"Future Lifestyle Fashions Limited Q2 FY-20 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Conference Call of Future Lifestyle Fashions Limited to discuss the Blackstone deal and Q2 FY20 financial results hosted by Motilal Oswal Financial Services Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Aliasgar Shakir from Motilal Oswal. Thank you and over to you, sir.

Aliasgar Shakir: Good evening everyone and welcome to the earnings call of Future Lifestyle Fashions Limited. With us we have on the call the senior management team comprising of Mr. Vishnu Prasad – CEO; Mr. Kaleeswaran – CFO and Mr. Adishiva Dixit – Chief Investor Relation Officer. I now handover the call to Mr. Adishiva for the opening comments post which we can have the Q&A. Over to you, sir.

Adishiva Dixit: Thanks, and good evening to everyone. On behalf of Future Lifestyle Fashions, I welcome you all to this conference call on Blackstone investment and Q2 performance update. On this call, we will refer to our latest Q2 investor presentation available on our website. Some of the information on this call may be forward-looking in nature and it is covered by the safe-Harbor language on slide number 2 of the investor presentation.

On today's call, we have Mr Vishnu Prasad, Chief Executive Officer of the company; we have Mr Kaleeswaran, our Chief Financial Officer of the company. We will have this call in three segments. Kaleesh will first take up the Blackstone investment details. He will then discuss Q2 performance and what future course of actions do we intend to take and finally, we can have a Q&A segment.

I will now handover this call to Mr Vishnu Prasad for his opening remarks before Kaleesh takes up the detailed discussion. Thank you and over to you, sir.

Vishnu Prasad: It gives me great pleasure to come on to this platform and connect with all of you as CEO FLF. This being my first opportunity to connect with you all, let me introduce myself. I am Vishnu Prasad. I have close to three decades of experience between fabrics, brands, manufacturing, exports and the last 15 years in retail in Future Group. In the last 15 years at Future Group, I was part of Big Bazaar, then moved into Central right from the beginning. Right now, I am leading Future Lifestyle team as CEO.

During this call allow me to be an observer as this being my first one. I will interact with all of you more in detail soon. As I handover the call to Kaleesh, let me state that despite tough macro-environment in the country, FLF has done reasonably well across all its business formats. It achieved revenue of Rs. 1,575 crores with the EBITDA of Rs. 136 crores in Q2 FY20

We will continue to work towards achieving our goal with the focus on execution. Thank you all and over to you, Kaleesh.

Kaleeswaran A: Thanks a lot, Vishnu. Good evening to everyone. Thanks a lot for joining this conference call. In this call, we will discuss Blackstone's investment. I will give you a quick macro overview as to where are we today and FLF's financial performance update in Q2 and H1.

We have also identified certain key focus areas for us which is going to drive value creation as we move forward in the near term, we will also try to state our endeavour against each of these pillars.

To begin with a quick snapshot of the Blackstone investment. I will start with probably giving you a quick overview of Blackstone as a fund. Blackstone is one of the world's leading investment firm and they create a positive impact and long-term value for all its investors and the companies where it has invested and the communities that they work for. The asset under management of Blackstone's globally is about $545 billion focusing upon private equity, real estate, public debt and public equities, non-investment grade product, real assets, secondary funds all on a global basis.

Moving on specific into the transaction that has been done with FLF and its holding company Blackstone has invested Rs. 1,750 crores. This includes 6% stake in FLFL via secondary market block from Ryka and Rs. 1,100 crores invested in FLFL's holding company Ryka. Blackstone, as you know, is not a passive investor and will be helping FLF create value for all stakeholders.

As a part of the deal, Blackstone has got one board seat in FLFL. In addition to that Blackstone's portfolio operation team members will help with advising us on strategic matters including people such as Mr Harish Manwani helping in this regard. Blackstone through their real estate investment business is one of the largest owners of malls in the country and we can benefit from the counsel of Mr Dalip Sehgal who is the CEO of Nexus Malls.

Similarly, there are other's in Blackstone's global network who would be advising FLF on strategic and operational business parameters. Typically, investment horizon of Blackstone is always around four to five years leaving enough room to unlock value in FLF lead by its strong business model. Apart from the above, to align with the promoters Blackstone has ring-fenced the entire promoter holding from further dilution. While it does not tantamount on to any pledge, however, the new wider definition of SEBI on encumbrances covers this and hence this has been disclosed accordingly.

