



“Aditya Birla Fashion and Retail Limited's Q1 FY2017 Earnings Conference Call”

August 31, 2016



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Moderator:

Ladies and gentlemen, good day and welcome to the Q1 FY17 earnings call of Aditya Birla Fashion and Retail Limited. The call will begin with the brief discussion by the company's management on the quarter's performance followed by a question and answer session. With us, we have Mr. Pranab Barua - Managing Director, Aditya Birla Fashion and Retail along with Mr. Ashish Dikshit – Business Head (Madura Division), Mr. Shital Mehta – CEO (Pantaloons Division) and Mr. S. Visvanathan – CFO, Aditya Birla Fashion and Retail. I want to thank the management team on behalf of all the participants for taking valuable time to be with us. I must remind you that the discussion on today's earning call may include certain forward looking statements and must be viewed therefore in conjunction with the risks that the company faces. Please restrict your questions to the quarter's performance. With this, I hand the conference over to Mr. S. Visvanathan. Thank you and over to you sir.

S. Visvanathan:

Thank you. Good evening and welcome to the Q1 FY17 earnings call for Aditya Birla Fashion and Retail Limited. Through this opening remark, I would like to take you through a brief background of what is our view of the industry performance, our own performance for Q1 and a brief on what we expect to be as the outlook for the rest of the period. So let me start first with the industry performance.

Apparel industry continues to show differential growth pattern across different segments of the market. As large number of consumers are upgrading from unbranded to branded clothing, value fashion segment has been growing fast, this segment witnessing double digit growth both through organic offtake and rapid expansion. However, the overall industry growth has been subdued particularly in the luxury premium and super premium segments with consumer still holding back on high value purchases across all discretionary expenditure. These segments continue to experience deeper discounting and frequent promotions which is affecting the underlying profitability. In terms of channels, e-commerce growth continued across all categories, though the rate of growth seems to have slowed down as compared to previous few quarters. With major players increasingly focusing on profitability and greater consolidation in this industry, we expect that disruptive discounts will come down going forward.

Now let me come down to ABFRL performance. While I will take you through the Q1 performance detail, I thought it is important that we revisit the key pillars of our strategic direction for the company. As outlined in our previous earning calls, the key pillars have enriched the portfolio through expansion into new consumer and product segment, accelerate growth in faster growing segments of value fashion, consolidate the intrinsic profitability of Madura Business by driving margin improvement through discount management, network rationalization while continuing to invest in brand building, driving digital transformation through omni-channel program.



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Now let me quickly brief you on what has happened in these 4 strategic pillars in the last quarter. On the portfolio expansion, I am happy to inform you that we have completed the acquisition process of F21 business for the Indian territory. The business is now integrated with ABFRL with effect from 1st July 2016. With this acquisition, we have one of the fastest growing brands in the young women fast fashion space. With respect to rapid expansion in the value fashion segment through Pantaloons, the Pantaloons business continued to grow the expansion even while the same-store growth in the last quarter accelerated to 16% and was among the best in the industry. The business opened 12 more stores during this quarter taking the total number of stores to 168 with the total area of about 2.7 million square feet. We also expanded the Pantaloons franchise by opening the first Pantaloons Women's store, a unique store dedicated to the lifestyle needs of the Indian woman with offering spread across western, ethnic and accessories. We closed the quarter with two women store of Pantaloons.

Omni-channel, we continue to expand the role out of omni-channel functionalities in our retail stores. 90 more stores were added in this quarter taking the total number of stores to 100 offering various omni-channel functionalities. These stores offer a richer integrated consumer experience combining the range and variety of online business with high levels of service offered through physical interaction as stores.

Let me come to the last point, this is a focus on intrinsic profitability of Madura brand. The premium segment of the market as I told you where most of Madura brands operate has been experiencing continuous promotion and discounting affecting the intrinsic profitability of these brands. We believe that while this is a short term phenomenon and will improve, our medium term as consumer segment picks up in the second half of the year; however, in line with our strategy outlined earlier, we continue to focus on improving the intrinsic health of MFL brand. Our discounts once again in this quarter were lower than the same quarter last year resulting in improved gross margins; however, this strategy continues to impact the sales growth of the business with overall sales being lower by 3% as compared to last year. This was compounded by little bit of excess inventory in the channel pipeline. We also have rationalized retail network by closing down unprofitable stores to further improve the network health. We believe that our balance focus on brand development and cost management will help us maintain profitability going forward.

Now let me come to the highlights of financial performance of ABFRL and the individual businesses. First ABFRL, the sales for the quarter was 1,415 crores which is a growth of 8% over Q1 of FY16. EBITDA was 76 crores which is a growth of 78% over Q1 FY16; however, you must keep in mind that Q1 FY16 also had a profit elimination adjustment of 26 crores. Pantaloons business, Pantaloons ended Q1 FY17 with revenue of 574 crores, a healthy growth of 31% and an EBITDA of 26 crores, a growth of 489% Q1 FY16. It is largely achieved due to an increase in the number of stores from 134 to 168 as at the end of the quarter, a reduction in levels of discount and a strong 16% growth in like-to-like sales. The own brands revenue grew



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by 26.5% on a like-to-like basis. Own brands now are 63% of Pantaloons revenue, up 650 basis points.

