



“Aditya Birla Fashion & Retail Limited Q2 FY17 Earnings Call”

November 24, 2016



MANAGEMENT: MR. PRANAB BARUA - MANAGING DIRECTOR, ADITYA BIRLA FASHION AND RETAIL LIMITED
MR. ASHISH DIKSHIT – BUSINESS HEAD, ADITYA BIRLA FASHION AND RETAIL LIMITED
MR. S. VISVANATHAN - CFO, ADITYA BIRLA FASHION AND RETAIL



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Moderator:

Ladies and gentlemen, good day and welcome to the Q2 FY17 Earnings Call of Aditya Birla Fashion & Retail Limited. The call will begin with a brief discussion by the company's management on the quarter and half yearly earnings performance followed by a question-and-answer session. With us, we have Mr. Pranab Barua – Managing Director, Aditya Birla Fashion & Retail along with Mr. Ashish Dikshit – Business Head, Aditya Birla Fashion & Retail and Mr. S. Visvanathan – CFO, Aditya Birla Fashion & 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 risk that the company faces. 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 Q2 FY17 earnings call for Aditya Birla Fashion & Retail Limited. Let me first take you through the industry performance. The second quarter, July to September period was marked by a long end of season sale for the industry. Lower sales in quarter one particularly in the peak wedding period of April to May have resulted in higher inventories across the industry and hence early EOSS for the industry. Not only was the discount period unusually long, it witnessed much higher levels of discounting and multiple promotions. This also created an overall fatigue with discount and a subdued post EOSS consumer offtake. The sales were largely restricted to East, during Pujo period which saw reasonable uptake of demand. The apparel industry continued the pattern that we saw in the first quarter where the womenswear, casual wear, value fashion and fast fashion segments continued to grow at a healthy pace. In terms of channels, e-commerce continued to lead growth across all categories.

Now coming to ABFRL's performance, first let me take you through strategic initiatives and new businesses and then I will take you through the performance in terms of the financials.

New initiatives and businesses; during the quarter, we continue to make progress in our strategic initiatives to intrinsically enhance our business model through clear focus on the following initiatives. The first initiative is brand development through investment in brand building, merchandise and refreshed store experience. We also looked at the season shifting from 2 seasons to 4 seasons to build an agile design and supply chain cycle. This is a significant internal transformation which we have undertaken and this will prepare the business to deal with greater agility for any changes in market conditions and consumer takes. Our focus on cost optimization and capital productivity continues and it has been a key area of focus for us as we are constantly driving capital efficiency through better working capital management and partnered CAPEX programs.



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As mentioned to you in the last many calls, digital transformation through own and partnered e-commerce through strategic partnerships and execution of Omni channel program across Pantaloons and MFL stores has been a priority area for us. We have enhanced our partnership with key e-commerce players in fashion and apparels through integration with our IT systems and supply chain as well as initiation of joint fabric business planning. We also transitioned our own e-commerce platforms from a single multi-brand platform to individual brand e-commerce website. This is an important step in our journey to also complete Omni-channel experience to our consumers. As of now, we have rolled out Omni-channel functionalities across 400 stores. Simultaneously, we are also enhancing the strategic play of our business in line with our plan to enhance our leadership position in the industry through new partnerships and market expansion.

As already announced earlier, we completed the acquisition of Forever 21 in the month of July 2016. This acquisition will give a key wide space of young women fast fashion in our portfolio. We are in the early stages of transiting the business into our portfolio and considering the market potential, we are confident of building a very strong position in this category. We also signed up a long-term distribution partnership with iconic British brand Ted Baker. Ted is one of the fastest growing brands in the super premium segment with a strong portfolio of products for men and women spanning casual, formals and accessories. We expect to launch the first Ted store by the end of this financial year. This partnership with Ted along with the partnership we signed with Simon Carter earlier on has strengthened our position in the growing super premium category of menswear. We are also pleased to announce the launch of men's innerwear and athleisure products under the Van Heusen brand. As per the planned strategy, we have launched it in South India in the states of Karnataka, Tamil Nadu, Telangana and Andhra Pradesh. These products are now available in leading multi-brand outlets, our own EBOs and department stores. Innerwear as a category also gives potential for growth and we plan to steadily build this category into a large and profitable business in the next few years.

Now coming to the highlights of the financial performance of ABFRL and the individual businesses. Sales for second quarter was 1,187 crores which is a growth of 13% over last quarter FY16. EBITDA for the period was 172 crores, a growth of 5% over same time last year. H1 sales grew by 11% while EBITDA grew by 20% and EBIT by 60% over H1 of FY16.

Now on the individual businesses, let me first talk about the Pantaloons business. Pantaloons posted a healthy growth of 22% with the strong same store growth of 6.2%. It ended in Q2 with sales of Rs. 727 crores. We expanded the network to 171 stores. Own brands now are about 63% of Pantaloons revenue while EBITDA for the quarter was 52 crores, significant growth of 78% over the same period last year. H1 sales at 1,301 crores grew by 26% and EBITDA at 78 crores grew by 131%. The like-to-like growth for H1 was 10.4%. The move to value fashion and increased share of own brands combined with expansion has helped Pantaloons to report substantial growth in sales and profit. The network of 171 stores at the



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end of Q2 FY17 includes 7 Pantaloon Women's stores and 2 Pantaloons Kids stores. The initial results for these new formats are encouraging. As part of the overall strategy to drive partnered distribution, we have launched 9 franchise stores and we expect this number to grow slowly and steadily as we build on the experience of running and managing these stores profitably.

