



“Aditya Birla Fashion & Retail Limited Q1 FY 2018
Earnings Conference Call”

July 27, 2017



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Moderator:

Ladies and Gentlemen, Good Day and Welcome to the Q1 FY 2018 Earnings Conference Call of Aditya Birla Fashion & Retail Limited. The call will begin with a brief discussion by the Company's management on the quarter's performance followed by a question-and-answer session. Should you need assistance during the conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded.

We have with us today, Mr. Ashish Dikshit -- Managing Director; along with Mr. Ashish Dikshit -- Business Head; Mr. S. Visvanathan -- CFO; and Mr. Shital Mehta -- CEO, Pantaloon Division. 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 earnings call may include certain forward-looking statements and must be viewed therefore in conjunction with the risk that the company faces. Ladies and gentlemen, 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. And to start the call, I will give you a brief outlook on the quarter's performance followed by question-and-answers from you all.

Good afternoon and welcome to the Q1 FY 2018 Earning Call of Aditya Birla Fashion & Retail Limited. I will first take you through the apparel industry update. The apparel industry had a very good quarter. In the month of April and May witnessed increase off take driven by wedding days. June sales was driven by an early EOSS which was advance by 15 days. This quarter therefore, captures some of the EOSS sales that would normally accrue in Q2.

The other big development in this quarter has been the GST council has fixed the rate at 5% for apparel below Rs. 1,000 and at 12% for apparel above Rs. 1,000. The prevailing rate was 5.5% VAT. The industry has geared for a smooth transition for GST regime.

Coming to the performance of ABFRL, I will now take you through the highlights of the financial performance of ABFRL and the individual businesses. Our businesses fared well in this quarter with both Lifestyle Brands and Pantaloon posting excellent growth with very healthy double-digit like-to-like growth.

Our new businesses continue to perform as per our plan. Overall sales for Q1 FY 2018 was Rs. 1,769 crores which is a growth of 25% to over Q1 FY 2017. EBITDA for the period at Rs. 82 crores was higher by 7% over Rs. 76 crores of Q1 FY 2017 and this is after accounting for



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losses in new business of Rs. 28 crores. These businesses are currently in the investment phase. We like rest of the industry started our EOSS early in view of the roll out of GST in July 17th.

I will now take you through the performance of the key portfolios of our businesses. These details have been uploaded in the Investor Presentation which is on our website and I will give you a brief summary of these businesses.

Lifestyle Brands:

Lifestyle Brands posted a strong growth of 14% with a like-to-like growth of 21% in this quarter. The sales for this quarter was Rs. 891 crores as against Rs. 779 crores in FY 2017. EBITDA for the quarter at Rs. 64 crores recorded an impressive growth of 17% over Rs. 55 crores in Q1 FY 2017.

Our focus on process improvement, product enhancement and improve merchandize management has helped us to grow during the wedding season in April-May even on the early onset of EOSS in June help drive the growth in June. The EBO network at 1,741 EBOs and 187 value stores at the end of Q1 FY 2018.

Pantaloons:

With a growth of 27% in Q1 on the back of strong 14% like-to-like growth, Pantaloons is among the fastest growing value fashion players in the country today. It ended Q1 with sales of Rs. 731 crores against Rs. 575 crores in Q1 FY 2018. Own brands now are 63% of Pantaloons revenue. EBITDA for the quarter at Rs. 46 crores grew by 78% over Rs. 26 crores in the Q1 FY 2017. Our focus on merchandize management implementation of 4-season and price value equations and continued expansion have helped in making Pantaloons as one of the fastest growing value fashion players in the country today.

The network expanded to 213 stores, up from 209 stores at the beginning of the quarter. At the end of the quarter Pantaloons had 29 franchisee run store.

Fast Fashion Business:

Forever21 was acquired by us in July 2016 and the growth numbers of this quarter do not have Forever21 in terms of the base revenue. People was operational in Q1 FY 2017. Q1 FY 2017 sales for the Fast Fashion Business was Rs. 120 crores; EBITDA loss for the quarter was at Rs. 14 crores.



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We added two stores in Forever21 in Q1 and ended the quarter with 18 stores with a footprint of 200,000 square feet. People operate through 90 EBOs and has a footprint of 238,000 square feet.

A quick view on our other businesses:

Q1 FY 2018 sales at Rs. 39 crores is a 63% growth over Q1 FY 2017. EBITDA for the quarter was at Rs. 13 crores, as against the loss of Rs. 6 crores in Q1 FY 2017. We have rapidly expanded our distribution for innerwear. And at the end of Q1 FY 2018, our products are being sold through over 2,000 doors. The consumer and retailer feedback has been very positive. We will continue to drive rapid expansion and invest in marketing and product development.

Our outlook:

Driving growth through expansion in existing businesses and investing in chosen white spaces with focus on profitability improvement will continue to be our strategy.

We are now open to questions. And thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Abneesh Roy of Edelweiss. Please go ahead.

