Q3 FY2024 Earnings Call Transcript – Feb 14, 2024

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 Q3 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 Michelle. Hello and welcome everyone and thank you for joining us on Arvind Fashions Limited earnings conference call for the third quarter and nine months ended Dec 31, 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 third 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. Thank you for joining us today for the Q3 Results.

AFL continues on its journey of profitable growth, even though the overall demand environment continues to stay subdued. We grew our sales by 5%, which shows the resilience of our business model and the strength of our five marquee brands. The highlight of the quarter was the 150-basis point lift in our EBITDA margin, even after we invested 130 basis points higher in marketing costs. This was made possible due to better gross margin, lower discounting, and tight control on expenses. We continue to strengthen the balance sheet with a reduction in gross working capital of 5 days in Quarter 3. This quarter's growth was largely driven by the retail and MBO channels.

Our growth was impacted due to a de-growth in our online B2B channel. Our growth in the offline channels for the year to date remains at double digits. As a strategy, we are pivoting our online business towards the marketplace model, where we hold the stock and have full control over pricing and visibility. In doing this pivot, we have a one-time de-stocking of our B2B online channel, which affects our primary billing. While this affects short-term revenue, it lays the foundation for a healthy online channel.

Our B2C online channel, on the other hand, has almost doubled, leading to strong tertiary consumer sales growth in the online channel. The negative impact on revenue growth for the online channel may persist for another quarter or so, after which the channel will revert to normal growth rates. While the environment continues to remain soft, we remain confident of the inherent strength of our brands and the growth drivers that we have put in place to scale up our business. We will continue to stay focused on our path of profitable growth and expect to further expand our margins and significantly improve the bottom-line in the medium term.

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, Girdhar and Ankit here, and good afternoon everyone else on this call.

With NSV of Rs. 1,125 crores and EBITDA of Rs. 150 crores in Q3, AFL has registered revenue of Rs. 3,165 crores in 9 months of this financial year and EBITDA of nearly Rs. 400 crores. Revenue growth is 5% in Q3 with a 2-year CAGR of 12% growth in NSV. EBITDA growth in Q3 is 18% and 2-year CAGR growth in EBITDA is 21%.

The quarter had started with trading for Diwali festival, but that got impacted by Cricket World Cup, seven-odd weekends featuring India Cricket matches saw like-to-like decline resulting in overall flat like-to-like growth during Diwali festival period. The industry followed it up with an early end of season in mid-December to liquidate inventory. Since at AFL, inventory is managed tightly, we registered the temptation of participating in this early EOSS, which helped with lower discounting by 1% in Q3 over last year Q3. With strength of our brands in seasonal winterwear products and continued casualization favoring our brands, offline channels have grown double digits in this YTD as well as in this quarter.

The performance of the retail channel is especially salient, where we are on course to meet plan of our square foot expansion. The margin from the retail channel has also increased because of lower discounting, especially in our key brand USPA where discounting is down sharply. MBO channel has also grown more than 15% with a healthy margin. This offline growth of double digits is driving EBITDA gains. Online B2C has also doubled in revenue this year through various efforts including buildup of exciting online exclusive collections, healthier stock levels, and required marketing support.

Besides the impact of India Cricket during Diwali, we also saw lower business from online B2B wholesale, which has declined sharply this year because of our strategy to de-stock this channel for healthy and controlled consumer experience with tighter control on discounting, as explained by Kulin earlier. AFL growth is in double digits, even in these muted market conditions, but for the sharp decline in B2B online channels, linked to de-stocking there. Our growth will continue with investment behind growth drivers like store expansion, premiumization, whole-hearted marketing investment, and development of adjacent categories. Once markets improve, we are keen to see growth moving towards 10% to 12% and even 15% if things go right.

Our key brand, USPA, saw a very healthy business in this quarter with reduction in discounting, growth in kids business of nearly 20%, large investment in marketing through highly visible legends campaign, and opening up two iconic large-size flagship stores like the one in Goa and Jayanagar High Street in Bangalore. The quarter saw healthy growth in EBITDA for USPA.

Most channels grew well for Arrow also, and we further invested into marketing campaign with Hrithik Roshan. We saw emerging leadership of Arrow in key categories, including blazers, formal shirts, formal trousers, and through youthful Arrow NewYork line. The quarter also saw a rollout of more stores with a new retail identity in Arrow, for example, at Mall of Asia Store of Arrow in Bangalore.

Flying Machine refresh is going on and efforts are underway to grow this subscale brand through distribution expansion and product update for higher sales and better profitability. Key channels like value department Stores and MBO Channel have shown enthusiasm already for this new avatar of FM and this brand refresh for FM will be continuing during 2024.

The premium portfolio of Tommy Hilfiger and Calvin Klein continue to outperform with very healthy growth and margin profile. These brands continue to set benchmarks in the industry on key retail KPIs. Our revenue growth could have been higher if we had participated in early EOSS, but we made a choice of focusing on profitability and discount reduction, given our tight control on inventory. We also made a choice of increasing marketing investment by 130 basis points in order to support growth and keep our brands top of mind. We chose investment in marketing over investment into discounting.

Our decisive focus remains on profitable growth through sell-thru improvements, full price like-to-like growth and reduction and discounting, all leading to an increase in GP and better EBITDA. EBITDA has grown value by 18%, an increase of nearly 150 basis points with EBITDA margin of 13.3% in Q3. EBITDA has grown due to the efficiency in sourcing, lower discounting and better channel mix. We continue our sharp focus on balance sheet de-leverage, ensuring price control on working capital which saw a further five days reduction in GWC with gains coming from reduction in debtor days. We saw a reduction of inventory value as market consumed inventory in festival time, and stock turns remain close to guidance of 4x. In these muted market conditions, we count our blessings through double digit revenue growth in offline channel, doubling of online B2C business, EBITDA growth of 18%, positive like-to-like growth in retail, reduction in discounting, and further tightening of working capital resulting in ROCE of higher than 15%.