Pre-Blackstone transaction FLFL pledge was at 26% of the promoter shareholding which has been reduced to 18% post-transaction by retiring all non-Blackstone promoter obligations at Ryka and consolidating with one long term active investor simplifying the holding even at the promoter level and thereby mitigating any kind of risk for FLFL.

Moving on we would like to start with macroeconomic updates and then H1 and Q2 financial performance. Let me start with the sector performance. If you look at the consumption pattern in the last few quarters, it has shown mixed signals. Talking specifically about Q2 the first half was slow while the festive period has been reasonably good. If you look at the consumer confidence index released by RBI for the month of September, people have not restored their full confidence in the economy.

According to media reports consumer spending fell for the first time in 40 years in 2017-18. The primary reason is attributed towards fall in demand across sectors like auto, realty and various other sectors. We believe consumer confidence in spending is still a few quarters away while there would be pockets of spurt in growth in between. Given this current state of macroeconomic parameters, we believe FLFL has done reasonably well. The slew of actions undertaken by us helped us to navigate through Q2 and H1.

We would like to discuss our business performance under two verticals. Our base business which comprises of Central, Brand Factory and Brands and the new vertical which is digital business lead by Brand Factory Online. I will start with giving you a quick overview of the base business, what have we done so far and how it has performed. We will start with Central.

Central has clocked net revenue of Rs. 819 crores with an overall growth of 18% for the quarter and it has been achieved through a like-to-like growth of 10%, defying slowdown. Getting fresh merchandize at the stores by tactically enabling liquidation at Brand Factory helped us to achieve this high growth. We have added one Central during the quarter in Ranchi. And overall, we have added four Central stores in H1.

Moving on to Brand Factory. Brand Factory has achieved a net revenue of Rs. 573 crores for the quarter with an overall growth of about 41%. Now the format contributes to about 36% to the overall business. Brand Factory did achieve a like-to-like growth of 6% during the quarter. This was the result of tapping upon the tactical opportunities to liquidate the inventory and getting other channels ready for fresh inventory for festive. While this has led to a 6% like-to-like growth Brand Factory has witnessed a strong double-digit volume growth.

In terms of store additions, we have added 3 Brand Factory stores in Gangtok, Ahmedabad and Tirupati in Q2 total three in Q2 and overall above 9 stores in H1.

Moving on to our next vertical which is our Brands business. For the quarter, overall Brands business grew by 21% and contributed to 43% of overall business making it one of the highest share quarters of own brand in recent times. Growth was largely led by non-Power brands like Converse, Privilege Club and RIG. The growth of these three brands combined has been in the range of 18% to 23% and Power brand’s growth was driven by Bare and Scullers.

Overall Power brand growth was flat. Key contributor being the closure of non-performing sub-brands under Indigo Nation and John Miller. The idea is to how do we consolidate brands and make it nimble and simpler.

Hence, overall summarizing the base business Central plus Brand Factory plus Brands, we grew by 17% at an EBITDA margin of 9.6% and EBITDA growth of 14%. There is a margin contraction in Q2 largely because of an increase in the share of Brand Factory and on account of the discount in Brand Factory that we talked earlier.

Overall in H1, the revenue growth was 17%, EBITDA margin was 9.6% and EBITDA growth was 17% for base business.

Moving on to our next vertical which is Digital Business we commenced our journey for the digital vertical lead by Brand Factory online in H1 of this financial year. Currently, we are hitting a run rate of about Rs. 3 crores per month in terms of revenue and Q2 digital business has incurred a loss of Rs. 15 crores largely lead by setup and platform building cost for Brand Factory online.

Moving on to next impact item on financials:

During this first half of the year, we saw IND-AS116 being implemented. The standard is effective from 1 April of 2019 which tends to treat both operating and financial lease on the same basis as compared to the erstwhile Indian Accounting Standards. While there are three methods under which you could account for IND-AS116, FLF adopted for modified retrospective approach. This has been a consistent approach that has been adopted by many of the other players in the sector.

When it comes to the impact of Ind-As116 our revenue got impacted by Rs. 4 crores, PAT got impacted by Rs. 10 crores for the quarter. As of 30 September 2019, our leased asset is about Rs. 1,140 crores and our leased liability are about Rs. 1,450 crores. We expect our PAT to get impacted in the range of Rs. 20 crores to Rs. 25 crores for the full year which was at about Rs. 15 crores for H1.