Abneesh Roy: Sir, my first question is on the margin profile. I understand End of Season Sale is a lower margin business. But both your key businesses have seen strong same store growth. But in Lifestyle your margins quarter-on-quarter have fallen significantly from 15.6% to around 7.2%. But in Pantaloons it has seen a big uptick from 2.5% to 6.3%. So, one, I wanted to understand Lifestyle why the margins have fallen so much and in Pantaloons the 6.3% I understand strong same store growth but what is the full year margin profile you expect for Pantaloons?

Ashish Dikshit: Abneesh, this is Ashish here. Quick overview. See, our Q4 margin profile is very different from Q1 profile and that has been the same case for last five - seven - eight right years. Q1 is typically a low throughput period, the share of End of Season Sale use to be even lower, this year it is a little higher. Q4 typically has two large events which is large End of Season Sale which props up the retail and very large intake that the wholesale business takes. Now, that is why your profile of Q1 EBITDA in both the businesses is very different from profile of Q4 EBITDA. So, that is part one. And that is why Madura business if you will go back couple of years and look at Q4 and look at Q1 you will find there is this level of difference. In fact, if you look at like-to-like Q1 profile this year, Q1 EBITDA is slightly better than the Q1 EBITDA same time last year. Pantaloons is being a pure retail business directly is co-relatable



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with like-to-like sales and while some part it has come in both the businesses with higher discounting due to preponement of End Of Season Sale. So, there is gross margin erosion high like-to-like sales. in Pantaloons case, most of it flows down. In Madura's case this impact that the retail business has is much lower. So, primary part of profitability is driven or a significant part of profitability is driven by other channel mix.

Abneesh Roy: So, in Madura, although EBITDA is up but on a full year basis what is the margin in Lifestyle part of the business you are looking at? Because it is very volatile in Q4 it was a positive surprise, this time it is a negative surprise.

Ashish Dikshit: Actually, in fashion business particularly with mix of wholesale retail, you will find it volatile if you compare quarter-on-quarter sequentially. I think a more fair and even way of looking at it and you will not be surprised and find greater consistency, if you look at same quarter last year. Even there sometime preponement of End Of Season Sale, shift of festive season, sometimes create some difference. But typically, that is a better comparison for you to make.

Abneesh Roy: Coming to innerwear in Q4 you had 1,300 doors. Now it is 2,000 doors that is a jump. But what is the number you are looking at FY 2018 and what kind of distribution you are looking at?

Ashish Dikshit: So, as of now we have just expanded in all the main cities in south. Our journey outside south has begun just recently. We are in the process of launching right now in Delhi. We expect the overall distribution by the end of the year to be anything between 8,000 to 9,000 outlets.

Moderator: Thank you. Our next question is from the line of Abhishek Ranganathan from Ambit Capital. Please go ahead.

Abhishek Ranganathan: Couple of questions from my side. Sir, if you could break down the growth for April, May and June on Pantaloons and Madura, how have they fared in each of these months?

Ashish Dikshit: See, different businesses have different profiles and also in Madura's case it is a function of channels. Are you Abhishek, looking for same store growth pattern or overall growth what are you looking at?

Abhishek Ranganathan: I am just looking at overall growth. For Madura I guess overall growth and for Pantaloons I think same store growth profile would help on this.

Ashish Dikshit: So, Pantaloons April - May was single-digit and it significantly shot-up in June and that is how we got to the overall 14% like-to-like growth.



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Ashish Dikshit: In Madura it was more even in April and May, the dynamics are slightly different, the wholesale business was more cautious towards June. And therefore, while the retail behavior is pretty much similar to Pantaloons, Madura's business have double-digit like-to-like in both April and May and a very strong even higher like-to-like in June but that is for retail. The wholesale part of the business did not follow this pattern. In fact, June was a little lower and therefore we could not get. The patterns are different in Madura across channels.

Abhishek Ranganathan: But I think April to June the LTL was high, that is quite encouraging because it actually indicates that possibly or rather let me put it this way that has driven this consistency in the end customer level sales coming through?

Ashish Dikshit: You are talking about Madura business?

Abhishek Ranganathan: Madura

Ashish Dikshit: Abhishek, as we have been seeing we have been on a journey of transition. There is a lot of work happening both at merchandize level and store level. We went through a whole period of refreshing the inventory, shortening the cycle, getting fresher newer products into that and that is beginning to show right from the early part of this spring summer. And therefore, we are very positively seeing the outcome of that as far as the season is concerned.

Abhishek Ranganathan: Right. The other question I have is on the losses of Forever21 and others, it is a significant number for the quarter about almost Rs. 13 crores from the other's business and Rs. 17 cr from the Fast Fashion which includes Forever21 and People. I wanted to get a sense on the trajectory of these two because you stated last time around that Forever21 we are looking at breaking even by the end of this year. Are we still holding onto that and what will drive the burn rate down on Forever21 and what will be the likely burn rate on others?

Ashish Dikshit: So, I think two significant businesses that we are currently building and scaling up, are in two dimensions of investment. Forever21 I think our bigger investment was in acquisitions and we took time understanding and resizing stores, etc., we continue to feel that Forever21 business will be positive or breakeven by the end of this year. As far as innerwear business is concerned, I think we are still in phase of expansion and launching the product across markets, we want to make sure every market that we go in, we create the depth and width and impact that is required to build a successful business in the long run. And I think, that business will continue to see losses through the course of this year and like to trim down.