Ankit Arora: Thanks, Shailesh. We can now open it up for Q&A.

Moderator: Thank you very much, sir. We will now begin the question-and-answer session. The first question is from the line of Priyank Chheda from Vallum Capital. Please go ahead.

Priyank Chheda: My first question is on how should we view the two contrasting data points, one on the SSG for our retail network which is muted at 2% while our wholesale MBO channel has grown at 15%. How should we use these two contrasting data points is the first question? And to the adjacent question on the same, is the strategic decision to do away with higher discount to our customer, are we compromising one of our customer loyalty who is still now being habituated to buy at a discounted price? So, these are the two questions on the strategic part.

Shailesh Chaturvedi: I just want to address the discounting bit. See our mantra has been profitable growth and anything we do we have to look at in the light of growth in EBITDA of close to 18% and we have been managing our inventory very tightly. So, always the question is on how we get the best realization for that inventory we are holding. And if you look at our 2% like-to-like growth in the market, one is yes, markets are muted. It got really impacted by the cricket in Diwali festival and those are big days of retail. And that is why, when I look at the industry number, our numbers are probably on the sort of better side and it could have been higher if the Diwali was not impacted, also the EOSS decision impacted, but we believe that this 2% has come on the back of last quarter where we had grown 9% like-to-like and previous year, same quarter we had grown by 12%. So, you will see in that context that on that 12% like-to-like we have grown further

2% and we have been continuously growing at a healthy pitch. Discounting is something we want to avoid as much as possible because it goes against our business rhythm because we need to do a certain number of weeks of discounting and the new season has to come at a particular time. So, anything earlier breaks that rhythm and we lose margin. So, we are very clear that we don't want to discount and our brand we have invested very heavily, our investment has gone up by 130 basis points in marketing, our brands are very salient, our sell-thru's are fairly healthy, industry leading. So, we didn't see the need to discount earlier and we believe amongst our consumers, our equity is very strong, we are very top of the mind, our full price sell-through, our EBITDA growth, our realization, premiumization, a lot of indicators give us the confidence not to take shortcuts and focus on the long-term profitable growth. As far as the MBO channel is concerned, it is the like-to-like and the full price sales are very similar, MBO also has grown at 15% because of large distribution expansion. So, it is a multiplying factor of new distribution as well as the like-to-like growth in those channels. And also, EBO, our sales density are much higher. On that base, further increase becomes a little difficult. In MBO channel, we will be increasing our sales density. As we go along also, large expansion is happening which is resulting into the 15% growth. Tertiary growth if you look at MBO, they are also similar healthy, but sales density wise EBOs are higher than MBO and MBO will also catch up with higher growth there.

Priyank Chheda: And it is very clear on the strategic decision that we have taken to clean up the online B2B channel, which is clearly visible with the lower sales, so is a large clean up done or is there something more to come up which we should read because it is one of the significant sales contributor to the whole of the revenues which is online B2B?

Shailesh Chaturvedi: It is a kind of courage to do the right thing. We believe that online should be played through a marketplace model as explained by Kulin earlier. And we are building that business very aggressively through the marketplace, through our own website, through only linkages. And that business fortunately is really growing, it is doubled in the Q3 this year, the B2C part. As far as B2B is concerned, since COVID did, that business had grown and now we believe the time has come to de-scale, de-stock that business, but consumer sales on B2B are still healthy. In fact, in Q3, even in B2B, where our primaries are down significantly because of de-stocking, our consumer sales are in double digit growth. So, we are very careful about growing the online channel. We are committed to that. Just that we believe it is better done through our own marketplace, through our own control on pricing and discounting, and through our own assortment that we believe in, and we can do a better job also. So, B2B is a short-term issue, in long term, we are looking at how we grow the tertiary sale with online channel and we may have one more quarter at best two more quarters of pain with B2B wholesale, but it will actually move towards B2C growth and our channel partners and we both are all aligned on this and we will grow the tertiary sales of our brand on online space also.

Priyank Chheda: And just a last question on a very broader portfolio perspective, which is all now clean power brands with more than Rs. 4,000 crores of sales, right, how should we view in terms of what should be a sustainable SSG if you can break down with ASP or a mix change plus a volume growth for a sustainable SSG we should view? And as well as if you can touch up upon, there is a portfolio like CK, Tommy, USPA which has a very industry leading retail KPI, so which are the areas that we would have to work on for our other two brands in the coming years which you can highlight also on that part?