Overall if I put together all our businesses the base business has delivered reasonably in a tough macro environment with a strong H1 performance of 17% revenue growth and a 17% EBITDA growth. Adjusting for new digital business and the IND-AS116, revenue was at Rs. 3,112 crores with a growth of 17% and our total revenue for the quarter was Rs. 1,572 crores at a growth of 18%. The EBITDA margin was about 17% for the quarter adjusting for IND-AS and PAT margin was about 1.3%.

Now, let me take the opportunity to talk about some of the key focus areas that we wanted to build in the organization as we move to the next few quarters and a couple of years.

We would like to elaborate on the key pillars that would define value creation for FLF. We are planning to focus on five pillars lead by our fundamental business model, capital allocation, cost leadership, balance sheet focus and therefore shareholder value creation. Starting with the business model given the current state of the sector we believe that we are reasonably poised to grow with our portfolio approach.

We have undertaken a lot of small steps in the last three to four years to reach a place where we are today. Our base business model is now much more robust, risk mitigated and sustainable and is backed by strong business fundamentals. Central is India's leading fashion destination; Brand Factory is a one-stop inventory solution and value branded fashion shop and own brands augment our margin model at both these retail chains coupled with strategic presence in third party channels, EBOs and online.

However, at the same point in time, we believe future growth cannot be achieved through yester year's ideas and actions. The time is right for FLF to take bigger steps to spurt the next level of transformation journey that we endeavour to make it in the next 18 -24 months. Allow me to take a few minutes to walk you all through the strategic guidelines that will define our future course of action starting with digital.

Digital is one of our critical pillars for growth. We are very focused to make Brand Factory Online a long term sustainable business where the endeavour is to serve the customer at an optimum value so that the cash burn is minimized, the penetration is maximized and we create a true omnichannel business model and it becomes more robust with scale.

As a part of this strategy, we have started integrating campaigns between physical retail and digital. While we are on the path towards consolidating online and offline, we see a cautious and mindful expansion of this business in the next 12 to 15 months. Details of the steps that will be taken have been mentioned in our investor presentation slide number 50.

Moving on to the next part:

One of the key pillars, as we grow, is prudent capital allocation and it is extremely critical to stay focused on this journey, we believe that given the company's fundamental while capital allocation or raising capital is not a constraint. It is important to factor in that, capital plus time will make us prioritize on the right assets and ensure that the value and time is allocated only to those assets which are going to give us disproportionate return on the capital employed and we have started pruning down the non -productive assets, non-productive assets could also be in the form of brands that are non performing. We have seen action towards cutting out some of the sub-brands that we have in our Power brands segment.

Investee brands that are not performing have been cut down. Similar action will be taken even in our stores. And all our future capital allocation will now be based on this criteria and we have talked about the progress that we have made so far in this journey.

Moving on to the next pillar:

As we endeavour to become a cost leader, it is not only about cutting costs but creating an organization that is culturally cost-savvy and is ready for tomorrow. We need to make our organization lean and agile and at the same point of time look at other cost buckets including rentals, CAPEX and other store operating expenditures which can be minimized and optimized at the same point of time.

In this regard, we have benchmarked our cost with both internal and external lens. We would be actioning many of these items in the coming quarters. To carry out this exercise we have appointed industry specialist consultants whom we are partnering with in the coming quarters. We also believe in total shareholder value creation and one of the key areas that have been identified apart from others is the related party transactions. We are looking at all our related party transactions, broadly dividing them into two buckets.

One, that is business critical, the other one is group consolidated transactions that help us in leveraging scale. At this stage, we believe a simplified business model driven through business-critical related party transactions are the essential ones.

We are relooking at all the other related party transactions in the coming quarters either to consolidate or to unwind. And this would make us an organization which is simple minimal and optimized. Another area that we need to move on towards simplification is also in terms of our investment structures which is towards our subsidiaries and JVs. Work has commenced around this also, allow us a quarter to come back with the detailed update on the next steps towards this.

We believe it is a journey of 18 to 24 months that we have commenced as mentioned in the earlier points which will lead to a stronger balance sheet and make us much more risk fenced company.

That's it from my end. Happy to take questions.

Moderator: Thank you very much. We will now begin the question-and-answer session.

The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: My first question is on the digital business. So one is what is the one off item in terms of cost in this quarter so what is the run rate you are looking at in the second half in terms of loss? Second will there be cannibalization to the physical store so how would you cater to that? And most of the issue with online fashion is return and the delivery cost. So how are you addressing that part? And how do you address these brands being available on say Amazon, Flipkart also? These are the questions on digital business.