Abhishek Ranganathan: And the burn rate will be around a similar rate which we can assume in this, what we are seeing in this quarter?



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Ashish Dikshit: Yes, difficult to predict but Forever21 clearly will come down but innerwear may go up and down depending on the launch pattern.

Abhishek Ranganathan: Okay. And what will drive this reduction in burn in Forever21, is there something which is one-off in this quarter?

Ashish Dikshit: No, I do not think there is anything one-off in this quarter. It is business as usual, the sales go up. During other quarters, we are resizing the network and therefore, resizing some of the stores which will happen in Q2 - Q3. New stores which I mentioned are coming through better pricing model in terms of the revenue rental rates that we are taking it will start to plough in towards Q3, Q4. So, it is combination of three - four things. Gross margin improvement, existing store coming back to profitability and more profitable store network beginning to play towards the end of this year.

Abhishek Ranganathan: Right. And one last on Forever21 is, how much of an effect will the migration from CVD to GST have in this business?

Ashish Dikshit: So, it is positive but it is a very competitive business, we will have to see eventually what stage because you pass on some of the gains. The import duty benefit is there but it will go down to consumers as more and more players will compete fiercely in this part of the market.

Abhishek Ranganathan: And that benefit, can you quantify what can that benefit be?

Ashish Dikshit: See. Abhishek, the extent of the benefit from import duty is visible but because it goes away in pricing that part of the benefit will get passed on. But likely gain is going to be in productivity and that is really difficult to establish at this point of time.

Moderator: Thank you. Our next question is from the line of Richard Liu of JM Financials. Please go ahead.

Richard Liu: Ashish, I just want to follow on to the comment that you just made regarding the difference in Madura margin between 4Q and 1Q and you alluded to 4Q being a larger quarter in terms of margin at 1Q being a lower quarter in terms of margin. And I guess, one of the reasons why 4Q is also higher in margin percentage is because of the higher throughput which you refer to two events. Now, if I look at the core Madura revenue, there is not much difference between what you clocked in 4Q FY 2017 and 1Q FY 2018, you did Rs. 909 crores in 4Q and you did Rs. 890 crores in 1Q. So, just Rs. 20 crores lower revenue but your EBITDA is actually half of what you did in 4Q why would that be?



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Ashish Dikshit:

So, Richard, I think we can talk about it greater length. But I want to establish some facts first that this is the case every year and you can go back and look at many-many years difference between Q1 and Q4. Second, Madura's business is mix of multiple channels. The share of retail versus wholesale and profitability arising in the two channels are quite different and while at an aggregate level sometimes it appears that both are similar but the share of two channels is very different. What happens in Q4 is retail typically gets benefited because larger part of the retail goes through End of Season period. And therefore, while the margins are lower in retail throughput is much higher to make up for that loss of margin, so retail is more profitable in Q4 versus Q1. Wholesale is more profitable in Q4 versus Q1 again and that profitability gets driven from because large part of Q4 is about wholesale customers stocking up for the spring, summers, the new merchandize at full price while part of Q1 is wholesale customer stocking down and if anything, selectively participating in discount in preparation of End Of Season Sale and therefore, picking up discounted merchandize. So, if you look at the constitution of both the channel and the kind of product that they are seeking to buy and they are buying you will find why the margin mix is different between Q4 and Q1.

Richard Liu:

Okay. So, if the quarterly margin percentage pattern has to hold, are we saying that Q2 whether sale is expected to be lower than that traditional Q2 because part of it got advance to Q1. You will still have that relatively higher margin in Q2 versus Q1 despite the fact that you have already cannibalized part of the Q2 sale in Q1?

Ashish Dikshit:

No, you are right. I think typically Q2 margins are better than Q1. This time because of preponement of sale into the Q1 we have to see how the Q2 will play out, I do not want to forecast right now Q2 but there is clear advancement of sale from July into June and therefore, to that extend there will be a drop-in sales in the first-half of this quarter.

Richard Liu:

No. So, I am surprised with is that in a business where you have about 35 odd percent of sales as fixed overheads there is nothing called operating leverage, despite the fact that you grew your top-line by 15%.

Ashish Dikshit:

Richard, it is not a surprise because as I told you look at, in fact it is very predictable pattern of EBITDA, you can see last quarter to this quarter is almost roughly similar as I am saying different mix of channel and the dramatic difference in profitability and change in the mix in the quarters actually drives this. May be separately we can take you through in greater detail to explain the impact of channel mix across quarters.

Richard Liu:

And is there any specific reason why would gross margin be down to 200 bps Q-on-Q, 4Q also had sale and 1Q also had EOSS. Despite that, the overall companywide gross margin is about 200 bps lower in 1Q versus 4Q?