Shailesh Chaturvedi: See, if you look at the last couple of seasons, we have been delivering really the industry leading like-to-like growth. I mentioned last quarter we had 9% in muted conditions. Previous year in Q3, we were at 12%. Last year in Q4, we were 18%. We have really pushed the same store growth agenda in full price season quite aggressively and markets are dull and when a big season like Diwali gets impacted by cricket, then the retail numbers in that month impacts the overall numbers, but we are very committed and we are seeing that between 5% and 7% should be our target. Actually, last 2 years we have been growing at a much faster pace than that. This quarter we are 2%, but we have seen industry is flat or maybe slightly negative. So, we continue to put the rigor in retail for same store growth - right from the whole storytelling that we do, the way we do the layout of our store, the way we train the staff, the way our visual merchandising happens, how the whole science of category wise assortment happens, the marketing support, consumer offer, so a lot of efforts are going behind it, we just wish the market improves a little bit and then that 5% to 7% like-to-like growth is possible. Also, I would say that this could be the base expectation from big brand and smaller brand, it could be even higher like-to-like growth because they may have lower sales density. So, a brand like U.S. Polo may be close to Rs. 2,000 crore, but the market size is very large. So, there is no need for us to worry about future growth. This brand can continue to grow at a rapid pace from here onwards and we will continue to open larger store. We will continue to invest wholeheartedly behind marketing to keep the brand salient and all other category, if you really look at the science of like-to-like, it is about walk-ins into conversion into market size. So, the walk-in, if we keep the brand salient, and the store experience good through word of mouth, walk-in keeps happening. As far as conversion is concerned, the store layout and the consumer walk-in and category assortment, adjacent category expansion, earlier, they were not buying underwear, maybe they are buying underwear now, earlier they were not buying footwear, they are buying footwear now, or tomorrow, women's wear. So, we continue to meet all the usage occasions of a consumer and also the age groups of the consumer so that we can convert the consumer at a percentage which is higher than the industry and then all these efforts also help the market size that not just a T-shirt in U.S. Polo, they may buy jeans also, they may buy underwear also, they may buy footwear also. So, all the science behind the walk-in into conversion into basket size, we are really working really hard towards driving all the aspects of retail science and we want to continue to grow better than industry as far as the same store growth is concerned.

Priyank Chheda: And just on the key retail KPIs, versus the stronger brands, versus the two other brands like Arrow and FM, where is the further work and energy required to be done in coming two years?

Shailesh Chaturvedi: See, what happens is a weaker brand may have a lower sales density, sales per square foot per month or year, and it could have a higher discounting. Those are the two things broadly, there are many more things, but I am just saying the walk-ins could also be lower in weaker brand compared to a larger brand. So, those things, we need to just push the agenda on sales density as well as on reduction of discounting and it is done through many things like new store identity, new product category, better product. So, like I said, we look at all the signs of it and in weaker brand we need to push the SSPD higher and reduce the discounting.

Moderator: Thank you. The next question is from the line of Varun Singh from ICICI Securities. Please go ahead.

Varun Singh: Sir, my first question is that like we have got just five brands, which we call as power brands, and maybe promoted Calvin Klein from emerging to power. So, like how are you thinking about capital allocation among these five brands to drive growth?

Shailesh Chaturvedi: So, I think what you are seeing the adjusted portfolio is the result of a capital allocation strategy that we have shut down many businesses to focus on few marquee brands and these are the brands that we all believe in and we are going to invest wholeheartedly behind each of these five brands or whatever it takes to build and we have the required financial sort of strength to push the agenda. So, now, since we have five power brands, each one is very uniquely placed. So, if you look at Tommy, CK is in certain segment, US Polo is in a different segment, and Flying Machine and Arrow are also very uniquely placed. So, we have a very differentiated five brands, and there is nothing which is stopping us investing wholeheartedly beyond each one of these five brands. So, we have done the capital allocation strategy, and that is how we have reached this short list of highly focused, decisively focused five brands. And now we will invest wholeheartedly whatever it takes to build these brands and revitalize the growth of these businesses.

Varun Singh: Sir, my question is more related to the marketing spends to drive growth and so how are you, for example, going to make a decision with regards to drive growth, maybe whatever kitty that we have given the overall consolidated revenue, or you want to drive it as an individual P&L driven investment into each of the brands?

Shailesh Chaturvedi: If you see investment in marketing used to be in 3.5% of NSV in that zone, now we are up to about 4% and that increase has happened across the brands, now the base of each brand is different. For U.S. Polo, 4% plus will mean lot more crores given the scale and size of that brand and Flying Machine, which is subscale, will need a higher percentage of NSV even with a lower crores of spend behind marketing. So, that is the decision we take because there is a minimum threshold of marketing required to make an impact and that is what we will do. Now, if I have to say if I am left with only Rs. 1 and this Rs. 1 has to go to one brand, then we would put behind U.S. Polo because at the end of it, U.S. Polo is our marquee brand, and it is very important for AFL. And this is where, if there is an unlikely situation where to make a decision among these five brands, then I would make that decision in favor of U.S. Polo, but I don't see a need to reach that stage. We will invest behind marketing, and we have increased 130 basis points in this quarter during muted market condition, because we believe it is important to keep these brands salient and grow these brands through higher marketing investments.

Varun Singh: Sir, my second question is on the large size stores that you made a mention, given that retail is incrementally becoming more important channel, and it is likely to become even more important going forward, given that the only maybe linear growth which is more under our control. So, given that context and given our aspirations of adding, maybe if not all, maximum franchisee owned, franchisee operated stores, I understand the customer experience in large size stores is superior, we have more real estate available to maybe put more categories that we are venturing out, but still having said that large size stores also create, I mean, it comes with the baggage or the obligations of higher rental, higher capex requirement and as a consequence, the necessity of the business are to be dependent on customer footfall. I mean, it cuts both way, right? If it goes right, we enjoy more, we will benefit, if it goes wrong, the downside is also incrementally much higher. So, what is the need for going for a larger size stores other than, the more real estate and category with that we need to put that as a reasoning. And in this context, if you can give some competitive successful examples, if not from India, maybe even globally is also fine?

