the market condition.

Now as far as this step is concerned, we are now almost – we are close to 13% post-Ind AS EBITDA and the difference we've been talking about in the investor call. We are in very knocking distance of that number that we have said. And if the markets were slightly better, we would have hopefully reached that number in this quarter. But we are very close to that number. And in Arrow and Flying Machine, we have some journey to travel. So that's the first step that we guided that we want to be a double-digit EBITDA in Power Brands, and we are very close to it, frankly, where very, very soon that 13% will go, and we will continue to grow at around 100 basis points.

Now if your question maybe more medium term and where we want to reach now, I would say, our aspiration is on a certain ROCE percentage, our aspiration is on certain cash flow that we want to generate to reduce our debt levels further and whether it's a near 0 debt level or very, very low that kind of number. So when I look at the ROCE metrics and work backwards to EBITDA, then our aspiration will be higher, and it will be closer to the kind of number that you mentioned, Ritesh, so that would be a medium term.

But I think we need to first achieve our first stage EBITDA margin in these uncertain times. And once we reach that, I assure you that we have plans to then take it to the next level of EBITDA to deliver the kind of the targets on ROCE and returns and debt levels and cash flow that we have kept for ourselves.

Ritesh: So what are the -- particularly levers that we should keep in mind for -- just to track about the upliftment of margins, ROCE, which you mentioned?

Shailesh Chaturvedi: Yes. So there are 2-3 things that will help us in the short to medium term. First is this whole rigor on operations. We want to push our sell-through, we want to push our discounting lower, which we've been doing in last 4-5 quarters, we have really upped our sell-thru's, our discounting are under control. So that lower discounting flows as a higher GP and you look at our GP last 3 quarters, now we are steadily above close to 50%, and that number has gone up, and we hope that it will continue to increase further. So that's the one territory from the efficiency of our operations.

Second, there's a lot of effort is going on to achieve the sourcing efficiency. We're working on many large levers to source even better. Also, as the brands are growing rapidly, that also helps us to reduce our sourcing cost. There's a lot of science behind that. So we also believe there is a gain coming in from the sourcing benefit.

Third side is the typical scale leverage. As we've gained scale, we grow all the growth drivers, then our overhead, you see last 2-3 quarters we've been gaining, even this quarter, there is a small gain in the skill leverage despite market condition and the change of the calendar. And we continue to gain that scale leverage going forward. These are the some of the points and besides scale leverage, lower discounting, growth of the businesses, discounting and the sourcing costs coming down, I think some of those things will help.

Also we are seeing a very good traction on the premium line of our brands, and premiumization is a key driver for us. And that's where we will see upliftment. And largely, then there are efficiency coming from the channel side as we grow a like-to-like. The retail profitability or the channel margins become better. So there are multi-pronged strategies to grow that.

But I think somewhere, if I would say, broad themes are larger scale, better efficiency of operation on both product side and on the channel side, both online and offline. So those are the -- some of the drivers we believe will take us to the kind of targets we have for higher margin in our brands.

Ritesh: So coming back to the brand-wise profitability, we did a phenomenal job in turning around Arrow as such. So what kind of again aspirational margin we do have for Arrow for this year? And similarly for Flying Machine?

Shailesh Chaturvedi: See, couple of our brands are already double-digit pre-Ind AS right? So I mean coming to Arrow and Flying Machine, both together, if you look at it at the very early stages of EBITDA margin, both are subscale, there is opportunity to increase their scale. And we are talking about EBITDA. Like I mentioned earlier in this call, early low single-digit EBITDA margin pre-IndAS. And we need to take this to 10%. And it will come through efficiency, having the right KPI of the brands and then scaling up. And Arrow is one step ahead of Flying Machine in that. And both Flying Machine and Arrow, we need to take the businesses in the next 2 to 3 years from low single-digit EBITDA to our aspiration is to hit 10% EBITDA in these brands also.

Ritesh: Pre-Ind AS level?

Shailesh Chaturvedi: Yes, everything what I said was pre-Ind AS.

Ritesh: Yes, very good. So one more thing about the Power Brand itself. So what about USPA? So the momentum has continued for us, which we did last year or we can expect some tapering down of the momentum?