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- Ashish Dikshit:** Richard, again, can I separately tell you? But the short answer is the following: I was only explaining the mix between channel how that changes within Lifestyle business. At a company, it is also a function of mix across various segments, how have each of the segments done and that is another set of complexity. So, maybe we can take it offline....
- Richard Liu:** My last housekeeping question if I may, what was the Forever21 square footage as of June?
- Ashish Dikshit:** 200,000 square feet.
- Richard Liu:** And people?
- S. Visvanathan:** 238,000 square feet
- Moderator:** Thank you. The next question is from the line of Himanshu Nayyar from Systematix Shares & Stocks. Please go ahead.
- Himanshu Nayyar:** Just wanted some update if you can share on the inventory and working capital cycle improvement that we have seen a result of the four-season cycle that we are currently doing?
- Ashish Dikshit:** So, last, I would say six to nine months has been particularly volatile in terms of overall environment in the industry. First, demonetization in Q3 which is the sudden and one-off event and now uncertainty is around one the date of implementation of GST, the rate finalization, and therefore, we have lived in environment which is typically long season, long period horizon businesses struggle to deal with. In these circumstances because we had moved to 4-season more frequent forecast and shorter lead time inventory management cycle, our business on inventory and working capital front has almost remained unaffected by such large changes happening around us. Our Q1 working capital inventory levels have further improved over the same time last year and this has happened in extremely uncertain environment in terms of planning and various reaction in the channel, anticipation of whether we should buy, stock-up yes or no. So, I think that validates very strongly that our control over our destiny because we are ordering more often, we are ordering more frequently, in operating shorter cycles has allowed us to operate our business in far more effective and flexible manner.
- Himanshu Nayyar:** Right, sir. And secondly, seeing the current demand trends, what is our outlook in CAPEX and store expansion for this year?
- S. Visvanathan:** See, store expansion in the case of Madura I think we will be around 100 to 150 stores as usual and Pantaloons we will be anywhere between 40 to 50 stores is the plan depending on how we get the locations and what we get in terms of the ability to put up the store. While we will target a higher, I mean probably we may think something like that.



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- Himanshu Nayyar:** So, what is our total CAPEX outlay sir for the year?
- S. Visvanathan:** Can I come back to you on that?
- Himanshu Nayyar:** Sure, not a problem. And just a final book keeping number, what is our debt as of June ending if you can share that sir?
- S. Visvanathan:** As of June ending the debt was about Rs. 1,800 crores.
- Moderator:** Thank you. The next question is from the line of Neha Bothra from Axis Capital. Please go ahead.
- Neha Bothra:** Sir, could you throw some light any price revision expected in the near future and also you mentioned about right sizing of some Forever21 stores. So, what was the size that was there earlier and what is the size now like you know after the right sizing?
- Ashish Dikshit:** So, I will answer first the question on the Forever21 right sizing. The impact of GST has been largely positive for Pantaloons, so I will get Shital speaking about pricing strategy as well as post GST scenario is concerned. Forever21 stores that we acquired some of the stores were between 14,000 - 15,000 - 16,000 square feet as well. We are currently targeting stores in the zone of 8,000 to 10,000. So, some of the stores we had to right size, some are still under the process of being right sized.
- Neha Bothra:** So, total how many stores do you have now and by the year end how many stores can we see I mean how many stores you plan to add?
- Ashish Dikshit:** We have about 18 stores as of now and we expect to add between further eight to ten stores during the course of this year.
- Neha Bothra:** FY 2018?
- Ashish Dikshit:** That is right.
- Neha Bothra:** And sir, on the price revision you said like you know what is your take on going forward, we see any upward revision of prices?
- Ashish Dikshit:** So, there are two parts, I will get Shital to talk. The impact of GST has been different on both parts of the business. It has been marginally favorable in case of Pantaloons and which aids in intended and stated strategy of value fashion and probably will accelerate that and as far as Madura business is concerned, we have had an adverse impact of about 1.5% to 2% on the entire value chain. We have to look at it, at this point it is too early because we do not know



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whether sentiments are right today to do any price shift but we will evaluate during the course of this year. On Pantaloons specifically I will request Shital to talk to you about what we are doing on pricing.

Shital Mehta: Yes, so Pantaloons as Ashish was talking about the new GST regime is a lot more beneficial so immediately post that from 1st July onwards we have factored in that benefits and re-priced our products starting in fact 1st July itself the new pricing has been we have implemented that and rolled up nationally.

Neha Bothra: I mean the prices have dropped you are saying?

Shital Mehta: Yes.

Neha Bothra: So, by how much there has been a price cut?

Shital Mehta: It depends I mean it has not been universally we have just prudent depending on the product but one would say I mean 2% to 3% average some places, we have not done that, some places may be it is 5% to 10%. But on an average around 2 - 3 percentage prices have dropped from 1st July.

Moderator: Thank you. We will take the next question from the line of Chirag Lodaya from Value Quest Research. Please go ahead.

Chirag Lodaya: My first question is on the GST, what kind of one-time adjustment for this transition stock we are anticipating?

S. Visvanathan: See, it depends upon the stock and where it is lying. So, as per the rules we are entitled to get a 40% deem credit on the one-time transition stock that is lying in various channels including our own retail channel. We are now in discussions with our various channel partners on this whole this thing. It will be difficult to give you a full-time number till we resolve those discussions.