Shailesh Chaturvedi: See, we are looking at only a certain number of large size stores. We are not saying that every store will be large size store. So, take U.S. Polo, our current visibility is that we want to open the next 10 large size, these 4,000 plus kind of square feet stores, and these have been identified in a very key location where, as a brand, we want to make a statement, and it is a very competitive decision, and also we want the brand to remain top of mind in the key location in the country and it is a long term asset that we are building. So, it will be very carefully modeled. We already done last two years a lot of stores model that are large scale and we have seen good result and now we are rolling out. So, rarely we do something where we have not modeled and seen the success and then based on those success parameters we take open. So, we will open only a certain number of stores and it becomes very important for image and for like you rightly said about the categories of women and kids and adjacent category etc. are coming in. So, whole lifestyle of the brand can be displayed in these chosen few lifestyle stores, which are also on franchisee system, FOFO, where we have like-minded partners who are building that business, and we have good experience of running large scale among our portfolio of five brands. So, we are very confident about that strategy. Also, we link these stores with Omni connectivity, so we get online visibility also. So, we go out of the way to push all our categories and make sure the sales density is comparable to our slightly smaller store, so that the stores remain profitable. And whatever we have seen till now of large-scale stores, they are fairly profitable stores and they are in key locations and with high sales density. So, we are rolling out, we believe in that strategy, but not all stores will be large, there will be limited number of very well-chosen stores like that.

Varun Singh: In that context, like how many stores we would have closed in the current year? And the reason that I am asking is also, for example, last quarter, you highlighted or maybe guided that U.S. Polo stores may be larger size from the current 1500-2000 square feet model. Therefore, I was having this maybe if not concerned, seeking to understand that if not larger than 2000 means maybe 3000. So, when you say 200 more store addition going forward, if not in FY24, so a bulk of it would be a 2000 square feet and like as you mentioned ten stores in U.S. Polo of 4000. So, I mean, in this scheme of thing, basically how is your store evolution strategy? That is my last question.

Shailesh Chaturvedi: You rightly said, this is a store evolution, I give you an example that in Indiranagar High Street in Bangalore, we had a store of a certain size and then we decided to make a bigger store. So, we had to shut down the old store. So, let us not look at it as shutting down a store, it's more as a relocation of the store to a bigger and more prominent location. We have done exactly the same in Goa also. And we keep doing this across our brands. So, this right word that you use is the evolution of the retailing standard as more and more categories come. And we have added Denim as a big category. We are adding women, we have added kids, we have added footwear, we added innerwear, and belts and wallet, and the need for square foot in brand like U.S. Polo is increasing. Same is for Arrow and Flying Machine and Tommy and CK. So, we are increasing the size and for that, sometimes we have to shut down the previous store as we find the new store. So, it is not so much as a store closure strategy, it is more as a relocating, evolution of the store to a better, bigger store with higher revenue and hopefully higher profit also. And that is done in a case-to-case basis. I can't give you a number. We continue to look for, right now maybe we are looking at 15 locations in the country where we want to open bigger store for U.S. Polo alone and as we find something, then we shut the old store and when we open the new store, then evolution happens.

Varun Singh: Just one question if I may squeeze in, what is the revenue contribution from non-apparel side of the business?

Shailesh Chaturvedi: Currently, that adjacent category, especially in U.S. Polo is now hitting close to 15% of the revenue and it is growing very rapidly.

Moderator: Thank you. The next question is from the line of Palash Kawale from Nuvama Wealth. Please go ahead.

Palash Kawale: Congratulations on the healthy expansion in margins. So, sir, my first question is on gross margins only. So, do you think that gross margins that you have achieved in the first 9 months are sustainable?

Girdhar Chitlangia: The gross margin that we have achieved in the first 9 months, we are seeing that as of now, it is going to be on a sustainable basis because the trend on the cotton prices continues. We have also maintained a very high level of sell-throughs and a control on discounting. So, all these put together will ensure that we will deliver sustainable base of gross margins.

Palash Kawale: And my next question is, so opex for first 9 months has increased by around 14% versus 5% increase in overall revenue. So, any brand which you would like to point out which is responsible for this or any comment on this?

Shailesh Chaturvedi: If you look at YTD, our capex is at Rs. 61 crores, this quarter was Rs. 26 crore so we are at an annualized rate of Rs. 80 to Rs. 85 crores of capex. Now, the only place, our expansion plan is very asset light, so most of our store expansion is on a FOFO basis with franchisee except that in Tommy Hilfiger we have taken over close to 25 stores where accounting happened in Quarter 3 and that is one change, there is no other major change that is happening from capex. Ankit, do you want to add anything?

Ankit Arora: Palash, I think your question also was on opex as well and maybe Shailesh just added a bit of flavor on capex, we understood kind of that. You would need to kind of also understand the piece around the channel mix change playing a role here as to what we really said when you grow retail, the franchisee commission expenses, which of course flow through the gross margins and that is the reason which is where you are seeing a trend going up. So, that also has a role to play in other expenses going up and of course, you would have heard Shailesh speak at length about advertising expenses being higher on a YTD basis also from a last year standpoint since we have invested significantly in advertisement. There will be more than about 100 basis points on the YTD level advertisement increase, which is forming part of other expenses on opex, which is what the line item you are seeing.

Palash Kawale: And if only one question that I could squeeze in. So, you were like, discussed focusing on margin expansion and return on capital, but what would be those levels for margin and return on capital after that you can see that now the focus would be on growth. Now you can push the pedal there. So, what would be those levels?

Shailesh Chaturvedi: If you really see that the profitable growth of a brand is critical, and we have been extremely tight on balance sheet. You will see on our inventory days, on our debtor days, we have maintained the best hygiene possible. So, when the working capital is tight and the brands hopefully will grow much faster pace profitably, then it will generate free cash flow and that is how we want to grow our ROCE. I think we have now crossed 15% and medium term we are looking at a ROCE of more than 20%. That is the first benchmark, and we believe that if we grow at the guidance that we have given and the kind of margin expansion we are saying at least 100 basis points every year in EBITDA. So, if you really do the math then we are confident that in the medium run we will see about 20% ROCE.