Shailesh Chaturvedi: No. U.S. Polo has done well given the slowdown in market and the calendar shift. We're quite happy with the strength of this brand, it is the leader brand in men casual, is the top brand in the country. And we are focusing on taking the appeal of the brand forward through extension.

I mentioned the adjacent categories are growing in high double-digit and very good share, almost 25% of the U.S. Polo business. We have categories like women's wear, footwear where we’re a leader.

Footwear has grown more than 20% in U.S. Polo. We have just launched women's wear line with Palak Tiwari, I mentioned. We have innerwear, small leather goods. So there's a lot of categories which are being pushed in U.S. Polo and with good consumer acceptance.

And also, we will back the brand with very high level of advertising and marketing investment, and I spoke about the Legends campaign, which everybody in the industry and the consumer side noticed, we really spent wholeheartedly, on overall, advertising went up by almost 100 basis points compared to last year's same quarter.

And it's a very special brand, a very large-scale profitable brand. And we will leave no stone unturned. When the Global CEO, Michael, came recently for the Legend campaign launch, he also mentioned it's the fastest growing market for U.S. Polo in the world. It's the top 3 market for U.S.

Polo in the world. So we have a very special position for this brand in India, and we will continue to capitalize on that trend and invest and grow this brand further.

Ritesh: Very good. Sir, coming back to Emerging Brands side, right? So last quarter, you mentioned about discontinuation of one of our brand. Was it at Ed Hardy or Aeropostale? If you can just say.

Shailesh Chaturvedi: See, this portfolio, there are 2 brands that we are in the very advanced stages of closing the commercial transaction because we have minimum royalty on these brands going forward. One was IZOD and other is Aeropostale.

So now IZOD we closed most of the financial expenses and other things last year. Aeropostale, we've just sort of done a negotiation and a deal with the parent company. And by next year, the Aeropostale royalty will also seize. We've got a new deal done with them. And these 2 brands now are in that sense, inactive. We don't produce these brands. But like I said earlier, in this portfolio of tail brands, we will have around INR 15 crores of EBITDA -- or INR 15 crores of royalty payment this year, which will drop to INR 10 crores from next year onwards.

Ritesh: Until how long it will drag?

Shailesh Chaturvedi: It's just a couple of more years, Ritesh.

Ritesh: Okay. So sir, one more last.

Moderator: We have other participants also waiting in the queue. We have the next question from the line of Mr. Varun Pratap Singh from ICICI Securities.

Varun Singh: Congratulations on a good set of numbers in a tough time. So my first question is on this category and brand extension into women wear. So just wanted to pick your mind with regards to how are we thinking about the women wear segment or category given that this segment has a different set of nuances altogether right from product development to the way the product is sold at the channel level, etc. And also, I mean, what are our aspirations? I mean, broad aspirations into this very segment? That's my first question.

Shailesh Chaturvedi: Varun, thanks for your good wishes. And as far as the women wear business is concerned, we do women's wear business in Tommy Hilfiger and Calvin largely on the accessory side and a little bit of apparel side. USPA also, our women's wear business in 2 parts. One is the accessories and the other is the apparel. So we sell footwear of women's wear for U.S. Polo very successfully in online portal. So you go to Mantra, you'll see handbags and footwear. And doing really well, and it's a profitable business at this early stage and with very good KPIs online.

So we're very happy with the business of footwear and handbags that we've recently done in U.S. Polo. The other side now is to extend into the apparel. There is a global line that U.S. Polo does, and we have understanding of women, and apparel. It's very early stage, Varun, right now. What we're doing right now is to piloting the women's wear apparel line in online space.

Currently, there's no offline distribution for U.S. Polo women's wear. We are working with our partners, and there is a large set of young consumers online women, and we are using that catchment to sell, and slowly and steadily based on the KPI, we'll extend it to other channels.

So right now, we are in very early stage, and we don't want to talk because some of this will be competitive also. So you will hear a lot more about the women's wear in times to come, Varun. But right now, it's very early stage. We already committed ourselves to the accessory business, handbags, and footwear. You can see it doing really well.

In apparel, we are a couple of seasons behind and we are testing the women's wear apparel line in U.S. Polo currently.