MFL business; MFL sales were 842 crores, a decline of 3% over Q1 FY16 while gross margins for the quarter improved by 30 basis points. EBITDA for the quarter at 47 crores was lower than the 64 crores in Q1 FY16. Most of the sales decline came in wholesale channels as we controlled dispatches for end of season sales. Retail sales was also impacted by lower discounting, resulting in like-to-like sales decline of 4%. Our discounts in this quarter were lower than Q1 FY16 by 180 basis points, a reduction of 10%. We have also critically evaluated the profitability of retail stores and aggressively rationalize the network by closing the bottom 76 stores while adding 55 new stores. This will improve the network health going forward. Our results for this quarter incorporate the impact of the IndAS accounting standards. The detailed bridge is available in the investor presentation uploaded on the website.

Outlook; going forward, we expect to see an improved demand situation around the festive period in second half of the year due to improved macroeconomic factors like higher GDP growth of about 7.7%, a good monsoon, implementation of the 7th pay commission and increased allocation to MNREGA. We also expect reduction of excessive discounting by e-commerce players compared to FY16. This is also backed up by the new FDA guidelines in e-commerce as well as internal focus on improved profitability. However, while H2 we expect to be better than H1 of this year and we see an improved situation in H2, the next quarter of H1 which is Q2 we expect a more subdued performance as it will be a business largely driven by EOSS. This EOSS has been longer and more competitive as compared to previous EOSS. At ABFRL, our focus will continue on the following; expansion and fast growing segments of the market, we will continue to expand Pantaloons and start growing the F21 business, selective partnership with international brands to fill up wide spaces, focus on improving the intrinsic profitability of the premium brands through calibrated discount management, cost rationalization including store network, continue to improve merchandizing and planning process, expand the omni-channel across all stores, pursue further growth through organic and inorganic routes in identified wide spaces. We will continue to be the largest and the most profitable player in the industry. We are now open to questions.

Moderator:

Thank you very much. We will now begin the question and answer session. We have the first question from the line of Avnish Roy of Edelweiss. Please go ahead.

Avnish Roy:

Thanks sir for the opportunity. My first question is on Madura. Sir you have been highlighting second half recovery. My question is from a FDI guidelines perspective which is impacting e-commerce, do you really expect that to be big, why I am asking this is another large listed retailer said that the coming together of Myntra and Jabong, that is in fact the bigger problem because now one of e-commerce guy has got 2 large fashion e-commerce, so that is the bigger



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problem they are saying. So what is your take on that because now again I am seeing last one month the discounting, the advertisement has again restarted in a big way for the e-commerce?

Ashish Dikshit:

Avnish, this is Ashish here. First of all I broadly agree, I think e-commerce industry has not reached a stage where discounting will be fully off. I think it is the reality of the industry at this point of time as the rates for customer acquisition continues. I do not think discounting as primary or at least a major vehicle for acquiring customers is not going to go away. Having said that, clearly in our discussions and in the actions that you see of the players, there is a far greater focus on looking at fundamentals of the business. I think going forward more and more players will be looking at overall economics at unit level and at company level and that should be a positive sign. I do agree however that as far as the short term is concerned, the difference may not be as large as you hear about and it might take a little while longer but at least the trajectory is in the right direction now.

Avnish Roy:

So sir your second half recovery what is it based on, you are saying this FDI thing, the e-commerce may take more time. So are you saying that 7th pay commission, MNREGA, monsoon those will impact because those are largely rural land and it may not be too much of an impact on Madura at least?

Ashish Dikshit:

Yes, I do not think these are individual factors which each one you can attribute to business performance. Having said that, I think optimism, overall industrial recovery, economic growth are all likely to be more positive in the second half compared to what the first half was. We have seen in such environment with the premium brands, the propensity to spend over better products improves. It is also built around slightly better marriage season going forward which at least for our premium formal brands has always been a primary driver for some of the high value purchases. So some of the expectation is built around that, the macro factors as well as the overall conditions that we see in the market. I do not think our business performance can be explained by one single factor whether it is e-commerce discounting or it is some of the government initiatives, but it is the overall environment which actually determines the premium brands business and the market and that is where we expect the recovery to affect us.

Avnish Roy:

Sir my follow on question on Madura was you have closed 76 stores to improve the network health. So is there any write-off impact because of this in this quarter and why such a sharp closure and what is the plan, next one year how many more stores you want to really evaluate whether they are working, not working, are these largely in the malls standalone stores?

Ashish Dikshit:

No, I think just while you look at one quarter number I think I will just take you back and pull back on how our business strategy is playing out. As you saw over last multiple years, we grew rapidly through expansion of brands, sub-brands, new product categories and distribution expansion. As long as the growth was in higher double digits, it was easy to expand and get into new categories. We have found in last 12-18 months as inherent market conditions



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deteriorated, the kind of growth expectations that we had from the business that was not coming through and that is the right time for us to look at our overall strategies on go-to-market. Some of the store closures that have taken place here is largely around the sub brands and some of the new categories that we had expanded into. We have become more calibrated, more watchful and we want to make sure that we calibrate our growth of network in line with the organic growth in the business. As the market sentiment improves, we will come back. In terms of overall closure in our network of about 1800 odd stores, it is not a large number. We expect may be another 40-50 stores which we will close over next 2 or 3 quarters, but I think large part of the work has been done, it is behind us and in the large network it is important that once in a while you look at the entire network comprehensively and see if there are places where improvement is possible.

Avnish Roy: And any write-offs you have taken in this quarter?

Ashish Dikshit: Whatever it is, store closure that comes as a part of the P&L, so there is nothing specific. These are small stores, so it really does not, individually they do not add up too much, even together the number is about 50-75 lakhs.