Moderator: Thank you. The next question is from the line of Sagar Parekh from One Up Financial. Please go ahead.

Sagar Parekh: Sir, the channel mix that you have given in the quarterly sales break up in the presentation, if I look at retail, so last quarter I am assuming would also have Sephora within the retail channel. Am I right in that?

Shailesh Chaturvedi: No, we have removed the Sephora data, it is like-to-like.

Sagar Parekh: So, then like-to-like, the growth is 3%-4% only, which includes 2% L2L and the rest would be new store additions?

Shailesh Chaturvedi: See, yes, I mean, also the annualization kicks in. So, the retail growth in this quarter is 10%, double digit, and 2% is the like-to-like growth plus, whatever you had stores opened more than 12 months, annualization of that and then the new store that we opened all adds up to 10%.

Sagar Parekh: And secondly, did I hear it correctly, you said U.S. Polo grew by 20% for this quarter?

Shailesh Chaturvedi: No, I mean what I said is that the discounting has come down in U.S. Polo and margins have been good. I didn't say 20% increase in U.S. Polo. What we mentioned was adjacent category that Kidswear maybe you would have heard somewhere the Kidswear, in my opening comment I mentioned that the kids category had grown at 20%. I get it now. So, I think that was about kids.

Sagar Parekh: Just U.S. polo kids?

Shailesh Chaturvedi: Yes.

Sagar Parekh: But you said 15% is the overall contribution of revenues from all adjacent categories for all brands put together, like including Tommy?

Shailesh Chaturvedi: U.S. Polo is where the highest share of adjacent category happens, it is a large business between among, innerwear, footwear, Kidswear, and on that large scale of USPA, the adjacent categories are now more than 15% of the revenue for U.S. Polo.

Sagar Parekh: And how much is the debt number as of end of December after the Sephora sale?

Shailesh Chaturvedi: Our net debt is now close to Rs. 225 crores.

Sagar Parekh: So, then next year basically we can be like debt free, right, because you have like Rs. 80-Rs. 85 crores of capex and you are talking about 100 bps margin expansion, so next year the entire growth is all FOFO related expansion largely, so basically your free cash flow will be very strong next year, so then we can assume like full debt repayment by next year?

Shailesh Chaturvedi: That is our medium-term aspiration and we have mentioned earlier that we have a desire in the medium term to be a debt-free company. Now, we will see, we are generating some free cash flow even now this year. And we don't have a major need for capex and that is why the profit is going into free cash flow and we will see how it goes. It is also a function of how much capital is required for growing the brand because that is the first agenda that we want to grow our brand's profitability to their potential and then whatever else surplus comes we surely use it to pay down our debt.

Whether it will become zero, I don't know. Ankit, you want to comment further on the net debt where it will reach.

Girdhar Chitlangia: As Shailesh said, our aspiration is basically to be debt-free in the medium term. Any surplus cash that we will generate obviously will be used to pare off the debt.

Moderator: Thank you. The next question is from the line of Abhijeet Kundu from Antique Stock Broking. Please go ahead.

Abhijeet Kundu: Congrats on good set of numbers. My first question was on the discontinued businesses. You have said that the provision for royalty for Ed Hardy and Aeropostale will accrue us profit because those losses will go away, we have got Rs. 39 crores in this quarter. So, these brands are dormant brands, or have we discontinued the sales?

Shailesh Chaturvedi: When the Sephora transaction happened, we had two brands which were dormant and were not active, but we are paying royalty for them as per the legal contract, which are the Ed Hardy and Aeropostale. So, we are not doing any production or sale or business of that, but we had a certain legal contract commitment. This was coming to close to Rs. 10-Rs. 12 crores a year for next couple of years and this year, that figure was around Rs. 15-20 crores. So, what we have done is that we have taken the present value of these future royalty expenses plus some other expenses linked to these brands and that we made the provision of Rs. 39 crores there.

Abhijeet Kundu: So, technically, we are not selling these brands anymore, so no royalty has to be paid, no expenses have to be paid, but these two brands are coming for renewal in two years, right?

Ankit Arora: So, Abhijeet, Ankit, let me just clarify that for your benefit. See these brands were already made dormant because we were very decisively allocating capital towards the five marquee brands, which is what Shailesh has spoken at length. We were not investing behind these brands. So, because there is no sale, but of course there is a minimum commitment on royalty, which is what we have to pay, and we have mentioned this on the call earlier as well in Q2. And so, the expense on account of that is what we have made a provision netted off against the gain on the Sephora transaction sale is what the number which is what you are looking at. So, there is not going to be any further drag coming on the profitability of these five marquee AFL brands going forward on account of this minimum royalty commitment is what we had to pay for the next two years pertaining to Ed Hardy and Aeropostale.

Abhijeet Kundu: How should we account for it? So, say for FY24, the discontinued operations, profit from discounted operations, so Sephora would be Rs. 74 crores only?

Ankit Arora: Your estimation is correct. So, there is no NSV coming in from Ed Hardy and Aeropostale. It was very marginal. So, the only NSV which is what was coming in, which has been discontinued, is only Sephora. And your estimation is broadly in line with the number, which is what you just mentioned.

Abhijeet Kundu: And my second question was, it has been asked earlier, but still two things in that. One is the accelerated store expansion that you had talked about 200 stores through FOFO route, which will essentially more of EBOs. So, in this, one is what would be the capex requirement, Rs. 85 crores is the capex requirement that you are saying per year, one is that?

Shailesh Chaturvedi: Yes, annual. You are right.

Abhijeet Kundu: Rs. 85 crores per annum

Shailesh Chaturvedi: Yes.