Kaleeswaran A: So, to start with the digital business loss that we have incurred in H1, about 50% of it pertains to platform building cost which is about onetime setup, the involvement of consultants who came into to get it up and running. We expect the additional loss in H2 to be around Rs. 8 crores to Rs. 10 crores.

Addressing specifically in terms of our strategies for Brand Factory online, first and foremost we look at a business model that is going to be sustainable and have a growth that is profitable and therefore two key parameters which will drive or which have been driving loss in online are more towards cost of distribution and cost of customer acquisition.

If the bill value is not going to be of a specific ticket size, we will be charging for transportation and therefore reducing the loss on account of transportation. Second is that returns have been a perennial problem in this channel. And one of the major attributes for returns towards this channel is on account of cash on delivery. So, as we scale up Brand Factory online as a business model, would not be having cash on delivery as an option which will take care to minimize the returns.

Now in terms of cannibalization of this business with our mainline business, data says that typically Indian markets have not been a market of convenience as always been a market of value. And when the brand is available at a value people typically latch to that opportunity. The current e-commerce opportunity in India has played out more like a game of penetration coupled with value opportunity that is there.

So, if I divide this into data, 70% of e-commerce business today happens beyond Tier-1 towns. And if I overlap this to Brand Factory store penetration today, our penetration of stores outside Tier-1 cities is extremely minimal. Hence, we see this as an opportunity to penetrate cities beyond Tier-1 and that is going to open a larger window for us to capture and grow the market while there would be minimal cannibalization in Tier-1 towns. we think fashion as a sector people would still want to have a look and feel at this point of time and we see very minimal cannibalization at this point of time.

Abneesh Roy: Right. Few follow up questions here. So will your expansion strategy for physical stores be impacted because of this? And second, this loss which you are saying for second half this will be mostly marketing cost?

Kaleeswaran A: Yes, the loss will be on account of marketing and people cost because the optimal level of scale-up for Brand Factory online will be roughly about a run rate of Rs. 15 crores per month. We are about a few quarters away from hitting that benchmark. The second is if I look at the overall store opening plan when we had made our business plan the endeavour was always to open about say 20 to 25 stores every year in terms of Brand Factory physical stores.

And largely expand this to Tier-2 and few Tier-1 cities also. Therefore, our ambition to expand new stores is not that high as compared to the penetration opportunity that e-commerce will be able to offer. We still think the run rate at which we will be opening about say 20 odd stores a year which will be balanced.

Moderator: Thank you. The next question is from the line of Sagar Parekh from Deep Finance. Please go ahead.

Sagar Parekh: Firstly, on this cost savings that you have highlighted, can you give an update on which are the parameters that you think where there can be some cost savings and have you all identified what would be the total savings that could be possible after 18 months to 24 months?

Kaleeswaran A: Sure, so how we have looked this is one is organizational design and how do we look at the overall organization structure and make it nimble-footed. Second is the rental cost. The rental typically falls in the buckets where there are rental escalations due for some properties and some properties, we believe base rental can be renegotiated. The third is supply chain and distribution cost that we have in business and how do we get that reduced. And fourth is can we consolidate some of our expenditures under one roof.

Say for example if it is the security cost can we get one agency at a national level or at a regional level to start with. Similarly, initiatives have been taken also on CAPEX per square feet to see how we reduce that. We are in the process of benchmarking these and getting an absolute quantification for savings against these items. Our CAPEX is something where we have already put together benchmarks. We are starting with Brand Factory as a pilot. The target is to reduce 15% to 18% of the cost per square feet for Brand Factory.

Sagar Parekh: And you mentioned that now on Brand Factory side the ambition is not too high in terms of new store addition. So what can we look at so initially we were at about 20, 22 store additions annually for Brand Factory. Now what would be the revised number?

Kaleeswaran A: We will be on the same run rate. We are looking at about 20 to 25 stores. When I said ambitions are upwards, we are talking about from the perspective of larger market opportunities that we have for Brand Factory and against which what is the pace at which we are expanding. And now with online coming in, the large part of market can be addressed through a combination of both online and physical stores.

Sagar Parekh: And just last question from my side. If I calculate the third-party sales of Brands, Central and Brand Factory the sales have been substantially down YoY. Can you comment on this?