Avnish Roy: Sir my last question is on Pantaloons you have done well in terms of sales growth. Could you elaborate on the franchise, how many franchise total now you have, what is the learning, what is the confidence level now? In the next one year now is there a firmer game plan on how much you want to take it to? Which parts of the country you want to take it to?

Shital Mehta: As of now, we have 4 stores and we are sort of calling this is a pilot, as part of that we have 4 stores and we believe that over the next 3-6 months we will be watching this space and how this franchise store sort of performs before we actually take a more decisive call on how fast we need to expand through franchising. So I think they are still at I would say pilot stage and early signs are reasonably encouraging, but we still need to be watchful for couple of more quarters.

Avnish Roy: But this quarter you have not added any further stores?

Shital Mehta: No.

Moderator: Thank you. We will take the next question from the line of Abhishek Rangathan of Ambit Capital. Please go ahead.

Abhishek Rangathan: Thank you for taking my questions. I have about 3 specific questions here. One is, the volume growth in Pantaloons is 65% and the value growth is 31%. Now I understand that we have possibly changed our proposition; are we moving to a point where we are driving down price



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points and if that is the case as a value fashion retailer typically the gross margins are lot lower than a conventional own brand retail. How do you explain this?

Shital Mehta:

Just to correct the point, our overall as against this 30% revenue growth, our volume growth is 44%. The 65% growth which you are referring to is our own brands volume growth. But at an industry level and at a company level as against 30%, we are at 44%. Second point is overall ASPs we have corrected by almost 8%-9% and it was our a strategy itself that how do we achieve twin objective of rationalizing the pricing and sharpening the pricing and yet expanding the gross margin and that improvement in the gross margin is going to come through two factors, one is the share of our own brands which are significantly more profitable will go up and second is the markdowns will come down that is precisely what has happened, that despite the reduction in the price points to the extent of 7%-8%, we have been able to expand our gross margins and that is how we see playing out going forward as well.

Abhishek Rangathan:

Right and when you mentioned your markdowns will come down, so are you saying indicating that you will be running a lower duration of sale because this time if I understand and this is the part of the second question which I have is that you started your sale earlier, so if I wanted to understand your like-for-like growth adjusted for this, how would it be?

Shital Mehta:

We had actually for us the preponement was to the extent of 2-3 days and I would say that at least 2%-3% of like-to-like growth is attributable to that. So even accounting for that we had a reasonably healthy like-to-like which would still mean the double digit, yes if I have to answer your question long term, we do believe that I think our markdowns whether it is coming through our loyalty discounts or the ongoing consumer promotions or the extent of discount which we give during the EOSS as well as the EOSS period. As a combination of all that, we are very confident that we should be able to shave off the markdown percentage which should negate any effect which we are seeing through the price correction.

Abhishek Rangathan:

Right and if I just want to refresh myself on the like-for-like growth calculations, you would be looking at stores which were existing like-for-like stores at the end of last year right in the first quarter 2016?

S. Visvanathan:

That is correct. Stores that are active in the entire quarter of last year. So it is exactly apple-to-apple.

Abhishek Rangathan:

Right, so that be about 104 odd Pantaloons stores excluding the factory outlet. So the basic thing I wanted to get a sense was that the like-for-like growth there seems to be 3 components, one is the EOSS, the second is obviously the initiatives you have taken and the third would be the fact that a good amount of these stores would have ramped up and they would have entered your second year of operations, am I reading it correctly? Is that also one of the reasons why the like-for-like growth has really healthy jump?



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S. Visvanathan: That is true absolutely. But having said that, I think even we are seeing that even more than 5-year-old stores as part of our new improved value proposition, we are seeing that there is a lift which is there in the like-to-like. So having said that, the recent store which we opened in last couple of years will always continue to show higher trajectory, but we are seeing this structurally agnostic to the geography and categories we are seeing that there is a like-to-like which has firmed up.

Abhishek Rangathan: Just one last question on Madura is that what explains the fall in revenue in the others category? Is the others category the large format of the departmental stores and the fact that the wholesale we have seen a slowdown, is that particularly due to resistance at price points of with respect to some of our brands?

Ashish Dikshit: Others is a small part. The largest part of what constitutes others is the depletion channel sales where we sell our discounted stocks at cheap discounts at places like brand factory and other such places. As we have been repeatedly saying one of the clear intent in strategies to continue to create premium invest in brands and not go down the path of discounting and lower growth margins. As a part of that overall strategy, we have to let go of some part of depletion sales which is easy to get but built on deep discount. So that is what is the difference as far as others are concerned. Coming to your question around wholesale, we had explained in the previous call that as we executed our strategy of control discounting, one of the things that we need to do in the entire pipeline because you are familiar that apparel industry typically operates with retailers having stock of between 16-20 weeks which means about 4-5 months of inventory is at any point of time in most retailers depending on the throughput and velocity, they manage that. As you are correcting some of these things, this flows into the secondary sales and then retailers correct their inventory line with that. Now that effect is flowing through in the first quarter of this year. A part of it will probably get flushed out by the end of year sales and which is why when we come to H2 we will have a much healthier pipeline, a more enriched gross margin mix of the business and fresher inventory coming to the pipeline. So all the corrective measures that we have started to take towards the end of last year would probably have got cleaned up by the end of Q2 this year.

Abhishek Rangathan: Understood and just for my understanding the departmental stores sales are captured in retail, is it?