Now coming to the brand business, MFL. Q2 of MFL sales were 1,171 crores, a growth of 5% over Q1 FY16. While gross margins for the quarter improved by 20 basis points in the back of our calibrated discounting strategy, EBITDA for the quarter was 115 crores as against 136 crores for the same time last year. The financials of MFL incorporates the innerwear expenses and the Forever 21 business which has been recently acquired in this quarter. Our like-to-like growth for the quarter was -10% as we continue to pursue our strategy of calibrated discounting despite competitive pressure. During the quarter, we continued the retail network rationalization by closing 60 stores. During the first half of this year, we have completed most of the strategic network restructuring by shutting those 136 stores and opening 100 new stores. This has made our retail network healthier and more profitable. The gains of which will emerge going forward.

Corresponding numbers for H1 for sales is flat at 2,013 crores and EBITDA was subdued at 162 crores primarily due to lower like-to-like growth and introduction of new businesses like F 21 and innerwear. Results for this quarter incorporate the impact of Ind-AS accounting standards. The detailed bridge is available in the investor presentation uploaded on the website.

Coming to outlook; even as apparel industry was beginning to show signs of healthy recovery and we were looking forward to revive H2, the demonetization announced by the government has become a dampener for discretionary spending and we expect the apparel sector also to be impacted for the next few months before it stabilizes. It is too early to predict the impact on H2 performance as the economy is still grappling its cash for basic needs. We are still assessing the full nature of the impact that we have on our volumes and say for the coming quarters. With this, I now end the opening remarks and the floor is now open to questions. Thank you.

Moderator:

Thank you very much. Ladies and gentlemen, we will now begin with the question and answer session. We have the first question from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy:

Sir, my first question is on Pantaloons wherein the margins have shown a good recovery to 7% plus, but the same store growth has slowed down considerably on a quarter-on-quarter basis. So could you take us through both these movements on a full year basis, where do you see the margins and why the SSG in Pantaloons has been EBIT volatile not just this quarter, in the previous quarters also it has been quite volatile.



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Ashish Dikshit: Let me answer the first question. As far as the gross margins in Pantaloons are concerned, it is a steady improvement that the Pantaloons business has been making over the years. It is both a function of product mix that we are delivering that equally aided by the shift to own brand business. Due to superior designs, we are able to garner greater share of own private label businesses. Combination of these two is actually driving the margins as far as Pantaloons is concerned. On the issue of like-to-like business, Pantaloons continues to show fairly healthy like-to-like compared to the industry. Q2 like-to-like was one of the better as far as industry is concerned and remember it has come in an environment which is fairly intensive in terms of discounting and therefore both margin improvement and a like-to-like growth is fairly creditable performance as far as Pantaloons is concerned. In typical pure fixed cost structure like Pantaloons, seasonality of the business does have impact on the margin as we go forward and the last quarter was also a function of the previous year's quarter one where there was a little bit of base correction that was involved.

Abneesh Roy: And sir this SSG of 6%, will this be largely volumes only?

Ashish Dikshit: No, in fact the volume growth is higher. Pantaloons as we have mentioned, we are constantly driving superior consumer proposition and volume has grown by about 8% and ASP is down by about 2%.

Abneesh Roy: And sir any colour on franchisee model, it is a bit early, but whatever you can share on franchisee model in Pantaloons?

Ashish Dikshit: We just launched the franchisee store and it is too early to comment on how it is faring. We need to have some more time. At least about 6 months to 1 year of operations allow us to go through 2-3 seasons and then we will be in a better position to comment on how the franchisee model is, while there is a lot of interest expressed by the franchisees wanting to put a store. We have to be cautious and we have to understand the model well before we can go out and open it in the market. We will share with you at an appropriate time how the franchisee stores are performing. Just like Madura, it is our intention to be capital led in Pantaloons also and to keep driving the Pantaloons expansion through franchisee. At the same time, we have to be cautious and have a working model before we go out.

Abneesh Roy: And sir my last question is on Madura, it has grown much better than earlier quarter. So if you could take us through Forever 21 impact and innerwear both in terms of revenue and margins you have done well, but if we knock off those two items, then how the growth numbers are in terms of revenue and margins?

Ashish Dikshit: So we do not disclose brand wise numbers. I would not beyond a point get into details of individual business, but I will give you the big picture in Madura is that it is pretty much planned strategy as we had shared in the beginning of last quarter that we are driving this



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business, we are going through a phase where we understand the industry is under severe attack from discounting and promotion. We want to make sure our brands which have been built over a long period of time and have the justified premium, continue to maintain that premium and therefore we are weathering that storm at this point with slower growth, but our margins continue to improve, our gross margins improved even this quarter despite increased competitiveness, this discounting was lower than last year same quarter and therefore the business is getting healthier. Innerwear is a very early stage, we have just launched 2 months back. Both from revenue point of view, it is still a very small number. Obviously, all these businesses do require initial investment, so today it has a small impact on EBITDA. I do not want to separately take that out because that is very early stage of the business. Similarly, Forever 21, the operations that have been acquired as on 1st of July and early days, we are still figuring out the business. It does not have material impact on the revenues because still small for a quarter compared to the overall size of the business that we have in ABFRL, but we do hope once we get on top of this business like we did with Pantaloons, we will be able to both fix the profitability and as well as build scale very quickly in this business.

Abneesh Roy:

Sir, two small follow-ups here. In terms of EBOs for Madura, what do you see net addition for the full year because first half has seen closures and any takeaway from earlier launch of your innerwear, any learning you are applying this time because you launched innerwear earlier also, so I was just trying to understand what has changed this time?