Chirag Lodaya: If you can just help me with the percentage, what kind of percentage hit on inventory you need to take?

S. Visvanathan: I do not think we should need to take a percentage hit on inventory right now.

Chirag Lodaya: Okay. And any price hike you are expecting in Madura?

S. Visvanathan: As, Ashish explained to the earlier person when he asked the same question we are evaluating it and we will see how this thing plays out now and take a call later on.



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- Chirag Lodaya:** Lastly, what was the gross store addition and closure in the quarter for Madura?
- Ashish Dikshit:** The gross difference is about 20 stores is the net closure, we have opened 36 stores and closed 54 stores in this quarter.
- Moderator:** Thank you. Our next question is from the line of Kaustubh Pawaskar from Sharekhan. Please go ahead.
- Kaustubh Pawaskar:** Sir, my question is pertaining to the festive season which has fall in a little bit early in Q2. So, should we expect that quarter three we will see lower growth in comparison to what quarter one is or it is too early to say?
- Ashish Dikshit:** Actually if you see the festive essentially it is the Pujo which is going to fall in Q2, three weeks before Diwali is still going to be in Q3. So, to that extent I mean it is not going to be very sharp shift one anticipates. As far as Q3 is concerned last year, we anyway had subdued revenue on account of demonetization.
- Kaustubh Pawaskar:** Okay, got your point, sir. And sir, my second question pertains to raw material, how are you seeing the raw material cost momentum especially the cotton prices and should we see some stabilization in the coming quarters or still there is expectation of increase in the prices?
- Ashish Dikshit:** No, I do not see on an overall level any price at least material difference happening. We are of course, looking forward to seeing how the post GST we are able to extract the credit from the value chain. But I do not see a significant impact right now.
- Kaustubh Pawaskar:** So, just to understand the Q1 margins on Y-o-Y basis I am not specifically talking about Q4. On Y-o-Y basis also there is a substantial dip, so should we expect that to slightly improve in quarter two if we consider from quarter two point of view of the margins?
- Ashish Dikshit:** No, so if you look at Q1 margins both are core businesses, Madura Lifestyle business and Pantaloons businesses have improved their margin as far as quarter-on-quarter is concerned over previous year. The net margin change that you are seeing is because of addition of new businesses and losses there. So, I think it is pretty healthy on Q1 over last year. Q2 this time because of demonetization impact preponement of EOSS may have a slightly different picture but we will have to see some more time before commenting on that.
- Moderator:** Thank you. Our next question is from the line of Shariq Merchant from Quest Investment. Please go ahead.



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- Shariq Merchant:** Sir, I did not follow your point on GST. So, in the Presentation you mentioned that there has been a one-time inventory adjustment. So, is it possible to quantify what kind of hit has been on the inventory that slowed into P&L?
- S. Visvanathan:** See, we will be in a better position to tell you at the end of this quarter in Q2 because we are still negotiating with our channel partners. So, it is difficult for us to quantify what will be the impact of this onetime adjustments.
- Ashish Dikshit:** Just to clarify, there is no inventory adjustment in Q1 financials. What we have indicated is there is a channel inventory and therefore, we need to arrive at if there is any impact arising out of that.
- Shariq Merchant:** Okay, understood. And my second question was on People. So, the idea was to build on this brand quite significantly does that thesis still hold? And how has People performed during this quarter and how do you see it for the rest of the year and next year?
- Ashish Dikshit:** It is a small business. Not materially large in the size of the company. It is still small, we plan to add large format stores, we are rationalizing the network of small format migrating to large format store. So, in terms of net addition People business itself may add about 15 stores to 20 stores this year. But these will be larger format stores.
- Shariq Merchant:** Okay. And do you expect to breakeven by end of this year or so?
- Ashish Dikshit:** Seems more difficult in people. But it would not be significant loss.
- Shariq Merchant:** Okay. And lastly, I also wanted to pick your brains on Ted Baker, how do you see this brand because in our earlier conversations you had talked about this potentially being the next Louis Philippe, in terms of positioning you wanted it to be at a premium to Louis Philippe because that is a white space in the market as of now.
- Ashish Dikshit:** See, Ted Baker is international well-known super premium brand. In Indian market, there is still not a very large market for those price points. We will start by seeding the brand in few metro markets towards the end of this year. In terms of therefore, its impact in terms of scale and size it is unlikely that in next few years it will make a difference to our business.
- Shariq Merchant:** All right. So, in terms of pricing, Ted Baker would be a 30% premium to Louis Philippe or it will be much more?
- Ashish Dikshit:** Potentially much more but I would say between 40% to 50%.