Ashish Dikshit: No, department store is also included in wholesale. Our wholesale what we have mentioned is includes department stores plus all multi-brand outlets.

Abhishek Rangathan: But this is not based on consignment or buy or sell. It is just the channel which you are attributing to your..

Ashish Dikshit: That is it.



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- Moderator:** Thank you. The next question is from the line of Chirag Shah of CLSA. Please go ahead.
- Chirag Shah:** Thank you very much for taking my question. Sir, in this quarter we have had a very sharp increase in rent expense and employee costs, now I understand the expansion that we have had in Pantaloons but is there anything else that we need to read into the rent and the employee cost?
- S. Visvanathan:** No, fundamentally it is basically the expansion in Pantaloons that is causing the drive in increase in rental cost.
- Chirag Shah:** And you said the closure related costs were very little?
- S. Visvanathan:** That will actually reduce the rent.
- Chirag Shah:** Yes, of course it reduces the rent but there is no one time closure fees that we have to pay to the malls that is included in the rental expenses, right?
- S. Visvanathan:** Our total cost is only about 75 lakhs in terms of...
- Chirag Shah:** Right and can you also help us on the net debt number the end of the quarter and in the backdrop of relatively high gearing that we have, how do we plan to invest in the several new initiatives that we have lined up going forward?
- S. Visvanathan:** Our net debt at the end of this quarter is about 2089 crores and we have a plan of funding going forward. So the only thing I can guarantee you now is I cannot tell you exactly what will be the funding strategies that we will have for the new initiatives. Bulk of the new initiatives will be financed from our internal accruals as it accrues and also we will be very cautious about the net debt to EBITDA ratio and the total gearing that we have. So it will not be allowed to go beyond the reasonable limits that it is there today and if there is a need, then we will have to look at the financing structure to see how we manage that.
- * This is an inadvertent miscommunication. The figure of Rs. 2089 crores is gross debt.
- Chirag Shah:** So is there a threshold net debt to EBITDA ratio that you would not cross?
- S. Visvanathan:** It is difficult to say, I think between 3.5 to maybe 3.7 is probably a right number to look at.
- Chirag Shah:** Got it and the net debt number that you mentioned is a net number, not the gross number, right?
- S. Visvanathan:** Yes.



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Chirag Shah: Sure and Ashish would it be possible to spend some time on your brand expansion strategies, in the past we have had quite an aggressive extension strategy, so what is the market acceptance now? What is the success so far and plans going forward and in the backdrop of the slowdown that we are seeing in Madura, is there a change of thought on the investments that we are doing in brand extensions?

Ashish Dikshit: See our overall strategy does not get altered by one quarter or couple of quarters here and there. We have strong faith. Most of the strategy has got played out not over 1 or 2 years but almost 5-10 years. We will continue to look at opportunities. Even as we speak, we are launching one significant brand extension by entering innerwear through Van Heusen as a first big new initiative for this year. So we will continue to stay invested in leveraging our brands, investing into the brands. What you are seeing currently is a correction which is more reflective of how we feel about market in the short term and some of the measures that we are taking in terms of improving the intrinsic health of the business. We are very conscious of the fact that as one of the leaders in the industry and one of the few companies which is profitable in this industry we must take accountability and responsibility assuring profitability of key parts of the businesses. So it is only because of that at this point of time some of the extensions that we have taken into retail and opening independent stores for each of the brand extensions that is what has slowed down a little bit. Our overall strategy of expansion through brand extension is not going to slow down. It has been a very big lever of our growth and we will continue to invest in it.

Chirag Shah: Got it and just one last question, is there a revised CAPEX plans that we have for the year and just one clarification, is the debt number that you gave us is including the cash outflow for the acquisition of Forever 21 or that happens in the current quarter?

S. Visvanathan: There is an element of Forever 21 in it, we will need a little bit more funding for Forever 21 going forward.

Chirag Shah: So the 2,089 crores number includes the part of the payout for Forever 21?

S. Visvanathan: Yes.

Chirag Shah: Got it and on the CAPEX front sir?

S. Visvanathan: CAPEX plan, I think we will be investing close to about 300-330 crores by the end of this year among all the 3 businesses, the expansion of Forever 21, expansion of Pantaloons and the usual stores opening in Madura.

Moderator: Thank you. The next question is from the line of Atul Mehra of Motilal Oswal Asset Management Company. Please go ahead.



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Atul Mehra:

Good evening and thanks for the opportunity. Just one question on Madura, as we look back in terms of last 5-10 years, so as I was going through the numbers in terms of growth, so we have not really had such level of weakness in growth for many years. I think even in 09, we were like +9% perhaps. So what is really changing in the marketplace which is resulting in such weakness in growth?