Ashish Dikshit:

So, I think there is a big difference in the way we look at innerwear about 8-10 years back when we launched it. At that stage, we were looking at this a just one more product extension to complete the lifestyle proposition of our brands. So it was merely 10 or 11 products in each of the brands. Today, our strategy is very different. We have built a focused organization behind it. We have created very deep competencies both in terms of consumer understanding, brand positioning as well as supply chain configuration because our ambitions are much larger. We are treating as standalone independent business in terms of management, ambition as well as our go-to-market strategy. So it is a very different game plan. The market is matured, it is probably more ready for a premium power brand to build the large business and that is why mentioned it is very different from what we had at that point of time.

Abneesh Roy:

The net EBO addition for the full year, what are you targeting in Madura?

Ashish Dikshit:

We continue to operate, be careful as far as EBO additions is concerned. As we said in the beginning of the year, we had identified close to about 140 to 150 stores that we would look for pruning during the course of the year. Close to 136 out of them have already been acted upon in the first half of this year. We may still have about 20-25 stores which as we go along we will evaluate after having seen their performance during the season, but at the same time we continue to also open stores. We will open close to 200 stores. We have opened about 110 stores so far. So we are looking at our distribution expansion far more carefully in light of our



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current understanding of how the market is likely to evolve the impact of e-commerce and our overall plan for distribution expansion. We continue to believe that there is a large open market that we have not explored. None of the premium brands in this industry has explored as yet and yes, we want to make sure that model is right and therefore as and when we feel there is a weakness, we take quick strong action to fix that which is what we have done so far.

Moderator: Thank you. We have the next question from the line of Anand Krishnan from Kotak Infina. Please go ahead.

Anand Krishnan: Sir, what percentage of sales actually consists of card sales for you. I will just come to the next question later if you could just answer this first?

S. Visvanathan: Card sales in a steady state basis is about 50 plus percentage. It was in fact 55% was the card sale and 40-45 was cash sale.

Anand Krishnan: Sir, any discounting that ABFRL was actually planning so that you could actually spurt demand in the short term because of the envisaged consumption slowdown that we are actually seeing?

Ashish Dikshit: See, we do not believe that when such macro and big scale changes happen, that small actions could actually create that. There is always in the industry couple of basket size promotions that keep running which basically work on the consumers who has already come in and how to either upgrade them to get a larger share of their wallet, but we do not believe in this point of time the forces also strong at small individual actions would not make that difference and therefore not specifically looking at more than what is usual.

Moderator: Thank you. We have the next question from the line of Vaishnavi Mandhaniya from Elara Capital. Please go ahead.

Vaishnavi Mandhaniya: Can I get the volume growth for Madura for this quarter?

S. Visvanathan: Are you saying like-to-like or overall?

Vaishnavi Mandhaniya: The volume growth on like-to-like basis from Madura?

S. Visvanathan: Like-to-like retail, you must understand retail is only about less than half of business, of which like-to-like is about 75% of the business. So for that, one-third of the business, our overall like-to-like growth which was mentioned in the opening speech is -10%. Volume growth has even declined, even steeper at -13%. Our ASP is slightly higher at about 3%.



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Moderator: Thank you. We have the next question from the line of Manish Poddar from Religare Capital Markets. Please go ahead.

Manish Poddar: Actually, all these one-offs, what would be core Madura margins and probably how much would be the drag of Forever 21 on EBITDA actually?

Ashish Dikshit: Manish, we do not as we said give individual elements, but to give you a sense, it is also function of what you call core Madura. We have 4 strong brands which are profitable and strong and well-entrenched. We have couple of businesses which are, I would say in settling state in terms of their potential and where they are whether it is people business on one side, international brand business on the other side, Forever 21, innerwear. So there is a portfolio plus we have investments intrinsically building the e-commerce digital portfolio. What we reported is combined number which combined the profitability of four brands which generally tends to be more steady and well balanced and we are launching new businesses and the profile of new business is such that all of them at different levels are detracting a small margin away from the overall core margin of the business.

Manish Poddar: So would it be right that your earlier mentioned guidance wherein you were expecting that Madura business margins to be flat this year, is there a downside to that guidance which you had earlier stated?

Ashish Dikshit: Downside, if any, is likely to come if there is prolonged impact of demonetization. On standard stable business, Madura's core business margins are well-entrenched and well-protected. We do not expect downside on it. But if the demonetization impact travels farther than what it has already done, then I think there will be downside, but it is difficult as Vish said in his opening remarks, difficult at this stage to project.

Manish Poddar: And in your sense, I believe you would be tracking industry much more closely. In your sense, would the old inventory across players would have got liquidated because of this prolonged end of season sale or you expect discounting to come in again early December?

S. Visvanathan: I think most people, this prolonged end of season sale was an outcome of muted Q1 particularly the month of May and early part of June which typically comes when lot of weddings was poor and therefore it led to a longer EOSS sale. In the normal course, I would have agreed with your assessment that most people would have refreshed their inventory well by the end of it, but I think we are faced again with a very unprecedented situation where the peak winter and wedding period where the sales estimates would typically be higher. You are now faced with the short term to medium term pressure. I do not know how industry will react to it. There is the possibility that there may be preponement of EOSS sales, but I think it is too early for us to comment on that. I think most people are hoping that this temporary phase gets out quickly but we will have to see for couple of more weeks on that.



