Aditya Birla Nuvo Ltd.

Transcript of Q2FY14 earnings call held on 13th November 2013

Management Team:

- Mr. Sushil Agarwal – Whole time Director & CFO, ABNL
- Mr. Ajay Srinivasan – Chief Executive, Aditya Birla Financial Services
- Mr. Pankaj Razdan – Dy. Chief Executive, Aditya Birla Financial Services
- Senior Management Team, Aditya Birla Financial Services
- Mr. Ashish Dikshit, CEO, Madura Fashion & business
- Senior Management Team, Madura and Pantaloons

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Moderator

Ladies and gentlemen good day and welcome to the Q2FY14 earnings conference call of Aditya Birla Nuvo. The call will begin with a brief over view of quarterly earnings by the management followed by a question and answer session. We have with us on the call today Mr. Sushil Agarwal – Whole time Director and CFO of Aditya Birla Nuvo along with other senior management team.

I want to thank the management on behalf of all the participants for taking valuable time to be with us. Participants are requested to focus on key strategic questions to make sure that we make good use of the senior management time. I must remind you that the discussion on today earnings call may include certain forward looking statements and must be viewed therefore in conjunction with the risks that the company faces. With this, I hand the conference over to Mr. Sushil Agarwal. Thank you and over to you sir.

Sushil Agarwal:

Thank you. Good evening and welcome to the earnings call of Aditya Birla Nuvo. With me, I have Ajay Srinivasan – CEO and Pankaj Razdan – Deputy CEO of Aditya Birla Financial Services along with the senior management team of Financial Services business. Ashish Dikshit – CEO of Madura along with the senior management team of Fashion and Lifestyle business. I will take you through the key highlights for the company. Then I will request Ajay and Ashish to briefly talk about the financial services and fashion and lifestyle business.

The company performed well across most of the businesses despite the challenging macroeconomic scenario. Normalizing for carbon black and Pantaloons transaction in Q2, consolidated revenue grew by 10%, EBITDA surged by 26% and net profit rose by 13%.

ABNL has built leadership position across businesses and is competitively well placed.

Financial services business continues to rank among the top 5 fund managers in the country. We are actually among top 2 if we exclude bank backed players. ROACE is strong at 28%.

Fashion and lifestyle business continued to scale up its retail presence and strengthen its leadership position. It has posted operating ROACE of 22% including Pantaloons.

Idea Cellular is constantly expanding its revenue market share and ranks 3rd in the country. Quarter-after-quarter leveraging is reducing since cash profit is outpacing the CAPEX requirement. ROACE is also improving.

IT-ITeS business reported steady growth in profits and cash flows.

Rayon business continued to grow well. In the agri business, exit from trading of imported fertilizer has rationalized working capital employed. Though this has lowered profitability at EBITDA levels, but savings in interest cost will more than compensate on a full year basis. In Insulators business, domestic industry sales remained impacted due to accelerated imports. ABNL has strong balance sheet and cash flows to support its growth plan. Standalone financial ratio and leveraging position has improved with net debt at less than ₹ 3,000 Crore and net debt-to-EBITDA at 2.1 times.

Let us break down our inflow and outflow for the second half. During first half, majority of our investments have already been made. We spent about ₹ 2,000 Crore for investment, CAPEX and dividend outflow in H1. To meet these outflows, we generated similar inflows in H1 like Dividend, Buyback, Proceeds from Birla Sun Life Insurance, working capital realization in agri business, cash profit from operations, cash inflow and debt reduction on transfer of carbon black business. Hence on net basis, there was a debt reduction of ₹ 1,000 Crore in first half.

In next 6 months, our investment plan includes funding growth of NBFC business and sponsor commitment towards private equity funds. We had guided annual capital infusion of around ₹ 400 Crore for NBFC business. Out of which, ₹ 225 Crore is already invested in first half. CAPEX target for full year was about ₹ 600 Crore. Out of which, we have already spent ₹ 224 Crore in the first half. Among other cash inflows, ₹ 671 Crore had been infused by the promoters in November 2013 on conversion of remaining warrants. So on net basis, we do not expect net debt to increase, but net debt to EBITDA will slightly rise due to anticipated increase in subsidy during second half.

With this, I hand over the call to Ajay for his views on Aditya Birla Financial Services with a request to hand over to Ashish thereafter. Thanks. Over to you Ajay.