Ashish Dikshit:

There are two things which are happening. At a structural level what has happened and over last 6-7 years, we have established and created a very profitable and fast growing business through the levers of distribution and brand extensions. As the underlying weakness in the market started to step from perhaps from last 4 or 5 quarters, we have been evaluating the pace at which we need to grow at this point of time without compromising on profitability. The big shift in last 24 months has been on account of perpetual and very deep discounting and promotion that industry is witnessing as e-commerce came in and started to focus on the segment of apparel, value fashion retailers started to come in and started to create new value at the bottom of the pyramid. That has created in consumers mind, I would think somewhat short term but definitely created a situation in which there is faster and greater pull towards both in terms of channel towards e-commerce as well as value towards lower priced products. In this scenario, the choice for us was to continue to participate in this kind of competitive environment with even greater discount but we feel that would have led to a longer term erosion in margin and brand premium. We have been through such periods in past maybe not at this level of intensity, but you would recognize that the level of impact that today e-commerce is creating on industries is much higher than anything industries have suffered in last 5-7 years. So we are conscious of these large forces around us. We want to be watchful and aggressive, so that if there is a war chaste we can get after the situation once the market situation improves. The good part is we continue to keep the premiumness of our brands, continue to keep investing on the core propositions on which we want to build these brands, expanding the portfolio, keep getting into new categories and when things get let us say more normal, we are ready for a much bigger play once again. We are also in this period relooking at our challenge strategies. Omni-channel has become a big push. We will probably be the first company with 500 omni-channel enabled stores by the end of quarter 2 this year. So lot of investment in technology, processes, training our people and building infrastructure to create this big digital shift. So in some way if I have to summarize, I think the structural shift was deeper this time, making cognizant of that we have measured our growth. We have relooked at our cost structure far more carefully and deeply which is why you will see the kind of network rationalization that we are talking about. We have invested for this company to be future ready by deeply investing in technology, digital readiness and omni-channel. We think we will come out much stronger and be prepared to get back to the kind of growth trajectory that we have demonstrated over long period.



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Atul Mehra: Right and is there a major differential trend in performance of individual brands maybe at the upper end or the lower end, so is there a major differential in growth trends?

Ashish Dikshit: Not very large, but clearly the lower end of the market is more vibrant today, but it is not a very big difference for us.

Atul Mehra: And just one data point here, what will be the percentage of sales from full price sales at this point in time?

Ashish Dikshit: So it varies across brands and across categories, as you would know formal wear business is less prone to in general by sheer nature of amount of fashion and risk it carries, it is less prone to this level of risk, but having said that there has been erosion in full price from early 60s to mid to late 50s, although it is different across different brands, different in more fashionable categories, lesser in more classic and formal businesses, but at a company level there has been an erosion on full price both in terms of the period in which you sell full price and the amount of share of business that you get at full price and which is one of the reasons that we have sort of controlled our discounting. We could have brought little bit more sale during last 8-9 months several quarters by participating more deeply in that process, but we have taken a conscious call to let go of some of that growth.

Atul Mehra: Right and just one final question, in terms of e-commerce given the platforms in itself, they are pretty much gaining some traction, so how is our e-commerce strategy now apart from omni, so are we aggressively looking at third party as an alternative channel or not?

Ashish Dikshit: The answer to that is absolutely yes. We are working very deeply with the larger e-commerce players to create the kind of partnership that we have created with any other channel in the market. Historically, we have been the largest partner of every single player in distribution channel whether it is department stores, whether it is large MBOs in the past. Same is the situation with the e-commerce players. We have no doubt that we are the largest players with most of the e-commerce players, I think by the time their focus came on the branded product at the higher end, it took them some time to build that traction at that level, but we are very confident that we will have very large business with them and we are excessively working on building that.

Moderator: Thank you. Our next question is from the line of Chirag Lodaya of Value Quest. Please go ahead.

Chirag Lodaya: Thank you for the opportunity. Sir my first question is related to digitizing the stores, when we say we are digitizing the omni-channel in the 400 stores, so what is the cost associated to the same?



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- Ashish Dikshit:** There are two elements of cost. One is the fixed cost that happens at the center when you create IT infrastructure for that. Most of that cost is behind us. We have invested close to about 20 crores across platforms, building platforms, implementation of that. What we are doing is now at a store level spend and that is the incremental store-by-store. It has two elements, one is to create endless aisle in each store which means each store would be able to offer consumers inventory across all warehouses and stored locations and in some of the largest stores, there is a digital display, but that individually each store is able to absorb that as a part of its overall economics. So it is not a big number which is going to shift anything as far as the overall business is concerned. The big part of the investment was the capital investment in building the IT infrastructure for it which is behind us.
- Chirag Lodaya:** Correct and secondly on CAPEX plan, so what number of stores we are looking to add in Madura, PFRL and Forever 21, if you can give some sense?
- Shital Mehta:** So in Pantaloons, we are looking to add about 50 stores.
- Chirag Lodaya:** It is net additions, right?
- Ashish Dikshit:** Yes, net additions. Forever 21 is bit early, we are absorbing the business. We have a pipeline of the stores but I think it is too early for us to give you a sense. There is a large pipeline, but we want to absorb that before we actually start opening this store, but there is a fairly attractive opportunity there. I think at this point of time between 5 to 6 stores is what we should be able to open by the end of this year. In Madura as I said, our store expansion is also married with network rationalization that we are undergoing. We would look to open about net 100 stores which is post rationalization of the network in the kitty by the end of this year.
- Chirag Lodaya:** Okay and sir in terms of margins, so how are we looking in overall margin trend for Madura? Are we seeing this Madura margins to deteriorate further this year and start improving from next year or the trend is positive?
- Ashish Dikshit:** I think we have just gone through a phase where most of the corrections we have sort of implemented in Q4 and Q1. We expect the positive impact of all the changes that we are making to start emerging from Q3-Q4. We expect our H2 margins to come back to in fact be better than H2 of last year. On a year basis therefore we hopefully should be very close to what we achieve last year and we should be looking a positive trajectory from there onwards.
- Chirag Lodaya:** And sir lastly, if you can give some sense on A&P, how it is shaping up?
- S. Visvanathan:** We had mentioned in several calls before that that Pantaloons operates with about 2.5% of advertising through sales promotion. Madura as a portfolio brands operate between 4%-4.5%.