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- Manish Poddar:** And just on the Pantaloons bit, what is now new store rollout guidance for '17 and '18 if you can highlight?
- S. Visvanathan:** As we told you earlier, our target is to continue to expand at the rate of 30-40 stores every year and we will be looking at that kind of expansion.
- Manish Poddar:** And just a bookkeeping question if I may. Why is the depreciation down for Pantaloons in this quarter Y-o-Y?
- S. Visvanathan:** As compared to the same quarter last year?
- Manish Poddar:** Yes.
- S. Visvanathan:** we had accelerated depreciation which we used to charge..
- Moderator:** Thank you. We have the next question from the line of Alekh Dalal from One Thirty Capital. Please go ahead.
- Alekh Dalal:** Just wanted to understand what the margin impact would be if there are sales declines and how the operating leverage work on the other side. Obviously, we have seen sales growth and therefore the margin leverages come up, but how does it impact on the other side when your sales drop in this quarter?
- Management:** You are talking of which business?
- Alekh Dalal:** For both the businesses.
- Ashish Dikshit:** You are right. I think there is operating leverage that we have built in these businesses which have helped and you can see in Madura, without that also we have managed to hold margins because it was a very well-considered and gradual sort of strategy in which we watched for a period, decided the strategy and created cost structure around it. So we have been able to hold down to margins in Madura. Pantaloons benefited from good strong growth, but this growth has also come through new store expansions apart from like-to-like growth. If the like-to-like growth falls a little bit, we absorb it through cost corrections and actions that we are taking. However, if the period is prolonged and the cut is deeper, then we will have to look at more structural sort of response which are little longer in the nature.
- Alekh Dalal:** What percentage of your cost structure you think you can actually variabilize because let us say if your gross margin is 50% and you have got certain fixed expenses and rentals and all of that, how much of the balance 50% you think can actually get variabilized to meet your declines in your sort of nominal gross margins?



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Ashish Dikshit: Over a medium term, it is possible to variabilize a significant part of it because if you look at the fixed cost of our cost structure on which this leverage operates, two big elements are overheads and the setting expense which is the store expenses. Now in absolute terms, it may look like store expenses that are fixed, but if you look at as we have done in Madura by pruning down the lower and less productive stores, you have the potential to actually create a very variable structure around that. But all that is possible over a medium term. In a very short term, it is difficult to create a very large shift around it.

Alekh Dalal: So can the margins basically evaporate here or we are not looking at such a dire situation if sales are down 20%?

Ashish Dikshit: So we are at this stage confident that with the level of challenge that we see in the market and our understanding of what is happening even post demonetization, we should be able to operate with just the way bit before we would have liked it, but not a very big surprise on that. The impact will be minimal at this point of time with what we see over next 4 to 6 months. But if the situation worsens significantly, then obviously we will have to reconsider that.

Alekh Dalal: And one more question. Just in terms of the ESOP plan and the options for the management team, where do we stand on that?

Pranab Barua: There is a proposal that is currently lying with the management and probably in a month's time it will be released.

Moderator: Thank you. We have the next question from the line of Chirag Shah from CLSA. Please go ahead.

Chirag Shah: I have a question for Ashish. This shift from 2 to 4 season cycle is a huge one, can you talk a little bit about how you are driving the organization for this change in terms of supply chain vendors being prepared for this change for the shorter cycle and our backend and the frontend seamlessly interacting for such change.

Ashish Dixit: That is a very good question, Chirag. We took almost 6 months to prepare ourselves for that. As you have rightly figured out, it requires configuration at multiple level starting with the internal process inside the organization conveying that and translating with these vendors to make them align with that. The whole purpose is to go to market often enough and faster enough. So basically if you look at it, we are trying to achieve two things. One is go to market more often so that you have the chance to react to the trends that you see in the market and post correct that. And secondly on the defensive side, it allows you to correct your inventory and planning in case there is a shift in the market and but to make that happen, we have worked internally as well as with an external consultant firm to evaluate the entire business cycle in apparel industry. We have worked with the vendors, it is easier in Madura because



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large part of business close to 40% by volume is in-house, especially in the premium brands the number is even higher. So our ability to react in the shorter lead time is much more. It was a more difficult process in Pantaloons business but we have been able to work with our vendors to create that. What it means is that we have hold our estimates little closer to the season. We give indications to vendors so that they are prepared for it and yet do not prepare too early and too far in advance, which allows us flexibility to react. It is very much underway both the businesses have launched this and therefore as we go forward, we have broken let us say next spring-summer into spring and summer and the 2 season already migrated to 4 season.

Moderator: Thank you. We have the next question from the line of Vicky Punjabi from JM Financial. Please go ahead.

Richard: This is Richard here. Can you help me understand more intense margin compression that we have seen in Q2 versus Q1 for Madura? Q1 Margins for Madura had declined about 170 bps and Q2, the decline was even higher about 235 bps. I am quoting both of them on Y-on-Y comparison. Can you help elaborate the reasons for the same please, especially since Q2 last year if I recall correctly had those bunched up steep advertisement activities that you had carried out in Madura, which I guess would not have been there in Q2 of this year, despite that a much sharper EBITDA margin compression this year you have seen.

Ashish Dikshit: First of all, as you can see Madura, the margins for this quarter include what I would call investments into new businesses we have acquired. There is an impact of that which is, I would say significant in context of your question may be not in significant in context of overall financial with the company. But it does change also the picture. If you remove that impact, the compression in the margin is similar across the 2 quarters, very similar to what we had experienced in quarter 1 last year versus this year and same is the impact this year versus previous year.

Richard: And this is despite that bunched up advertisement cost that was there in Q2 last year, which I guess was not there in Q1. So I mean given that context should not you have saved a much more on SG&A Q2 this year versus....

S. Visvanathan: Yes, it got counter balanced by the investments as I said.

Richard: No, but there is still decline about 170-180 bps without the investments right?