Abhijeet Kundu: And second is that we are talking about the gross space addition, the net space addition, how should we look at it? I know earlier also you said that it is difficult to say that, but the color on what would be the net space addition would help us to derive the overall sales growth because there would be element of a same store sales growth and there would be element of a store expansion which will play out over the next two years?

Shailesh Chaturvedi: I would put this gross addition, net addition into two parts. One is, there is a regular business. In regular business, typically 3% to 4% of distribution gets shut because those markets become not good or the store is not viable, we make mistakes or something else happens. The market is very dynamic and moving. So, that is a normal 3%-4% of your distribution. You do clean up on an ongoing basis. That is a reality, some malls become ineffective, some high streets become ineffective etc., that number happens. So, what we track more than the number of store, because when we shut, they are smaller store, maybe larger numbers, but we open larger, bigger number of fewer stores. But I think that emphasis on square footage internally, we look at how many square foot or what is the CAGR on square foot that we are looking at. And that is the target we are looking at to grow forward more than the store number. Store numbers are also important and they indicate eventually the square foot expansion, but our internal KPI is more and more on square foot expansion and the plus minus of the store evolution, transfer, closure, etc., keep happening, but we are very keen on adding a certain high quality square footage in our brands.

Abhijeet Kundu: And what would be the targeted one? Like 10% of that 3%-4% will go off, so 7% is the square foot addition?

Shailesh Chaturvedi: If you look at our square foot expansion, it is more like 1.75 lakh to 2 lakh. It depends on the markets also. So, it is in that zone that we are targeting right now.

Moderator: Thank you. The next question is from the line of Niraj Mansingka from White Pine Investment Management Private Limited. Please go ahead.

Niraj Mansingka: Just two questions. One, what was the growth in the square footage on a Y-o-Y basis?

Shailesh Chaturvedi: We have opened more than 120 stores. We can just check the number and I can just confirm.

Ankit Arora: We will have to just check the exact data. Niraj, I can settle back separately on this.

Niraj Mansingka: So, the reason I asked you is that what you said is more of a gross number of opening of stores, right? And what is the net number of stores if you can give that on a regular basis also, and now also it will be useful because that shows how much you have actually added on a net basis rather than gross?

Shailesh Chaturvedi: We will take this as feedback, and we will ensure that data is made available on a regular basis.

Niraj Mansingka: But what is the number for the quarter? How many stores you might have added on the net basis?

Shailesh Chaturvedi: We added more than 20 stores in this quarter and more than 120 stores in the year. That is the number we have currently.

Ankit Arora: We added 31 stores on gross basis in Q3.

Niraj Mansingka: Please let us know the net store in future, so that will be more realistic way to look at rather than the gross number. The second question is on revenue growth. Can you share what is the revenue growth for each of these brands like U.S. Polo Assn, Tommy?

Shailesh Chaturvedi: We don't share brand-wise data for a competitive reason and also, a lot of our brands are licensed, so our global partners are also very sensitive to that and industry also, our competitors also don't share. But we give enough color so that we mention how the brands have done and how they are doing. So, we have not given in the past a very specific brand-wise sales number or EBITDA number.

Niraj Mansingka: But it can be from color on, which is the highest growing brand and how is the lowest one, just wanted to have some color on that actually?

Shailesh Chaturvedi: The Tommy CK business has a very premium portfolio; they are growing faster because, people say K-shaped recovery or premiumization is working well right now. People are buying little more differentiated products. So, last couple of quarters, we have seen a higher growth in premium categories in Tommy Hilfiger and CK, and also the premium parts of Arrow i.e. 1851 or premium parts of U.S. Polo also has grown well. And as far as the lowest growth right now, FM is under a new refresh, and we are waiting for a lot of piloting to happen in FM. Once we see the fruits of that piloting we are doing, we will expand. So, right now, the growths are lowest in FM and the highest in Tommy/CK.

Niraj Mansingka: And the last question, can you just share some color on what you are doing so that you shared about refreshing the brand on FM, can you share what you are doing and how you want to compete with other brands which have taken over your market share over on that front?

Shailesh Chaturvedi: If you look at FM, it is a very strategic asset in our portfolio, it is owned by us. We don't pay any royalty in that and it is our own brand, which we have a partnership with the Flipkart group. And that partnership also gave us a unique edge in online space, understanding of that space. So, when we looked at the brand, we said, let's refresh the brand. This was one of the first Jeanswear brands, maybe the first Indian Jeans brand in country and we have done refresh of CK, we have done refresh of Arrow, and then we said now do it for Flying Machines. So, what we did is that we said that the Flying Machine will be a brand which will be built on four pillars. One pillar is Jeanswear. Now it is a very large market in India, especially in the MBO channel, etc., a very large business happens in the Jeanswear, and FM is the first authentic heritage Jeanswear brand, so we said that is the first pillar. Second pillar is youthful, and you look at how India is a young country, the Gen-Zs are becoming important, millennials continue to remain important. So, we said, this is a brand where youthfulness, the appeal to Gen-Z and millennials may be very important. Third, what we said will be kind of a value proposition that will be attractively priced for the product that we give, not the cheapest in that sense, but it will be attractively priced. So, the third pillar that we have decided to focus in Flying Machine was to focus on value proposition and the fourth was the most emotional pillar that we said, in a young country where social media is very important, we want to target online imagery of young customers where they are nobody, but they should feel like somebody really hot. And this expression of that fire emoji that people get, people crave for that emoji coming as a reply to them on social media of the fire emoji. So, being hot and the internal phrase we use is damn hot. And the fourth pillar will be that it should look like a damn hot and it should solve the problem of somebody towards his journey, as a machine will take it from an anonymous person to somebody damn hot. So, those are the four pillars.