Kaleeswaran A: See this has been largely led by Lee Cooper. Focus for the quarter and the half-year has been more around secondary sales rather than the primary sales. If you look at the market as such when you do not have a distribution value chain that you can control it is not fair for us to leave the stock at a third party counter and expect the consumer to pick up and if it does not factor an entire reverse logistics cost and bring it back to Brand Factory and liquidate. So, the call was to go slow on the primary. Try to liquidate as much as secondary stocks that are available in these stores and move ahead

Sagar Parekh: So, Lee Cooper can you give us some numbers for Q2 as well as H1 how much was it as compared to last year?

Kaleeswaran A: See roughly Lee Cooper was about Rs. 260 crores H1 last year. We have delivered about close to Rs. 270 crores, Rs. 272 crores in terms of overall H1 primary sales in H1 FY20 and in terms of secondary growth it is about 7% to 8% secondary sales growth.

Sagar Parekh: So Rs. 270 crores was this year H1 as compared to last year it was how much?

Kaleeswaran A: About Rs. 260 crores.

Sagar Parekh: So there was still growth right so then the declines?

Kaleeswaran A: Above was about 1% to 2% in terms of your primary growth but secondary growth is higher.

Sagar Parekh: And in terms of profitability how did Lee Cooper performed?

Kaleeswaran A: This is something we can take it on a one to one basis. We do not disclose our format wise P&L.

Moderator: Thank you very much. The next question is from the line of Alok Shah from Edelweiss. Please go ahead.

Alok Shah: First question is on the digital business, so you had mentioned that Brand Factory is now going online and things like that. So essentially the whole genesis of Brand Factory was that it would be a liquidation model in the offline format and the online would be done largely by Amazon and Flipkart and Myntra of the world.

Now if we also go online, are all the brands in sync and secondly do you think in terms of offering from the brand, do we have enough because when you go online the product suite required should be really extensive and exhaustive. So is it going to be an omni play or there is a different assortment on online, different assortment on offline how would that work?

Kaleeswaran A: See eventually if you look at it, one of the critical things is that you have a price parity and you have the consistency of offering between your physical store and the digital vertical. While it will be very difficult to get an SKU to SKU match at a broader principle apart from one or two events that are exclusive digital by and large you need to maintain price parity. So, it would be difficult to manage a different assortment for online and offline.

So that is not the path that we are trying to go in. We will keep it consistent between both the formats. Now coming back to the first question in terms of availability of the merchandise, what we believe is that typically in a good season or a bad season on an average 15% of stock today gets liquidated for any brands across the fashion sector. And the availability of channels is to liquidate this 15% stock is far and few.

Today while Brand Factory on the physical side is one of the largest players in this, still share of the business that Brand Factory could cater to any large brand is about 10% to 15%.

Liquidation today happens either through factory outlets or it happens through venue sales or limited online channels that are there today.

So, I do not think there will be a dearth of opportunity for online in terms of stock availability. But having said that there would also be pockets of own brands that are exclusive to Brand Factory which is doing well on the physical side like Privilege Club or a Santa Barbara Polo Club, would continue to do well on online also. And that would be the track for driving growth on own brand side apart from the third-party brand stock availability.

Alok Shah: And second and last question was in one of our strategic plan you had mentioned that there are some success of JVs where some transaction will happen so as to unwind the same. So can you quantify how many subsidiary JVs is where the transaction is likely to happen, time line, the cost involved, the funds, how you are going to have that fund to the transaction?

Kaleeswaran A: See while by and large we are looking at simplifying our portfolio at Lee Cooper and our investee brand company, the primary one that we are looking at is Lee Cooper. While at this point of time we have multiple options available to get the transaction simplified in the Lee Cooper entity which is FSRL either to tap equity fund raise or we have an opportunity to get strategic partner coming and investing in this.

We still have some time hand for us to go ahead and complete this. I would say roughly we are about 2 to 3 quarters away before we complete the transaction. This will be step 1 towards simplifying in terms of our out structure for subsidiaries and JVs. The next one which is the transaction that we have with FLBL is slightly far away and that is something probably we will take it up in the coming quarters.

Alok Shah: So essentially after all these transactions gets over so FLF ends up owning pretty much 100% in all the inventory brands?

Kaleeswaran A: We will start with Lee Cooper. Allow us not to comment on the other organizations because we are at early days in terms of finalizing the model for it.