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- Moderator:** Thank you. We will take the next question from the line of Vinod Bansal from Franklin Templeton. Please go ahead.
- Vinod Bansal:** Couple of questions, one on F21. Now have we arrived at what we think could be sustainable model for this business in terms of economics what kind of sales per store or per square feet and margin that you are looking at?
- Ashish Dikshit:** Vinod, we are still trying to get the mix right. We think we should move this business to a high 40's margin which is slightly higher than where we are today. Sales productivity often is a function of that specific location. But what we are targeting is we should be able to operate at overall expense which is rent plus everything else put together in high teens or at least early 20's. And therefore, create the leverage between these two pieces.
- Vinod Bansal:** Sorry, I did not understand. I got the point that high 40 is gross margin.
- Ashish Dikshit:** And the selling expense in early teens, early 20's that kind of mix and that is really the plan which we will have to build this business.
- Vinod Bansal:** Okay. So, it would be quite a profitable business on a unit margins basis in that sense. It is not a necessarily a low margin high throughput sort of equation you are playing with.
- Ashish Dikshit:** I would not say that as yet from where we stand. We would first like to make sure that we get to breakeven stage and then try and target something close to 8% - 9% operating margin.
- Vinod Bansal:** Okay. And you say that you are still trying to be the mix right, was it the product mix you are talking about or something else?
- Ashish Dikshit:** No, mix of store size, category mix, so I mean the whole business model itself.
- Vinod Bansal:** Okay. And on this innerwear business, sorry, this will be very basic question. I suppose you are not opening any stores per se for the innerwear. You are selling mostly in your existing EBOs as well as on your existing channels, would that be right?
- Ashish Dikshit:** We may open few stores because innerwear is also as an industry undergoing transformation where consumers are looking at variety and some of the existing models do exist. We are going to experiment with some but that is not going to drive our revenue at this stage.
- Vinod Bansal:** Sure. I was just keen to understand it would be gross margin positive and I suppose reasonably healthy gross margin. What are the main cost that you incur therefore, that becomes Rs. 39 crores sales there are Rs. 13 crores EBITDA loss because you are not opening stores. So, that



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part of cost will not be there. And is it just purely people cost as in the staff cost or something else is there?

Ashish Dikshit: No, Vinod at one level yes, there is subscale business every cost sort of adds up in terms of overhead. But the real cost in this business right now as we are launching is the marketing, support, visibility, shop-in-shops, so whatever it takes to actually create a strong presence and visibility in the market.

Vinod Bansal: Okay. And I know it is too early to say, but typically what kind of sales do you need to see to get to a breakeven? I used to hear generally for brands like the typical the private brands that we operate with Rs. 150 crores kind of sales number leads to breakeven at EBITDA level. Does that hold good for innerwear business as well or it is higher scale to achieve?

Ashish Dikshit: No, innerwear business as you rightly suggested is a primarily variable cost business. The fixed cost is really overheads and team and so on and so forth. So typically, the breakeven model should be more comfortable here between Rs. 100 crores and Rs. 150 crores. But I think it is also a function of ambition that we would have in this market as we grow. And therefore, the other fixed cost element which is the marketing and marketing investment in trade is something that we would like to keep at least in few years next year or a year and half at a reasonably high level to create visibility presence, trial and so on. That is the only other fixed cost. That can be pulled off and the business can become on variable basis profitable quite early. But we look at this industry quite strategically and want to make sure that we are positioned well for future.

Vinod Bansal: Sure. Basically that this is not going to breakeven next year for sure?

Ashish Dikshit: Yes.

Vinod Bansal: Given the larger objective that we have.

Ashish Dikshit: Yes.

Moderator: Thank you. Our next question is from the line of Manish Poddar from Renaissance Investment. Please go ahead.

Manish Poddar: Could you just probably comment on the wholesale part of the business for the Lifestyle vertical? How is that channel behaving and would they be also entitled for that inventory credit later on and how many of them as a percentage of total would be registered? Any color on that would be helpful sir.



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Ashish Dikshit: So, we have to cut to almost three kinds of wholesale customers one is the large format stores department stores and you understand them well, they are visible. The second is small multi-brand outlets and the third is our franchise stores who buy in wholesale from us and take care of themselves. The first one which is large format stores are fairly large entities and take care so therefore there is no issue on GST registration and anything else. The second one which is our exclusive store even if they are in wholesale model are all fully enable to move into GST scenario themselves. Individual multiband outlets I think by and large 90% to 95% are fully ready and geared up. There may be few exceptions here and there. So, I would say the wholesale business is pretty ready to move into the new scenario.

Manish Poddar: Okay. And so this Madura business now we have got the four calendar season stabilized, so let us say on a store basis I do not know how many inventory or stock keeping units you keep. So, what percentage of the total stores would be how much of the network is under all this Four-Season channel? And then what percentage of the store's inventory would be under this Four-Season format and what do we do if let us say at the end of the quarter the inventory does not get liquidated or sold.

Ashish Dikshit: The idea here Manish is not to see our business as four times and if inventory does not sell at the end of the quarter you do something about it. I think our system of twice a year End of Season cycle itself is good enough to absorb any inventory mismatches. The idea primarily is to design more frequently, design for shorter period and react to the market more often. These are the principles on which four season cycle is. All our business not only stores, not only some stores, all our businesses operate with this model, so it is not a function of which part, which store, the whole business is on that model except our core products the white shirt and a blue shirt and a black trouser which will be on a more continuous in this business. So, it is not store specific that is the business model which is affects every channel.

Manish Poddar: And I have few bookkeeping questions, so the innerwear is completely under the other segment for us, is that right?