Varun Singh: Understood, sir. Very clear. But a second follow-up on this would be when we choose online as a platform to start this very line. So if you can give some insights with regards to the unit economics and especially on the cost of doing business online, compared to cost of doing the same business in the offline space, for example, we would have entered into a large format store, getting some shelf space out there and kind of venturing out or would have started to do this business. Some color on difference in the cost of doing business compared to a large format stores, which is also a broking method of selling all product compared to an online platform?

Shailesh Chaturvedi: See, Varun, women's wear, or any business, we do online, offline, I must say that our focus is on profitable growth. So we are not going to do any business where we will lose money. And after the initial modelling and based on all the KPIs and the metrics that you mentioned, once we have a green signal and we have a tick box, then only we'll expand the businesses.

So at this point in time, also we keep doing a lot of trial in many business categories. And once something passes our test on profitability and future profitable growth, only those categories are launched. So even women's wear and online, our KPIs are good.

And I think, see, in this -- the 2 things we focus is on the discounting one and also the stock turn. So at this point of time, both on stock turn as well as on the discounting on the online platform, women's wear of U.S. Polo apparel is doing really well. So we are happy with this. We just want to see for couple of season so that we see it sustainable. And then we will grow it. So we will always be focused on profitable growth.

Varun Singh: That's very clear. Sir, correction, my question was that I wanted to understand that what was your basic reasoning for choosing an online platform and not a large format store, for example, a Shoppers Stop or some other platform or with regards to kick-starting the business.

Shailesh Chaturvedi: Yes. So we have a very large young women shopping online, and you see from our own Sephora experience also we saw a lot of discovery today happens online, especially for young women that we are targeting. So it was an easy decision to first prioritize on the online channel because it's easy to experiment.

Also, you don't split your inventory. So they is a large pool of inventory in our marketplace. When you go to physical stores or department stores, anyway the stock gets cut sometime, then it leads to cut sizes and discounting. And I think the speed of experimentation is higher online. So it's easy to then experiment for young women online. So it was an easy decision in that sense, Varun.

Varun Singh: Very clear, sir. And just one last question, if I may. What would be our total revenue contribution from all the category extensions, for example, footwear, etc. as on today?

Shailesh Chaturvedi: So Varun, category expansion has happened in 2 sets of brands. One is U.S. Polo, our strongest brand and in Tommy, CK piece. So in U.S. Polo, the extension, which is children's wear, women's wear, innerwear, footwear, which is a very large business, all these put together now touching 25% of the brand. And these growth rates are also in double digits. So that's the USPA piece.

The second is in the Tommy Hilfiger and Calvin Klein, where we've been selling watches or children's wear or underwear or small leather goods, like belts and wallets, and eyewear, etc., for many, many years now. That business in retail is close to 20% of the contribution, and that's also growing at high double digit right now. So a high-teen percentage. So in Arrow and Flying Machine, we are testing the adjacent category, still early days.

So we've just done footwear launch in Flying Machine with online and it's doing very good response in that value attractively priced segment. And in Arrow, we've just done beside suits and blazer, we have done launch of small leather goods like belt and wallet, and we will continue to extend the accessories in Arrow as we take the business forward. So that's the piece. And in both U.S. Polo and the Tommy, CK bucket, adjacent category have a good share of business.

Moderator: The next question is from the line of Rajiv from DAM Capital Advisors Limited.

Rajiv: My question is on standalone bit, which is INR 200 crores revenue. That is entirely Arrow wholesale, right? Is there anything else in that?

Ankit Arora: That's right, Rajiv.

Rajiv: Yes. And in the base quarter, you had the footwear bit as well, the USPA footwear bit. So what is the clean number in the base quarter, let's say, like-for-like?

Ankit Arora: I will have to just check that. U.S. Polo footwear is what we had moved effective January itself from Q4 of last year, so that's not anymore there in the reporting quarters going forward.

Rajiv: Sure. And just an extension of this. So usually, Q2 and which is a wholesale heavy quarter, usually 30% of the entire business. That means this wholesale bit, the Arrow part itself is close to 650 crores kind of business, right? And assuming that your retail is also 20%. So it is already INR 800 crores, INR 900 crores kind of size in terms of the brand itself, is it?

Shailesh Chaturvedi: Well, it's less than that, Rajiv, Arrow business.