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

Ankit Kedia: Sir, we have seen some decline in the Power brands' revenue. You said we would have cut some extended brands in Indigo Nation and others. So is this exercise complete or there is still some inventory remaining in these brands?

Kaleeswaran A: See from a brand pruning list, this is the journey that we have just started. We have got it done for two major brands which we have to cut it down and closed. We still believe there are one or two opportunities that is available apart from this also. We are trying to see is there a strategic play available for these brands, either as an exclusive model for Brand Factory or a larger play that is available including both our distribution and third-party distribution. That is about it. May be about one or two more sub brands that are there in the Power brands portfolio.

Ankit Kedia: Sir, my second question is on the gross margins. We have seen a 200 bps decline in gross margin partly because of increasing shares of Brand Factory. How much of that would be on back of liquidation? I believe around 300 bps, 400 bps margin decline would be on Brand Factory alone?

Kaleeswaran A: Yes, you are right about it, Ankit. There are two parts to it in terms of the margin mix. So roughly if you look at it share of Brand Factory which was about 30% a quarter before has moved to about 36%. The second thing is that while we got a fairly double-digit growth in terms of Brand Factory's volumes the value growth was about 6% on account of higher discounting in Brand Factory which has shrunk the margins by about say 300 bps to 400 bps.

What it has done for us is that eventually, it has got fresh stock in for Central which has delivered a double-digit like-to-like growth.

Ankit Kedia: And sir, two more questions. One is on the CAPEX side. We have seen some Rs. 250 crores CAPEX in the first half and given that we are going to have four more Centrals in the second half. Could the number double or will the number be cut given the cost measures we have taken?

Kaleeswaran A: We see CAPEX to be in the range of what we have spent last year considering that we have four more Centrals in the pipeline and about say 8 to 10 Brand Factories that will come in the balance of the year. That should take up CAPEX to from about Rs. 250 crores to around say Rs. 450 crores. On the cost reduction in CAPEX, action will commence in new stores.

Ankit Kedia: And sir, my last question is on the tax rate. We have not mentioned in the press release anything on the tax rate. Could you the government's order on the tax rate will it be at the full tax for the year or we are looking at the cut in the tax?

Kaleeswaran A: We have adopted the new tax rate and it has been implemented in Q2.

Ankit Kedia: Sir, but the tax for the first half is very high if I see hence for the full year tax rate would be around 26%?

Kaleeswaran A: That is right. That is a fair assumption.

Moderator: Thank you very much. The next question is from the line of Krunal Shah from Enam Investments. Please go ahead.

Krunal Shah: So the investment of Rs. 1,100 crores by Blackstone and Ryka is it via equity or debt?

Kaleeswaran A: The Rs. 1,100 crores in to Ryka is in the form of debentures.

Krunal Shah: Convertible debentures?

Kaleeswaran A: No, at this point of time. Allow us not to comment on the transaction details considering it is at a promoter level and not at the operating company level.

Krunal Shah: And the second question I had was, in Brand Factory if we see last two quarters our SSG has been declining. So previously we used to do mid teen kind of number, now it has come in single digits. So anything to read into it or something that is change on ground?

Kaleeswaran A: I would divide this into two parts, Krunal. The first one is to say if there is consumer demand that is coming into Brand Factory. That can be attributed to the volume growth that has been demonstrated by Brand Factory in H1. The average volume growth that H1 level is over 15%. The traffic is good, the conversion is good, but it has come at the cost of discounting which was a tactical call that has been taken.

Eventually, in the fashion business, we have two choices, we leave the inventory on the table and expect things to get better and therefore get into a better sale proportion in future which we are not sure about it. The other one is to be nimble and agile and ensure that you keep freshness at the store. We followed the second initiative more on the tactical side for H1, which has led to a significant double-digit volume growth but a single-digit value growth.

As we move forward, we think this year is one of the toughest. Probably on a lighter way, it is a million-dollar question for anyone to answer is to predict growth. So, from our end, we are trying to take all the actions to be nimble and agile and to do what is right for the business and move towards a business model that is like what we have been delivering in the past. Near term quarters we will continue to be tactically strong and ensure that stock is converted to cash.

Krunal Shah: See my point comes from the fact that if you see the store network under Brand Factory year-on-year there a 30% growth in that. So that should contribute to your volume growth. Now if SSG is not coming then are the new stores cannibalizing the SSG or what is happening because more the number of new stores my understanding is SSG should be higher?