S. Visvanathan: Yeah. So there is an offsetting factor in Q2, it is right.

Richard: Next one, if I hypothetically assume that this steep discounting continues for longer time that envisaged. Who is going to bear this discounting cost over the medium term, is it the company



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or is it the channel partner and if it is the company, what do you think happen to gross margin in this kind of a scenario?

Ashish Dikshit:

In the long run what happens is Richard that these margins are absorbed largely by manufacturers than by retailers. You know in this industry the retailer margin, there are enough retailers, multi-brand retailers that exist and their margins are not very strong and therefore one way or the other, these margins tend to get passed on to manufacturers. This is the reason why as one of the largest players in the industry despite competitive pressures and overall shift in the discounting structure in the industry, we are trying to secure a situation where we do not sort of accelerate this range to the bottom. And that is one of the reasons why we are withholding our growth if it comes with those margins because that is easier in the short run, in the long run that becomes the new base structure in the industry. The short answer to your question is it always goes to manufacturer, at least significant part of it.

Richard:

How do you intend to take the present gross margin then in this context?

Ashish Dikshit:

As you can see in our own business, we have created fairly strong structural programmes. It is not by coincidence that despite this we have managed to keep our gross margins where they are and in fact improve as we are going forward. There are multiple things that we are doing. There is at the core level, a better inventory planning system is one. Movement from 2 seasons to 4 seasons which leads to lesser risk in inventory is the second. At merchandise level, we are also looking at more sort of complex that nuance merchandise classification through which we take away the fashion risk, at least calibrate the fashion risk in the business to the extent that it gets less amount, less share of your merchandise open to discounting. So there are several tools that we are using, eventually discount is the means to deliver a certain price value proposition to consumer. We are also looking at how in the longer to medium term, what kind of adjustments do we need to take in the product price value creation and that is the longer term piece, but we are working on that as well to make sure that our margins are protected even as our pricing gets more competitive going forward.

Richard:

Are you actually still carrying out that strategy of calibrating pricing across stores. I recall when we met last, you spoke about prices having become too high as a result of which consumers are probably shying away a bit, is that getting recalibrated as we speak?

Ashish Dikshit:

I do not think I will say that because we keep our pricing constantly benchmarked and keep listening to customers on that. So what is happening in relative terms as unorganised market moves to more organised in the role of value fashion growth and the private labels of department stores, the e-commerce value, consumer is getting reasonable product at a much lower prices and therefore there is obviously a value migration that we need to constantly watch out the game. We are very careful against that and watch that very closely. As I said, we are therefore constantly looking to recalibrate our price value equation. Introduction of new



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price points in several of our brands was one strategy, creating slightly heavier weight at the lower price point products in the markets where we feel the pressure higher is the other piece. But generally speaking, we are not dropping our prices so significantly that it will have impact on the pricing, all that is being done through a calibration. We are also looking at where are we getting back through lower discounting through more efficient inventory planning, etc. So it is an end-to-end value game which we are constantly looking at.

Moderator: Thank you. We have the next question from the line of Sumit Agarwal from ICICI Bank. Please go ahead.

Sumit Agarwal: Just wanted to understand on the Madura side probably if you can help me, for the last few quarters the Madura is getting stuck at something like a 1000 odd crores give or take run rate. Is it that the brand is getting matured or is it that because there is a cost correction taken by you in terms of the discounting and hence when do you see Madura part growing?

Ashish Dikshit: See if you have been on our calls, this is a part of clearly articulated strategy that we laid out at the beginning of this year where we said over next couple of quarters we are doing 3 things. In face of what we are seeing in the market for longer term strengthening of our business without losing the margin structure and profitability structure of the company, we said we will look at one retail store rationalization and that is being played out. We will continue to calibrate our discounting to make sure that the industry discount structure does not move further notches below than we are at already and therefore that again compromises of growth in the short term and in even shorter term because we had a pretty steep shortfall post last Diwali, we had said we will take those correction in terms of resetting our supply chain and inventory management practises to bring down our inventory levels to the new level that we want to operate with and move to a more frequent season cycle. So all that has been done, these are transformation process which in an industry with lead time of 6 to 9 months do take couple of quarters and that is what we are doing with the business. Intrinsicly, we are basically correcting our business for most steadier, resilient and continued profitable business and in doing so for the short term we will have to let go off the volume and the value growth that we otherwise we are used to.

Sumit Agarwal: Sir agreed, probably that short term pain is there in terms of for this brand. So once all this cost correction is done probably how do you see this part growing? Will it start growing at a low double digit or high single digit or can you just help us understand how?

Ashish Dikshit: We are very hopeful to getting into double digit growth very quickly. Even today, that option is available Sumit in many ways but we have chosen to exercise a different strategy, to execute that strategy required that we exercise discipline and patience across multiple pieces. We are very confident that double digit growth rate is available even today and it will definitely come back as soon as this program is over.