Rajiv: Your Q2 is not 30% of the entire the wholesale bit? Is that because we see that in Madura. Their wholesale historically has been like that their Q2.

Ankit Arora: To correct you, Rajiv, wholesale, which is basically, if I were to classify nonretail, would have been closer to about 60% of our business in Q2.

Rajiv: No, no. I'm talking only about this Arrow bit, not the entire. I'm saying this INR 200 crores. If we were to annualize, this will become INR 600 crores, INR 650 crores on the wholesale, right? The Arrow wholesale, this particular standalone entity?

Girdhar Chitlangia: So Rajiv, as Ankit said, I mean, wholesale is about 60% of the business. So even if you annualize, we will not get INR 600 crores.

Moderator: The next question is from the line of Ankit Kedia from PhillipCapital.

Ankit Kedia: Sir, a couple of follow-up questions from my side. Sir, what is the size of the U.S. Polo store today? And given that adjacencies are only increasing, and with kids wear, women wear assuming 1 year down the line, you want to open them in the store. Are we looking for a larger size stores, incrementally in U.S. Polo as we open the stores?

Shailesh Chaturvedi: Ankit, you're absolutely right, the store size from 1,500 to 2,000 square feet, we are now taking it to a higher level, including you know, attempt at opening even larger, larger stores than that. So with so many new categories coming in possibility of someday women's wear were coming in. So there will be a need for a bigger space. And if I look at last 2 months, we opened a lot of big stores in U.S. Polo.

Ankit Kedia: So from a unit economics, right? What the previous participant also asked, right? Do you see the throughput or the margins in these adjacencies higher to reciprocate the rentals which we pay for these larger stores?

Shailesh Chaturvedi: So our adjacencies are very profitable. And in many cases, footwear and all are even more profitable and it's a large scale now almost close to INR 300 crores business.

So that said, also, when you look at some offline retailing point of view, the beauty of the adjacent categories, they don't take too much of space. So footwear does a decent percentage of our revenue of retail space from a small wall, or an underwear just a small gondola, or belt and wallet from just a standalone small gondola. So typically, adjacent category has done well, they will be accretive from margin point of view, also from sales per square foot per day point of view.

Ankit Kedia: Sure. And my second question is it's been 1.5 years, we have moved to consignment sales, right? And we can see the full price sell-thru's, inventory being fresh and your inventory turns being better. Now our check suggests that we're also opening more factory outlets in the market. So how frequently is the supply from the stores going to the factory outlets? And how does that supply chain work to get a better understanding of this consignment?

Shailesh Chaturvedi: Sure, Ankit. Here, the factory outlet has better realization also, typically, you know, the other methods were to liquidate to jobbers at lower realization or also sell online OSM, but sometimes, the cash conversion may be slower there. So we build this outlet channel. And that attempt is just enough to liquidate what we get back from the market.

We are not like trying to make a separate business out of this. So we have -- after the season, we take back twice a year spring summer or autumn winter and then we send the goods back to the outlet. So that method is just to liquidate it in a very efficient with a lower discounting, better margin for us. And also in retail, we get the money next day morning in the bank. So that's the idea.

Ankit Kedia: It's just that the inventories are so optimal, are we losing sales by having such low inventory? Or do you think this 90 days -- 85, 90 days is optimum inventory at the store level?

Shailesh Chaturvedi: No, we have adequate inventory. And in this uncertain time, we are adequately placed. And inventory, we can push higher. So we can -- if we run out of inventory, then we can push things higher. And we saw COVID recovery also, the demand was very high compared to what market industry anticipated. And we did push higher inventory quickly in the market. So in our industry, typically, higher inventory is the problem, lower inventory is a lesser problem. And if we -- as you rightly said, if we run out of inventory, we can produce goods and send it to the market quickly.

Moderator: In the interest of time, that would be the last question for today. I would now like to hand the conference over to the management for closing comments.

Ankit Arora: Thank you, everyone, for joining us on the call today. I understand some of you may have follow-up questions. But in the interest of time, we'll have to close this call. If any of you have any further questions, please feel free to reach out to me separately, and I would be happy to take them offline.

Thank you so much for joining on the call and look forward to interacting again next quarter and wish all of you a very happy and prosperous Diwali.

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