Kaleeswaran A: Allow me to slightly differ there, Krunal. The overall network growth of Brand Factory driven by new stores is 41% value. The like-to-like growth is 6% and like-to-like volume is upwards of 15%.

Krunal Shah: So the volume mix was better but the value mix because of higher discounting was slower, okay.

Kaleeswaran A: Yeah.

Moderator: Thank you very much. The next question is from the line of Kaustubh Pawaskar from Sharekhan. Please go ahead.

Kaustubh Pawaskar: Just want to understand from the digital business of Brand Factory, is it a right understanding that digital business will take care of Tier-1 town of your Brand Factory business because there the penetration of online or ecommerce sales is higher and going ahead the focus on expanding the stores would be in the Tier-2, Tier-3 towns where you can have some savings at the rentals as well?

Kaleeswaran A: Yes, so it is a combination now in terms of how are we going to do this stuff. What we see today as an opportunity is that Brand Factory online will be more than a Tier-1 phenomenon. It will give us the penetration opportunity to ensure that we capture the markets in Tier-2 and Tier-3 and below also. From a store expansion perspective, I think our mix today is largely towards Tier-1, almost 80%.

In a five-year horizon, we think this will come down to anywhere between 60% to 70%. As you rightly said, we do believe there will be the leverage that will be available on lower rental cost as we move towards this Tier-2, Tier-3 cities.

But at this point of time, we are seeing parallel tracks Brand Factory online will start with to help us towards more non-Tier-1 cities and the physical store expansion will be focused towards Tier-2 and Tier-3 also. One of the significant reasons is that typically a plain vanilla online-only company has to spend a significant amount in terms of acquiring consumers. The cost of customer acquisition ranges anywhere between say 8% to 15% depending upon the business model.

Today Brand Factory is very well known in Tier-1 cities and as we penetrate on the physical format into Tier-2, Tier-3 cities also we believe the customer acquisition cost will significantly come down for Brand Factory and therefore making it true omnichannel player.

Kaustubh Pawaskar: And in terms of margins for your bridge business earlier the understanding was there will be a gradual improvement in the margins there would not be any significant improvement. So that commentary still remains that there will be 30 bps, 40 bps gradual improvement in the bridge business margins every year?

Kaleeswaran A: Our guidance was always a 30 bps-40 bps margin improvement over a period. It is not within one year. What was about a 20%, 22% share of business coming from Brand Factory, today has reached almost 36%, 37%. So there will be a natural contraction of margin that will happen. That will be augmented over a period by intrinsic margin improvement across these verticals independently.

Kaustubh Pawaskar: And on last one. How was the festive season for you because we are hearing the comment from most of the companies that festive season was not in line with what it was last year. In fact they have said some of them of have said flattish kind of sales during the festive season. So can you just throw some light on that?

Kaleeswaran A: While we will not be able to comment on our quarter performance, what we will be able to state is that if you look at the festive calendar, there has been a little bit of shift. But having said that we saw a reasonable growth in October.

Moderator: Thank you very much. The next question is from the line of Sagar Parekh from Deep Finance. Please go ahead.

Sagar Parekh: Sir, one question is on the debt side where do you see the debt by the end of this year and by FY21 and considering our growth plans?

Kaleeswaran A: Our guidance on debt has been less than 2 times EBITDA. We had at about 1.5x EBITDA at this point of time. We would expect it to be around the same range as we close the year. And as of next year our endeavor is to ensure to keep the absolute debt constant at similar debt to EBITDA levels or lower.

Sagar Parekh: So we have received this Rs. 300 crores from Apollo, right?

Kaleeswaran A: Yeah, that is right.

Sagar Parekh: So then the debt should ideally come down with the cash or we have already utilized the cash?

Kaleeswaran A: Yes, so it has been utilized at this point of time towards expansion.

Sagar Parekh: So is there a structured deal with Apollo or it is a pure equity deal?

Kaleeswaran A: It is an equity deal.

Sagar Parekh: Okay so there is no fixed IRR promised to the investor, right?

Kaleeswaran A: No, nil.

Moderator: Thank you. As there are no further questions, I will now hand the conference over to the management for closing comments.

Kaleeswaran A: Thank you. Once again thanks a ton for attending the conference call on our business and financial update for the quarter and first half. As we move ahead, we look forward to share with you in terms of the progress that we have made on each of the activities and line of business that we talked about today.

Moderator: Thank you very much. On behalf of Motilal Oswal Financial Services Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.