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There would be quarters where it is higher, there are some quarters where it is lower but that is more a function of timing of festivals and other activities and I do not see a big shift in that.

Chirag Lodaya:

The reason I am asking, so last year you were mentioning your overall A&P spends have gone up drastically in FY16 as compared to FY15. So just wanted to get sense in FY15, we will see this overall A&P intensity going down or it will be maintained in the same level?

Ashish Dikshit:

I think there was a particular quarter when this question was raised where Q3 of last year spends were exceptionally higher because we had come back with a fairly great intensity in the market at that point of time, so that is one quarter exceptional impact. Some of that has shown in the full year, but going forward as in the past we will operate at around 4%-4.5%. It will keep marginally changing as we look at different parts of the market differently.

Moderator:

Thank you. We have the next question from the line of Sujay Pai of DH Consultants. Please go ahead.

Sujay Pai:

Thank you for taking my question. My question is around Pantaloons. Primarily the growth for Pantaloons seems to be coming from the women's wear segment. I just wanted to understand about the launch of Pantaloons kids and do we have some sense of number on the kids wear segment and how this strategy is panning out and on a full year basis how the numbers would look like?

Shital Mehta:

As you rightly said, we are the leader in the women's space and we had taken a strategic call that we want to develop also the adjacent market which is where the kids opportunity was identified, right now for both segments as we continue to grow aggressively in our own stores in terms of the mix of women's as well as in kids, we have also initiated the pilot of specialty stores. So we have now till Q1 we have two women stores which we opened and one kid store. These are the 3 stores which are right now going through the pilot. Early results are again encouraging, but as I was saying earlier as well, franchising as well as the specialty stores of kids and women, all these 3 initiatives are right now through the pilot and only after we have opened at least 8-10 stores each in each of these 3 initiatives, we will be able to take a more stronger view on how do we need to expand on these 3 formats going forward.

Sujay Pai:

Right and also I just wanted to understand whether the omni-channel strategy is playing out as was expected?

Ashish Dikshit:

So the omni-channel stores which we had launched is just about couple of months back. The real impact will have to see over a longer period of time. Right now, it is too early to say the contribution is less than 5% coming out of omni-channel sales at this point of time and the stores where it is launched. We will have to wait and watch how consumers react to that, but



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we feel that there is a large opportunity of missed sales that our store team will be able to fill up through this strategy.

Moderator: Thank you. Next question is from the line of Maulik Patel of Equirus Securities. Please go ahead.

Maulik Patel: Couple of questions. First one is on your strategy on the category extension which you embarked some time 2 years back, can you please give update on that?

Ashish Dikshit: Sorry, this question is with respect to Madura Pantaloons. So strategy of category extension is really not new strategy. We have been at it for a very long time, I would say as far back as 8-10 years. We continue to look for opportunities. The key categories that we had extended was really new usage occasions and consumer segments and therefore as casuals market grew, we expanded our brands into casuals, we launched denim in most of our brands where we felt that consumers are amenable to buy denim and casual products from our brands. We got into accessory categories like shoes and handbags. So much of it is play and in action, these are early days, most of these categories of new products are sub 100 crores individually, but over a long period of time, each one of them will become substantial part of our business. As I mentioned earlier in the call that we have now decided to extend play into innerwear segment that is the new category extension that we are looking at. Each of these categories take a few seasons to evolve where the product gets firmer, we get better understanding of the market and the category performance becomes more stable and it takes after that couple of years for it to get to some size and scale. So we will continue to keep looking at opportunities, keep expanding this. It helps the brand in 2 ways. One is once the consumer comes in, we are able to get a greater share of the wallet. Secondly, it allows to make our retail more productive. Third, it gives us in distribution new spaces and new ways to grow through new channels and each one of them therefore sort of aid in building stronger business.

Maulik Patel: And sir second question is on the macro and related to the GST, what could be the revenue neutral rate for both as an entity and probably is there any difference between the Pantaloons and the Madura?

S. Visvanathan: See our current calculation shows based on the current structure of taxes, revenue neutral rate between 13.5%-14%. It is not different for Madura and Pantaloons.

Maulik Patel: And let us say if it comes into around 18%, then there could be a some kind of a slowdown in terms of volume growth in FY18 if it is implicated?

S. Visvanathan: If it is happening only to Madura, the answer is yes. It is happening to the entire industry, whatever rate happens, happens with the entire industry. So the industry as a whole will have



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to look at prices, will have to look at vendor negotiations, will have to look at cost management and try and manage the situation at that point of time.

Moderator: Thank you. Next question is from the line of Tejas Shah of Spark Capital. Please go ahead.

Tejas Shah: Thanks for the opportunity. My first question pertains to Madura. Our new strategy we are following of controlled discounting, our gross margins improved as we mentioned, but because of the strategy and because of the lower throughput, EBITDA took a hit. Now just wanted to understand what is the goal we are seeking from this strategy because clearly we would not be gaining market share if not losing and lower throughput is also not allowing margins to improve. So just wanted to understand what is the objective evaluation of the strategy from the numbers perspective?