And in terms of execution, how we are doing it is that we first changed the logo of the brand, we changed the font of the brand, we got a new propeller, the new font, we got a new color scheme, we got a completely new merchandise architecture which is targeted Gen-Z customer so that the product also looks damn hot. We got a new retail identity developed for Flying Machine that we opened in a Commercial Street, a high Street in Bangalore around a year back. And now we are using this pillar of new merchandise direction, the new retail identity, new ad campaign, which is focusing on being damn hot, we are trying to excite the young customers, Gen-Z plus millennials, so that they feel that they are damn hot when they wear Flying Machine. Now, early journey we are testing a lot of these things and what we have seen is that the MBO channel and the value department store have already got very enthused by the new avatar of Flying Machine. Also, we have renovated almost like 12 odd stores with a new identity, and we have seen very like good like-to-like growth or double-digit like-to-like growth in those stores. Still early days, we see a full effort, another year to get everything right to build it, but that journey has started and if you see our vision is also for Flying Machine to be a Rs. 1,000 crores brand, it will also have to have all the adjacent categories that we talk about, and we are very keen that we will add three-four new adjacent category in Flying Machine, and we will build distribution, we will build new product category and expand through value department store and as well as through our EBOs eventually. So, that journey has started.

Niraj Mansingka: And just, you said the 12 stores that you have renovated have seen very high double-digit growth?

Shailesh Chaturvedi: Yes. Since you asked that specific question, because typically when you are early stage, we want to keep quiet and keep doing the right thing and once we see a model work, then we talk about it and expand it. So, it is a very early stage of, we are seeing green shoots, but still, it is early days of the recovery for Flying Machine.

Moderator: Thank you. The next question is from the line of Jatin Sangwan from Burman Capital. Please go ahead.

Jatin Sangwan: I noticed that deprecation has increased Q-o-Q. I guess that was because of the addition of Tommy Hilfiger and Calvin Klein on COCO model, so if you could breakup deprecation by ROU assets and PPE, and the same for interest, breakup on lease liability and interest due to borrowings?

Ankit Arora: Jatin, Ankit here. So, just want to kind of clarify, interest is a very small portion, quarter-on-quarter, it has increased only by about Rs. 2 crores, which is generally on account of our IndAS adjustment because of our COCO stores. Yes, your observation is absolutely right on the depreciation side of it, it has increased by about Rs. 7 odd crores. There is a one-off in the depreciation on account of COCO store conversion, which had happened in PVH, which is what we have been speaking to you all about. Since the entire documentation and lease signing of all those COCO conversion stores got done in Q3 and hence there is a one-off charge and a cumulative impact in Q3 to the extent of about Rs. 5 to Rs. 6 crores in this quarter out of that Rs. 7 crores and this depreciation number will come down by about Rs. 3 odd crores, Rs. 3 to Rs. 4 crores from Q4 onwards. So, there is a one-off cumulative impact in depreciation on account of that.

Jatin Sangwan: And if you could give the breakup also deprecation by ROU and similarly for interest?

Ankit Arora: So, interest on our borrowing usually is around Rs. 18 to Rs. 20 crores and rest is on interest on lease liability and on depreciation the number is on fixed assets is about Rs. 15 odd crores and the rest is deprecation on ROU assets.

Jatin Sangwan: And what is the gross debt number that we are carrying as of December 23?

Ankit Arora: You asked about the gross debt number, right?

Jatin Sangwan: Yes, gross debt number.

Ankit Arora: So, that will be under Rs. 350 crores.

Jatin Sangwan: And what was the similar number on September 23?

Ankit Arora: I will have to just check that. Our net debt number was Rs. 476 crores as of September. You can look at the reported balance sheet which is what would have been part of the H2 financials.

Moderator: Thank you. The next question is from the line of Ankit Kedia from Phillip Capital. Please go ahead.

Ankit Kedia: Sir, my first question is regarding the MBO, you mentioned that the tertiary sales are in line with the retail like-to-like growth while we have reported 15% overall growth. So, just wanted to know how much are the MBO counter additions in the quarter, Y-o-Y growth and over the next two years, what is the aspiration for the MBO counter addition? And of the four brands which we have, if U.S. Polo is the highest counter addition or Arrow, what would be the other two brands like Flying Machine or the other brand versus the leader? So, how much of the depth we can increase by and also the width from the MBO channel?

Shailesh Chaturvedi: So, MBO is growing, in the Q3 is grown at more than 15%. Also, if I look at the YTD data, also it has grown double digit. It is growing well now, it is a function of, like I said earlier, expansion, annualization, and like-to-like growth. Also, MBOs are working at a lower sales density than our EBO. EBO have at much higher sales density. So, the growths are higher in MBOs because there is a scope to increase the sales density and by putting our own manpower to build more category assortment correctly, reducing category, putting the right category. Also, our sourcing has been very efficient, our OTIFs have been very efficient, so we have been launching the season really on time among the best in the industry, so MBO channel is benefiting from better sourcing and better supplies also from our side. So, that is the growth picture, and if you see aspiration, again it is a very large market and the market share of different brands or companies will be still not that good and huge ability to grow and go to newer towns with the MBO channel and like every other channel. So, I think there is a secular growth possible in MBO channel and we will be very careful on hygiene and that is very important for us that the inventory level at the MBO channel as well as the debtor situation with the MBO channel, we are very careful, watchful, and we are growing with very good hygiene. That is very important in terms of our aspirations. As far as the scope is concerned, U.S. Polo is leading brand. That is the first brand we take to a new city or to a new counter or new MBO channel because the desire for that brand is very high. It is a very large brand, country's leading, probably the biggest men casual brand in the country. Every MBO counter wants that brand first. Tommy CK have a little more exclusive reach because that price point doesn't work everywhere. So, that is a really careful expansion of Tommy CK. Arrow and Flying Machine both show very good potential to grow the MBO channel further. In the last two years, we have really expanded the Arrow MBO channel significantly. As the model started working, we started expanding. FM, we are doing that and the last number I remember in spring-summer 24 and the fall-holiday 23, the previous season and the current season, we are opening almost like 90 shopping shops in Flying Machines between the two seasons and we will continue to expand as the brand starts proving itself in the MBO counter and we continue to grow. So, overall, I think it will grow at a healthy pace, but I think the important thing is to maintain the hygiene of inventory and the collection.