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- Sumit Agarwal:** And probably by this year end, all this programs would be getting over?
- Ashish Dikshit:** One way to think but yeah, the results of these should start appearing from end of this year.
- Moderator:** Thank you. We have the next question from the line of Chirag Lodaya from Value Quest Capital. Please go ahead.
- Chirag Lodaya:** My first question is related to impact of demonetization. So if you can give some sense what kind of sales impact we have seen in last 15 days on a month-on-month or Y-o-Y basis. Some kind of quantification will be helpful.
- Ashish Dikshit:** I think you will have to take this very carefully because this picture is changing very quickly. When the demonetization was announced, in the first few days we saw sales impact as high as 40%-45%. But that was only for a couple of days. Immediately by the end of that week, it had come down to about 30% as close as we are moving further away from it and people are finding other options, it is around 20%-25%. So we expect going forward hopefully this constant improvement will continue to rapidly improve. You know at what level it will settle and how quickly.
- Chirag Lodaya:** Second on debtors, so our absolute debtor has gone up. So is it because of Forever 21 acquisition or our core Madura debtors have also gone up.
- Management:** Compared to which quarter as the comparable debtors?
- Chirag Lodaya:** Compared to March.
- S. Visvanathan:** Yeah, that is basically because sales if you see in this quarter are much higher than the sales on the period January to March. So there is an increase on account of that. Then, we will have an increase on account of the slightly increased credit period which we have given to our dealers and distributors. These are the two important factors which have impacted the debtors growth. Fundamentally, this is because this quarter has more sales than the quarter 1 which is Q4 of last year.
- Chirag Lodaya:** And what has been the CAPEX for H1?
- Management:** Excluding Forever 21 acquisition, it is about 135 crores.
- Chirag Lodaya:** And sir lastly what is the net debt as on September?
- S. Visvanathan:** 2,650 crores.



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- Moderator:** Thank you. We have the next question from the line of Mayur Parkeria from Wealth Managers. Please go ahead.
- Mayur Parkeria:** I have some basic question in understanding the number, help me with it please and sorry for the basic question. The segment liabilities which we disclosed in the segment results shows the total figure of around 2,100 crores whereas the liability side of the balance sheet is around 5,000 odd crores. So what gets eliminated while doing this because when we understand segment, it is all the external liability should be part of the segments. So bearing net worth, practically that should match with the figures.
- Management:** I think I will take this question offline and tell you the full response on this. We will give you the reconciliation of this.
- Mayur Parkeria:** The second is, when we say wholesale business in the Madura, can you please explain me what is the nature of this wholesale business, I am sorry for this basic lack of understanding.
- Ashish Dikshit:** No problem, I think it will help everyone with that. See we have in Madura about 40%-45% business and it varies across brands and it varies across quarters. I am giving you a broad number which is the pure retail business in which the company is selling directly to consumer every piece and therefore it is recorded at that level. The remaining business that you see, which is the other half of our business is the wholesale business. It consists of our sales to large number of multi-brand outlets which will be close to 50%-55% of the wholesale business. Remaining wholesale business, the large part of it comes from our sales to department stores where again we are selling to them and they are then selling in turn to the consumer and therefore as far as we are concerned in terms of recording sales, it is a wholesale business that we are creating.
- Mayur Parkeria:** So all the retail chains also will be part of the departmental stores which will be in the 45% of the wholesale?
- Ashish Dikshit:** That is right. So we sell to them and they sell to consumers.
- Mayur Parkeria:** Sir, if I have my understanding right, at the consumer level the final product pricing which we see will be always be on MRP basis which will be similar whether the sales is through and our own EBO or whether it is at the departmental stores or at the MBO, right?
- Ashish Dikshit:** Price of our products remains same because it is MRP listed on the product.
- Mayur Parkeria:** So, in the case of wholesale sales, I am saying in broadly what would be the kind of realization difference which will be coming at the company's level?



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- Ashish Dikshit:** Fairly significant. If you look at our pure retail business, the same product with Rs. 100 MRP, you will recognize anything between Rs. 85 to Rs. 90 assuming that there is 10%-15% discount in the industry on an average annualized level. Many brands, it is higher; for some brands, it is lower, so I am just giving you an indicated number that is the recognition you take on the book. While wholesale business is concerned, you have to get the entire channel margin and any other cost that you incur on that. So, revenue recognition could be anything between Rs. 60 to Rs. 70.
- Mayur Parkeria:** Rs. 60 to Rs. 70 as comparable to 85-90 whichever..?
- Ashish Dikshit:** That is right.
- Mayur Parkeria:** And the last one was in this quarter we have seen that OCI, the comprehensive income at around 8 crores, what is that?
- S. Visvanathan:** Basically that is because of the resetting of the actuarial valuation which we do for every quarter based on our actuarial valuation for superannuation and gratuity.
- Mayur Parkeria:** So, this is one time impact which is coming?
- S. Visvanathan:** Yeah, quarter-to-quarter it will change because every quarter we will get an actuarial valuation done based on the number of employees and the discount rate for this particular kind of...
- Mayur Parkeria:** So, if the interest rates are falling, we will continue to see the liabilities going up?
- S. Visvanathan:** Yeah because one time set has happened, if it continues to fall there would be an impact on this.
- Mayur Parkeria:** Sir, my last question is on the debt reduction plan or the debt outlook plan, where do we see our debt levels in absolute terms or in as a percentage of equity over the next 3 years and how do you plan to achieve if there is a reduction plan?
- S. Visvanathan:** Currently, our debt is running at about 2,060 crores and if we continue to perform the way we are performing, we see a constant reduction in debt happening subject to the fact that we do not need to do any other major acquisition. If there is a major acquisition, then we will have to see a combination of debt and equity at that point of time to see how we finance, but on a steady state basis we expect the net debt EBITDA to come down to close to about 2.7-2.5 over the period of say 2 to 3 years.
- Mayur Parkeria:** Net debt to EBITDA over 3 years, you will see 2.5 to 2.7?