Ashish Dikshit: So Tejas, I think in the short term if you look at any strategy like this, it would have the impact that you are suggesting which is the throughput comes down at some level, your fixed cost structure remains at what it is and therefore on EBITDA in the short term, they tend to have the negative impact and which is really what is playing out. So we were conscious of it and we were aware of it. As we have repeatedly said that we need to build this business over a longer term. Our ability and the desire to create reasonable premium for our brands to build a profitable business will continue to remain goal. When we are taking short term corrections like this, couple of quarters will go because you are also aware that this is an industry with 6-9 months of design to supply lead time. So even as you are playing out that strategy correcting your price value equation, making sure inventory is clean across the channel, in the short term it has the kind of impact that it is having for us and we are prepared for it, but what we did not want to do was to go down a path where we sort of become leaders and further perpetuate continuous discounting and deeper discounting which the whole industry will suffer from and therefore lot of our actions are built around intrinsic value proposition, working on them, improving on them and making sure that in the short period, the resultant impact it has both on higher inventory and lower secondary sales is something that we sort of grind through our way. Focus comes back on cost, we are looking at rationalization of network, looking at every piece of selling expenditure and overhead to see how to leverage cost lot better. So as a company, we have decided to take a hard look at some of these things with the medium term perspective and in the short run therefore it does play out economically in the way you have described, but we are confident that this is the right thing to do.

Tejas Shah: And continuity on that question when we look at some of our peers margin who have perhaps not as strong brand equity as we have and in some of the foreign brands where they are paying 5% or 4% royalty, even after that they are also delivering much higher margin than Madura brands portfolio. So just wanted to understand where is this gap because I believe the whole advantage of having that 4%-5% to ourselves is to be more competitive either on pricing or



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more competitive on the margin side. So just wanted to understand why there is a gap between these two segments of the market?

Ashish Dikshit:

So I do not know which segment you are referring to in terms of competition and margin, but let me just comment on our business. We have a portfolio of brands with the varying degree of profitability. We also are continuously and perpetually investing into either younger brands, new product categories, or initiatives like digital and innerwear and therefore the overall mix margin is what we were optimizing at Madura level. Increasingly post consolidation, we are looking at our business at ABFRL as an integrated business where Pantaloons plus Madura margin is what we are looking to optimize. As a large player with the clear desire to grow and play into all spaces, we will have to make sure that the margin mix of the overall play such that we are playing in all the growth segments, creating levers of future growth as well as continuing to optimize on the margin mix. Madura's core brands margin continued to remain healthy and it is one of the healthiest in the industries. I do not know too many people of any size and substance who have that kind of margin in that segment, but our overall mix has obviously impacted at this point of time, but this is something which is what we are trying to correct and that was the first part of my explanation.

Tejas Shah:

Fair enough and sir lastly, last question on Forever 21, do you have any store rationalization plan in Forever 21 or we would start building business on the current platform itself?

Ashish Dikshit:

No, they have very successful set of stores right now, the 12 store network that we have inherited as the part of this acquisition. These are good stores. Over next 3-6 months, we will look at how to make them stronger, but really the focus is on growth. This acquisition is to deliver us market and industry leading growth in the fast fashion women segment. We want to play that game very aggressively and the brand is very strong and therefore we have got a great opportunity in front of us to leverage and fulfill one of the big portfolio brands that existed in the company. We were very positive and I think the only thing we are looking at how to pace our growth and that is something we will absorb in next couple of months and may be able to talk about in next couple of quarters more clearly.

Moderator:

Thank you. Next question is from the line of Manish Poddar of Religare. Please go ahead.

Manish Poddar:

Could you give us the volume and the price split for Madura during this quarter, Madura brands?

Ashish Dikshit:

So on a like-to-like level, our overall volume growth and ASP was practically flat. It was I think half a percent or 1% down and therefore our like-to-like volume was also same as our like-to-like sales growth which is -3%, -3% like-to-like volume decline and about a percentage ASP decline which was resulting into 4% like-to-like sales value decline.



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Manish Poddar: Sir do you think so that discounting which you have called off in the Madura brands, would it make sense to take this down in FY17 with the industry consolidation and with the market environment being there in the place?

Ashish Dikshit: I think what you are asking is in retrospect that we have done it later than one when we actually did, is that the question?

Manish Poddar: Right.

S. Visvanathan: We were at a phase in the industry last year where every quarter discounting was going up, the level of promotion and average markdown that industry was dealing was very high. I am not saying it has come down, it continues to remain high. We have consciously decided to moderate it, it is not that discount has disappeared. It is just moderation of that and I think we will have to play this balance as we go along in maintaining the premiumness and premium of our brands with the market share objectives and there will be times when you will have to correct it, there is no right time to do it. I think we will have to judge it as we go along and keep adjusting our strategy.

Manish Poddar: How the category growth rates, actually I was just trying to understand because I believe we will be losing market share for sure given the competitors are clocking in at least a double digit growth rate in this period. So would my understanding is correct?

Ashish Dikshit: Most of our competitors have from what the listed results have early single digit like-to-like growth. So we obviously would have lost some share with the negative growth, but that is something that is conscious and part of the strategy and as I said some of these things required about 3-6 months of inventory correction before we come back, so it does not worry us, it is a part of our strategy that we feel very strongly in. We will be able to come back very quickly because brands are much stronger, brands are very strong and that is the only thing we continue to focus on.

Manish Poddar: And if you could give us any guideline or ballpark number for the working capital days let us say going down the line?