Ashish Dikshit: Yes.

Manish Poddar: And what is the store count for People in this quarter versus previous quarter and how much of the square footage you mentioned initially?

S. Visvanathan: 238,000 square in People.

Ashish Dikshit: Current number of stores will be about 90, we will give the exact number 90.

Manish Poddar: And how many were these in the base quarter?



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- Ashish Dikshit:** I do not have the exact number but we will come back to you, it will be about 115 to 120 because we did rationalization during the course of last year.
- Manish Poddar:** Okay. And just one more smaller thing is how much is the total square footage under F21 right now?
- S. Visvanathan:** 200,000.
- Moderator:** Thank you. Our next question is from the line of Ishpreet Kaur from Karma Capital. Please go ahead.
- Ishpreet Kaur:** This is on GST, would there be any benefits with regards to the input tax credit on rental expense in Pantaloons?
- S. Visvanathan:** Yes, I mean typically you would have the sales tax input credit on all rental expenditure.
- Ishpreet Kaur:** Could you quantify the kind of benefits that could be there roughly?
- S. Visvanathan:** See, that will be difficult to do so. We know the quantification but we would not like to put it on this thing.
- Ishpreet Kaur:** Okay. And what would be the total area for the Pantaloons stores?
- Ashish Dikshit:** 3.2 million square feet.
- Ishpreet Kaur:** Any guidance on what will be the margins for Pantaloons for this year?
- S. Visvanathan:** See, typically we do not give you guidance on margin. But you see every year and quarter-on-quarter we keep improving our Pantaloons EBITDA margin. So, I would say that overall, we should be in line with what we are achieving in this quarter.
- Moderator:** Thank you. Our next question is from the line of Piyush Gandhi from SBI Life Insurance. Please go ahead.
- Miyush Gandhi:** Sir, two questions. First, your thought process and probably if you have zeroed in for some casual wear brand strategy?
- Ashish Dikshit:** No, as of now we are still perusing multiple option including extending and focusing on our brands. As and when there is development we will of course, share with you.



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Miyush Gandhi: Okay. And second thing, on your omni-channel whether spends are done, how is it working and some clue on that?

Ashish Dikshit: So, omni-channel require two levels of investment and two changes, one was at the back-end which is creating infrastructure, IT system, connectivity to create one view of inventory, one view of customer which is an integral part of omni-channel. So, all that has been done over the last 12 months to 15 months that is bigger part and that is done and over with. The second part of the investment is more incremental which is store by store creating digital kiosk and screen where you allow customer to actually experience that. That is incremental and small and that continuous to go on quarter-on-quarter. As of now, we are at about 500 stores and we will keep rolling out. But that is not material, if your question is referring to further capital expenditure on that.

Piyush Gandhi: Sir, actually I was trying to understand some benefits of it in the first phase of roll out whether it has helped in inventory management, what has it helped for?

Ashish Dikshit: So, I think the primary purpose of omni-channel is not so much internal of managing inventory better or something else. It is to give consumer a seamless experience of shopping online and offline and getting a large variety of offline just as he gets online. And similarly, because we have a large network of store getting the fulfillment benefits of offline with the variety benefit of online. As we have rolled out at this 500 stores, stores do typically anything between 1% to at good times 5% of their business. Overall, we are still at a very low level, at about 1.5% - 2% of revenue which comes from omni-channel, although attribution of business to omni-channel is not a straight forward thing. So, this is an investment in line with how we think consumer's taste and behaviors are changing. It will over a longer period of time pan out and hopefully become a larger part of our revenue. But more importantly, offer consumer a choice which today they do not have in pure offline or the pure online environment.

Moderator: Thank you. Our next question is from the line of Abhishek Ranganathan from Ambit Capital. Please go ahead.

Abhishek Ranganathan: Sir, just a follow-up question is that on the EOSS advancement how much of the growth you attribute to advancement of EOSS for this quarter?

Ashish Dikshit: Difficult to break that Abhishek. But I would say, again, two businesses have seen differential growth rates. As I was saying Madura brands were operating at high double-digits in first two months and it really kicked-up in the month of June. Pantaloons was a little lower in first two months and again it kicked-up pretty strongly. The wholesale has shown slightly different tendencies because they were down stocking instead of up stocking and therefore our primary sales came down in that period. So, it is a mix, but it is a significant impact.



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Abhishek Ranganathan: And one on transition on any unutilized credit and deem credit which on transition from the VAT system to GST. Will we see any impact on margins on our own stock when we carry input formats Madura and Pantaloons and may be Forever21?

Ashish Dikshit: So, to the extent that our current stock that is there in our stores is designed for a different tax structure and today's tax structure is slightly different at overall level that is the impact I was talking about 1 percentage - 1.5 percentage. Of course, ongoing basis this is easily absorbable in a business like us and I do not think it should have material impact. One-time transition impact is really what we have to assess fully.

Abhishek Ranganathan: Right. So, this 150 bps you mentioned is for Madura or for Madura and Pantaloons both?