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- S. Visvanathan:** Even lower than that depending on the cash flows that we generate.
- Mayur Parkeria:** And this is assuming no...?
- S. Visvanathan:** No other acquisitions or any other inorganic...
- Mayur Parkeria:** If your permission, last one more question on the side that our total EBITDA for the year would be around 500 crores give and take, right?
- S. Visvanathan:** We cannot give you any....
- Mayur Parkeria:** No, I am saying in the past what has been in FY16, what it was?
- Management:** You have the numbers.
- Mayur Parkeria:** And we have a capital employed even if we say operating which I exclude the goodwill of around 1800-1900 crores, we would have the operating capital employed of 3000 plus odd crores that would give us an operating return on capital employed of 14.5% to only 15%. Is there a management benchmark or target which would like to achieve over the next 3 years, I am not asking for quarter or a year or two year but over the next 3 to 5 years in terms of the overall at the company level?
- S. Visvanathan:** We will not be in a position to give you that kind of information now.
- Mayur Parkeria:** Any directional statement sir?
- Management:** Directional statement obviously if you look at Madura's ROCE over a period of time, it has only continued to increase and we will be targeting the same kind of improvement year-on-year through working capital management and through partnered CAPEX and also EBITDA improvement. So, to give you a number now we will discuss.
- Mayur Parkeria:** No, number no but will it be significantly higher than the current suboptimal numbers or because even Madura only in two years was it anywhere upwards of 40%-50% but after those it has been coming down drastically bearing those two years, it has always been in the 20s range. So, is that the kind of number overall we can look at?
- S. Visvanathan:** So if you look at Madura's performance for a long period, the return on capital was in high double digits in 2015-2018, then it went to 20s, then it started to rise and even today it operates in a standalone basis with very high return on capital. I think the operating leverage will start to come in, right now we are in the phase of expanding Pantaloon's business which is capital intensive till we figure out a more sort of franchise model for this or when the rate of



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expansion of new stores becomes the smaller part of the base because today when you are opening between 40 to 50 stores and a net worth of 100-120 stores, it is fairly significant increase in the capital. But once we get to 250-300 stores, 200 plus stores which we will get to in next 2-3 years, the incremental capital employed will actually come down as the base of the business and that is when the multiplication starts to happen very fast.

Management: And also when we clarify to you on the segmental liabilities and how we are allocating equity and borrowings within the divisions we do not know because we do not allocate. So we will send you the clarification and then you can work it out for the past.

Moderator: Thank you. We have the next question from the line of Sanjay Singh from Axis Capital. Please go ahead.

Sanjay Singh: Just wanted to know on the innerwear front, what kind of supply chain you have set up, is manufacturing on your own exclusive, what exactly is being done there?

Ashish Dikshit: So right now the business is too small for us to own a manufacturing, Sanjay. We expect next year and a half-two years as we go national build deeper distribution and build large volume. It is an option that is available to us. You must remember that we run a fairly large manufacturing business, one of the largest manufacturing business in apparel industry in India. It is a product that we understand extremely well to make but at this stage of the business, we want to keep higher flexibility keeping in mind what is best required for the frontend and therefore at this stage we are not investing in a manufacturing setup, but that is something that we will consider maybe two years from now.

Sanjay Singh: And is it an exclusive manufacturing setup you have now or?

Ashish Dikshit: We have fairly good tie-up but we do not have the scale right now to keep it exclusive because that would require committing a certain volume at this stage but the partnerships are deep and work almost as well as an exclusive in terms of arrangements on current development and quality management, but we are not in a position to consume the kind of volume that are required in a typical base level manufacturing plant in innerwear today that will change pretty quickly next two years and that is when we will evaluate.

Sanjay Singh: But it is not a very CAPEX intensive business, right?

S. Visvanathan: No, asset turnover is very high in this, in any form of apparels but even in innerwear.

Sanjay Singh: And secondly in terms of pricing positioning where exactly is this VH placed, is it mid premium or it is in the super premium part?



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Ashish Dikshit: No, it is not super premium. It is premium segment, it is pretty much the kind of Van Heusen positioning that you would expect. We obviously have the differentiated product offering wide enough but where there are products which are very differentiated which are slightly more expensive, but we are operating in the large premium market which really is the

Sanjay Singh: This is slightly more premium to the market leader in terms of pricing, the price points per say?

Ashish Dikshit: It is roughly around that. There are products which are low premium than that but in terms of overall brand positioning and the customers and segment that we are targeting, we are playing exactly where the market is today.

Moderator: Thank you. We have the next question from the line of Rohit Kadam from Credit Suisse. Please go ahead.

Rohit Kadam: Just have a couple of follow-ups on the demonetization part. Firstly for Madura, is the wholesale channel more impacted than the retail channel for us and my second question is are you seeing a variance in the impact between the Pantaloons business and the Madura business from demonetization?

Ashish Dikshit: So, fair question I think wholesale is currently more impacted. I do not think in real sense, wholesale and retail will be dramatically different because the consumer behavior at both ends in terms of cash versus credit is roughly similar, although it is fair to expect that wholesale business at least smaller MBOs and that too smaller towns have a high share of cash. We do expect that impact to be slightly higher than our own retail. Also the question of Madura versus Pantaloons, as of now the difference is minimal, although you would expect that Pantaloons business should be able to come back a little faster being a pure retail business.

Moderator: Thank you. We have the next question from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor: Just one question on the demonetization part. If you can just help us with what were your cash transactions, obviously you bill everything but how much would be transactions in cash in terms of sales as a percentage before and after 8th November if you have some sense on that?

S. Visvanathan: 45% before on an average, it fell down to as low as 5% in the first few days. It is now settling in the early double digits.

Harit Kapoor: So, are you seeing that progressively improving as days are passing by?



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Ashish Dikshit: Two things are happening. The progression in terms of overall sales coming back is much faster but not all of that change is coming through cash improvement. There is definite uptake as far as card adoption is concerned, so share of wallet is improving but overall cash is also beginning to come to double digit numbers as we move forward.