Ashish Dikshit: We do not give the breakup of working capital, but just to give you a directional sense of what we are trying to do. A part of our strategy of lower markdowns, managing discounts etc. is really not about controlling ourselves, but creating healthy pipeline for our business which means our inventory number of days is something that we are bringing down, we have taken few big calls in both the businesses Pantaloons and Madura, one of the big shifts that we are doing is moving from 2-season cycle to 4-season cycle which allows us to react faster to the market. The attempt is to create a linear supply chain through lower inventory and greater



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freshness and that is really the objective with which we are approaching the whole supply chain question.

Manish Poddar: And one, but if I may. Right now the average ticket size of Pantaloons roughly for FY16 would be somewhere in the 10,000-10,500 bracket, where do you see this average ticket size going down let us say 2-3 years down the line?

S. Visvanathan: Can you define ticket size, what do you mean by ticket, is it...?

Manish Poddar: Average sales per square feet in terms of that. Sorry, I was talking about the average sales per square feet.

S. Visvanathan: Per annum?

Manish Poddar: Per annum, so that is somewhere around 10,500, where do you see this growing down the line for us, which is given the volume and pricing shift which you are trying to figure out?

S. Visvanathan: I think a lot will also depend on how much of the space additions which happen because as you add the space for the first 12-18 months, the productivity usually is around 70%-80%. So that is also something which we need to keep in mind. Having said that as far as the Q1 is concerned, we have improved our space productivity by almost 10%, but 10,000 is sort of a good benchmark to have. From an industry perspective also if we are able to sort of stick to that despite the additional space on an annual basis, I think we would be happy.

Manish Poddar: Okay great, one final bit if I may squeeze in it. This store addition guidance and the CAPEX, how these numbers will be for let us say FY18 and FY19?

S. Visvanathan: It is a bit early in this call to give you that kind of guidance.

Moderator: Thank you. The next question is from the line of Tushar Sarda of Athena Investments. Please go ahead.

Tushar Sarda: Thanks for taking my question. I just want to understand because you have said that Pantaloons has grown and the competition is really from e-commerce, so which I assume the lower end of the value, whereas your Madura is the higher end. So is Madura really facing competition from e-commerce or is it the brands like Zara and H&M which is pulling down Madura?

Ashish Dikshit: These brands have not really reached the market that we are present in. Also they operate in the women's wear segment. So Madura has very little in common as far as these brands are concerned both in terms of consumer and product segments apart from the fact that the



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geography is very limited. So that question is not valid as of now, of course going forward as we get into women's wear segment like we have got into Forever 21 etc. we will have to compete for that space, but that will be with a different set of portfolio brands that we will have to play that game.

Tushar Sarda: Okay, but the e-commerce competition will really be at the lower end or is it impacting Madura?

Ashish Dikshit: See, e-commerce it is not about lower end, e-commerce is about, impact is discount on familiar brands at lower prices and therefore it is lot of premium brands at discounts, not just through e-commerce but even through physical retail which we talked about which affects the overall demand for the full price season. That is a challenge that industry is experiencing.

Moderator: Thank you very much. Due to time constraints, we are able to take one last question. The last question is from the line of Pravin Yeolekar of IIFL Enterprises. Please go ahead.

Prakash Kapadia: Hi sir. This is Prakash Kapadia. Thanks for taking my question. Sir if you could give us some sense on what percentage of our Madura sales comes from top 10 cities? What are the number of stores which are in top 10 cities for us?

S. Visvanathan: I would not have that number right away.

Prakash Kapadia: Some ballpark number sir, directionally or as a percentage, rough cut number?

S. Visvanathan: Let allow us to come back to you, we will come back to you with a formal number.

Prakash Kapadia: Sure and sir if I look at the last annual report, if I look at the ASP, the ASP number for the consolidated entity, Pantaloons and ABFRL put together was 407 crores. So on a sales of 6,000 crores that comes to roughly 6.6% and I think on the call I heard the sales percentage was much lower ASP, so am I missing something, or am I reading something incorrectly.

Ashish Dikshit: Can you write to us with that question, we would give you a reply on that because we are not clear what is the last annual report numbers you are using etc. If you write to us, we will give you a written reply on that and clarify it to you.

Prakash Kapadia: Okay. I will do that and sir last question is media reports shows us cotton prices are firming up and historically we have seen a positive impact in SSG due to increased cotton prices, so just wanted to get your sense, how easy or how difficult is it to increase prices in the current environment and when was the last price hike for the Madura portfolio, if you could give us some sense that will be helpful?



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Ashish Dikshit:

See, last price hike was not too far back. We have continuously looked at how the industry cost structure and try to absorb that either through price increases or sometimes through product rationalization. The last such incidence was the introduction of excise duty which happened towards the beginning of this year for some price increases were done right across the product category not just by Madura, but practically every player in the industry. As far as the question on current price is concerned, the current increase in cotton price while it is a fact it is a much smaller impact on the overall business for us.

Prakash Kapadia:

Okay and sir we feel pretty confident we will be able to take price increases in case cotton shows this increasing trend and there is enough room despite the current environment?

Ashish Dikshit:

I think that is something which will be a bigger question for the whole industry. From our understanding of cotton prices and we have got a fairly good understanding at this point of time what looks like for next 6 months or so, it does not seem to be a factor which is very large, to that extent we should be and like rest of the industry should be able to take that.

Moderator:

Thank you very much. That was the last question for this evening. On behalf of the management, we thank all the participants for joining us. In case of any further queries, you may please get in touch with Mr. Rahul Desai or Ms. Niralee Nagda. You may now disconnect your lines.