Ashish Dikshit: This is for Madura. Pantaloons would have the similar thing but on the other side of it which is the gain of that much. But as Shital had mentioned earlier in the call our intent is actually to use this to drive throughput productivity with even sharper pricing proposition.

Moderator: Thank you. The next question is from the line of Neha Bothra of Axis Capital. Please go ahead.

Neha Bothra: Sir, just wanted to cross check a few things, you said that you shut around 54 stores in Q1 FY 2018 if I have not mistaken and have added 36 stores. So, could you give me a break-up of how many were Pantaloons and how many was Madura?

Ashish Dikshit: This is only Madura store.

Neha Bothra: This is only Madura, okay. Any Pantaloons store that you have closed the store?

Ashish Dikshit: One store.

Neha Bothra: Okay. And going forward, would we see more store closure on Madura mainly and Pantaloons like what is the scene?

Ashish Dikshit: No, I do not see anything in Pantaloons. I think an occasional store here and there in a year is all that we do. Madura we had started the network rationalization last year, we just do that. I think we are pretty much at the tail of it may be a quarter more or so, is all that we will have.

Neha Bothra: Okay. So, total what is the number of stores that we have right now across brands basically?

Ashish Dikshit: So, Pantaloons is about 213 stores; Madura all formats put together will be closer to 2,000 stores.



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Neha Bothra: 2,000 stores, okay. And sir, on your debt 1,800 crores is what you have as of June 30th. What was the debt last year same quarter?

S. Visvanathan: Last year same quarter was around 2,000 crores.

Neha Bothra: So, any further reduction in debt you are contemplating?

S. Visvanathan: See, this quarter we have been lucky enough to have impact of lower inventory because of better throughput in sales and also because of the GST impact there was a lot of deferment of purchases by both from the vendor side and from the partner side. I am not sure, if we will be able to hold on to this level of debt going forward. Most probably we may be going back closer to the Rs. 1,900 crores to around Rs. 2,000 crores of debt by the end of the year.

Moderator: Thank you. Our next question is from the line of Harshil Gandhi from JHP Securities. Please go ahead.

Harshil Gandhi: Sir, are we seeing pricing pressure on account deep discounting by online platform?

Ashish Dikshit: No, I think we are seeing greater normalcy right now. It is a phenomenon that we have experience for much of last year. I do not think it is getting any worse than what it was. In fact, if anything there is a little bit of normalcy right now.

Harshil Gandhi: Okay. And sir, just a follow-up on that, what traction are we seeing for online sales of our product on our portal as well as other platforms?

Ashish Dikshit: So, our portal continues to be a smaller part of it and idea here is not really to drive too large traffic to that. We will grow it organically and systematically. On other portal, the productivity is good but still a large part of online purchase especially in the premium segment is driven by discounting and therefore, we are cautious, we are growing rapidly every year but it is still not a very large part of our business.

Harshil Gandhi: Okay. And sir, what are the average sales per square foot for Pantaloons and Madura business? And what may be the peak potential for each of them?

Ashish Dikshit: It is a very difficult question honestly to answer because even amongst the 2,000 stores that we have, the variability is very large. It is a function of location, town, mall versus high street and so on. I think it is a very-very large variable to comment on.

Harshil Gandhi: Okay, sir. Lastly, what would be the cost of funding?

S. Visvanathan: Our current cost of funding for debt is about 7.83%.



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- Moderator:** Thank you. We will take our last question from the line of Tejas Shah from Spark Capital. Please go ahead.
- Tejas Shah:** Sir, there was some government notification issued in the first week of July that price tags of the inventory and trade can be changed once. So, if that is possible, I was just wondering, this transition loss can it be reduced or contained with this price tag changes or not? Or is it not possible logistically?
- Ashish Dikshit:** We thought about it and evaluated it closely, we tell that it is logistically very complex and very difficult and may create greater confusion in consumer's mind around veracity and validity of pricing itself. And therefore, we are not going ahead with it.
- Tejas Shah:** In any of the channels or only third-party channels?
- S. Visvanathan:** No in all the channels.
- Tejas Shah:** Okay. And sir, second question was on Madura margins. So, your commentary suggests that a lot of building blocks that we wanted to change the strategy in the business are in place now. So, obviously this quarter Madura margins are not like-to-like comparison. But do we believe that directionally we have, we are in right direction for improvement of margin sustenance in that piece of the business?
- Ashish Dikshit:** Yes, I would say these are very strong brands and they continue to remain vibrant, growing very well as the organic performance of last couple of months said, we had laid out our strategy. We talked about it in various quarters last year and it is playing out exactly the way we had said so. And therefore, we will continue to see improvement on that.
- Tejas Shah:** Sure. And sir, lastly, last quarter you mentioned about revenue neutral rate for Madura piece and Pantaloons. So, just wanted to check in that calculation, have you taken rent input tax credit already or that is an addition to that?
- Ashish Dikshit:** No, of course, it is taken full taken.
- Moderator:** Thank you very much. Ladies and gentlemen, on behalf of the management, we thank you all participants for joining the call. In case of any further queries, you may please get in touch with Mr. Rahul Desai or Ms. Niralee Nagda. You may disconnect your lines. Thank you.