Ankit Kedia: Sir, specific number I was looking at the number of counters we are present in MBO today and over the next two years what will be the counter addition?

Shailesh Chaturvedi: I am sorry, I don't have specific data on that and like somebody mentioned earlier on the store count these are the areas that I think we will take this as a note of better information sharing with the investors. So, this time please excuse me, we will come back with this kind of information.

Ankit Kedia: Sir, for last quarter also same feedback was shared with the team. Sir, my second question is regarding discounting. Now if I go online on U.S. Polo or the footwear brands and other brands, discounting is very high in online channels. Obviously, you are moving away from online B2B, where the discounting is higher. So, how much inventory is still in the system where if a consumer goes online and sees the discounting, it remains high versus the store where you are actually controlling the discounting. And over the next two years, where do you want the online B2B business to be positioned or reduce the inventory out there?

Shailesh Chaturvedi: So, if you look at our aspiration, we will want our B2C model with the partnership with these portals that are key marketplaces, we want it to be close to 75% of the overall online business. Currently, it is inching towards 50%. So, that is the scope to sort of convert the business towards more and more B2C and our aspiration should be as high as possible, because then we assort the product very scientifically and also we manage the experience and the pricing and control the discounting. So, that is one part of it. Now, as far as the current discounting on B2B portal is concerned, let us look at two ways. One is that we are de-stocking, like Kulin mentioned earlier and I also elaborated that we are very keen to de-stock, and the consumer sales are growing, but we are reducing that stock level, and in a couple of quarters where the de-stocking will get done and it will reach a BAU level where the inventory should be. Also, I want to explain you that fact that when the discounting happens the large part is what is known as OSM, the old season merchandise which we pull back from our physical stores and other distribution and online is a very efficient way of liquidating OSM. What should we do in outlets, etc., so online one side is a very efficient outlet model, and that model continues as OSM merchandise and also we do some online exclusive merchandise that's called SMU, which B2B people pick up and sell. But a large part of that online exclusive merchandise now we are doing in B2C with our own marketplace, and we are building that business with our own control and our own sense on pricing. So, that process is on, that strategy is being implemented and initial primary billing hits we are taking, and I think in a couple of quarters this will stabilize.

Ankit Kedia: And sir, my last question is regarding U.S. Polo kids and footwear, we have seen a very healthy growth in both these categories from a U.S. Polo side. So, how many counters or how many EBOs today are both these categories present? Or do you think there is scope to now linked only on consumer demand or there is still penetration remaining for both these categories?

Shailesh Chaturvedi: Yes, so we started the journey of adding footwear to all the stores and now majority of our U.S. Polo stores have the footwear and it accounts for a healthy share of U.S. Polo stores and you will see neighboring key U.S.

Polo store where you will see footwear being present. As far as Kidswear is concerned also opens up opportunity to open exclusive stores of Kidswear in future, so we will look at that version also. Also, footwear is sold through our own, we have a footwear chain where we do multi-brand stores. That also pilot is happening, and we sell footwear through those stores also. So, you see our expansion will happen and clearly that feedback on how many stores is present etc., we will provide that information.

Moderator: Thank you. The next question is from the line of Rajiv Bharati from DAM Capital. Please go ahead.

Rajiv Bharati: Sir, what part of this 120 gross additions are COCO stores?

Shailesh Chaturvedi: Very few. The number will be less than 20.

Rajiv Bharati: And in terms of this depreciation increase, Y-o-Y, is it safe to assume that bulk of this can be attributed to your COCO conversion on the TH side?

Shailesh Chaturvedi: And like Ankit just explained in previous question that accounting happened in Q3 and that is why there is a one-off, Rs. 7 odd crores depreciation compared to the Q2 has happened and now it has come down by Rs. 3-Rs. 4 crores as this stabilizes. So, COCO, our expansion is based on asset light model and in Tommy, particularly where we have taken over almost like 25 stores and some new stores will open on a COCO basis because the capital efficiency there and increase in ROCE. So, in Tommy, we will continue to open the COCO Store, but other than that, they will be only on very specific occasion, bulk of our retail expansion in other brands will be on a FOFO basis.

Rajiv Bharati: Because when I see the minority interest part, which is for your Tommy CK piece, which is I think -2% decline, and if I adjust this depreciation difference, it seems that you have grown 15%-20% profitability on Tommy CK combined, is that number right?

Shailesh Chaturvedi: We are growing at something similar to what you are saying.

Moderator: Thank you. Ladies and gentlemen, due to the paucity of time, that was the last question for today. I would now like to hand the conference over to Mr. Ankit Arora for closing comments. Over to you, sir.

Ankit Arora: Thank you. I understand some of you may have a few unanswered questions, but management had a paucity of time, so we will have to close this call. Thank you everyone for joining us on the call today. If you have any other follow-up or any more questions, we can take that separately and I am always available to answer those. Thank you so much for your time and have a lovely evening.

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