Harit Kapoor: And the second thing was, are you guys actively doing anything in terms of making the payment process easier in terms of cash backs or tying up with banks, digital payment agencies etc. to make lure the customer in terms of payments etc.?

Ashish Dikshit: There are two aspects. One is facilitating the customers in terms of payments other than cash that we are doing. We are tying up with most of the banks, we already have tie up even with the digital payment agencies and companies. We are accelerating that rollout as deep as possible and that is pretty much on that. What we are doing let's hope is doing something to get customers because we believe that today the impact of that is likely to be much slower, we may just end up giving lot of margins to people who already are our customers by offers of that nature. So that is relatively less today but we are doing everything to facilitate consumer who wants to shop through multiple payment mechanisms being made available at our retail stores.

Harit Kapoor: Third and last question really is on within Madura Pantaloon, are you seeing any trends from a sales decline perspective which are divergent region specific. So say example one region doing far worst than the other in terms of the sales decline that you mentioned?

Ashish Dikshit: In context to demonetization?

Harit Kapoor: Yeah, in context to demonetization completely?

Ashish Dikshit: North was impacted more severely, so North the overall share of cash business in our portfolio was also high. Having said that, North is recovering better at the base level because winter wears and as winters are begun to settle and the weddings are more sort of prominent in that business. So, they are probably neutralizing each other but the impact was higher in North and West than South and East.

Moderator: Thank you. We have the next question from the line of Aakash Mangani from BOI AXA Investment. Please go ahead.

Aakash Mangani: I would like to understand your foray on the non-apparel side of the business in Madura, how is that progressing, how profitable is that for you as a business, what are your plans over there, be the first question?

Ashish Dikshit: So I think we talked about innerwear that is the most significant initiative that we have in non-apparel in Madura. Other than that, shoes was the last big initiative that shaped reasonably well



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and this got integrated as much with other product categories. So we do not treat it separately, it is pretty much operating like another product in the portfolio. We do not have anything due in significant at this stage, which we have not done for last few years. So nothing which is very recent in that sense.

Aakash Mangani:

And the other question is generally over the last say 2-3 years, the casual wear segment seems to be growing much faster as compared to the formal wear segment and I understand that over the next couple of years that would be the trend as going forward as well. So is there a strategy to skew the product profile more so towards casual wear and how would you sort of want to go about doing that?

Ashish Dikshit:

So, this is something that we identified almost five years back and we have played out the strategy in each of our brands. So if you look at Louis Philippe, Van Heusen, Allen Solly, they are sub brands which have got created in the casual wear side. Whether that is LP Coat, LP Jeans, or V Dot in Van Heusen or Allen Solly casual, Allen Solly sport, Peter England casuals, Peter England jeans. So in recognition of this definite shift in the market, each of our brands have created strong sub brand in proposition and as market is shifting, the share of these businesses constantly improving and increasing. At one point of time, they were insignificant business, today roughly casual wear is almost half of Madura's business that will probably be surprising to many people who know these brands more for their formal wear strength but that is something that we are doing. Going forward as we are expanding our overall portfolio, we will continue look for opportunities either through new brands or through acquisitions to further strengthen that.

Aakash Mangani:

So as of FY16 if that is half of Madura sales, how would that have been let's say 4 years back?

Ashish Dikshit:

So FY16 will be about 40%-45%. If you go back to FY10 that number may be between 20% to 25%, so that is the kind of shift that is underlying this strategy and you could feel if you visited any of our stores and just look at the share of casual wear inside that store, you will feel the difference.

Aakash Mangani:

The other thing is that you mentioned on your expansion plans with regards to EBOs, with regards to the steps of the government taken on the last couple of days, this is expected that the real estate industry would slow down significantly. So do you foresee one yourself not being able to get those kind of deals if the pace of mall construction and so on and so forth slows down the next couple of years or you foresee us getting better deals with regards to where you can sign up or lease rental cost going down, any comment on that?

Ashish Dikshit:

All of them. We expect broader pressure on real estate and therefore there could be some slowdown as far as real estate, new development is concerned. On the positive side, real estate sector is also looking for structural reforms, there are big players coming in and some of that



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may actually help on the other side. Finally, we do hope, not expect as much clearly but we at least hope that due to actions which the government has taken there would be easing of real estate rentals. It normally does not slow down because people tend to hold on in anticipation of something but over 6 to 9 months, I think we will hope to see slight softening at lease of rentals across.

Aakash Mangani: How much would real estate be, rental cost be as a percentage of for Madura, any sense on that?

Ashish Dikshit: So, I think the way to look at is what the real estate cost for our retail business is alone because Madura is a complex combination of multiple wholesale and retail businesses. For a typical retail business of premium brand, real estate cost could be anything between 18% to 20% and sometimes even higher depending on how premium the locality is. So it is a fairly significant cost for retail.

Aakash Mangani: The last question is what would be your cost of debt right now and what is your sense on where that could end up in year or two the cost of debt for you guys?

S. Visvanathan: See, currently our cost of debt in H1 is about 8.3%. Where to end up, it depends upon the overall market interest rates and our ability to continue to fund the low-cost funds. I think anywhere between 7.5%-8% is what we should look at I think probably in one or two years' time if it continues like this.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was our last question. I would now like to hand the floor over to the management for its closing remarks. Thank you and over to you.

S. Visvanathan: Thank you very much for all the questions and we hope we have clarified most of your issues and doubts. In any case if any of you have any further questions, you can send us an e-mail and we will try and respond to all your questions on e-mail. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Aditya Birla Fashion and Retail Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.