Ajay Srinivasan: Thank you. I think most of you have numbers with you. So I will just spend a couple of minutes giving an overview and then hand over to Ashish and we will take questions thereafter. I think the quarter ended September was obviously an extremely volatile quarter for various markets, for equity markets, for bond markets and obviously the currency markets. All of you in the markets would know that. So I think our results have to be looked at in the context of that volatility. For the quarter, we posted revenue of ₹ 1,526 Crore. For the half year, it was about ₹ 2,890 Crore. Revenue was marginally higher than Q2 last year and higher than half year last year as well. Our earnings before tax at ₹ 159 Crore for the quarter and ₹ 388 Crore for the half year was lower than last year largely on account of the Life Insurance business and I am sure you will have questions, we will take that later.

Funds under Management grew by about 6%. We now have about ₹ 108,000 Crore of assets under management. Our lending book at about ₹ 8,300 Crore grew year-on-year by 61%. We continue to grow this business carefully given the environment in which we are operating. In fact some of you would note that we actually have had a flat book versus the prior quarter in this entity.

Going forward, we have a completely new range of products in our Life Insurance business. Our focus is now to continue to drive distribution growth and efficiency in the Life Insurance business. Mutual Fund business is growing its market share and we hope to continue to grow this business profitably. Our NBFC again we want to make sure that we maintain and optimize the risk return tradeoff, but clearly we see opportunities to continue to grow in this area. General Insurance broking business had a very good first half. We are looking to continue on that momentum in the second half and we want to ensure that the balance businesses are value creating for Aditya Birla Financial Services. With that opening, I will hand over to Ashish.

Ashish Dikshit: Thanks Ajay. Second quarter has been extremely good quarter for apparel business. Madura has grown by 30% in this quarter and taking it first half growth to more than 25%. You are all aware of the overall economic situation which on consumer side has been flat on overall terms. So it must be seen in context with that. To further validate our overall strategy of distribution expansion, having a multichannel strategy is actually helping us grow. Our brands have grown consistently. I think all four key brands have grown about 24% in the first half. Across channels, the growth has been again fairly steady. Retail channel has grown by about 27%. Wholesale has grown by

39%. Retail channel growth, I must point out, has come despite somewhat slower like-to-like growth of 7% this quarter compared to double digit growth last quarter.

Overall, I think the market continues to remain quite tough. The organic growth that we have seen in the market have not really improved and it got further validated during the Diwali period the markets have been rather subdued. But I think with our strategy, we are utilizing all the levers of growth and actually delivering healthy topline growth. The same has resulted into leveraging the scale and therefore our EBITDA margin has expanded to 14% in Q2 with growth of 82% over last year. While some of it has come through margin expansion, significant part of it is primarily coming from the revenue growth and operating leverage that we have built in this business.

Our focus on managing capital continues to remain strong. Working capital management and franchisee model led growth has resulted in actually reduction in the capital employed and resultantly return on capital employed is 82% for the quarter and about 47% for the first half. We have added 174 new stores in the first half, 89 of which has come in this quarter. About ₹ 40 Crore has been spent as total CAPEX for the business. So that is the summary. Any other questions that you may have, we can take them now.

Moderator: Thank you. Ladies and gentlemen we will now begin with the question and answer session. We have the first question from the line of Suresh Mahadevan from UBS. Please go ahead.

Suresh Mahadevan: I had couple of questions. One is I wanted to get a quick update on the banking license particularly ABNL's structure and would also like to get an update on the various value creation initiatives if any. So that is one. The second question actually revolves around your fashion and lifestyle business. It seems to me that the Indian economy is not doing too well, but you have posted a stellar performance in the fashion and lifestyle business. So just wanted to understand some of the drivers, I understand there are some new stores we have added, but just wanted to get your color on that and related to that how is the integration of Pantaloons going with ABNL? Thank you.

Sushil Agarwal: So Ajay will also add while I will quickly answer to the part question of Suresh. On question relating to banking license, at this stage when the evaluation process is currently going on, I do not think I can add more than that at this stage. So as far as structure is concerned, as you may recall that Aditya Birla Nuvo has a 100% subsidiary company called Aditya Birla Financial Services or ABFS. All our investments in financial services businesses are under that company which is in accordance with the new banking license guidelines, as per which, Promoter Company needs to have a 100% non-operating holding company which is ABFS. At this stage all financial services investments other than Life Insurance company, which is still directly held through Nuvo, all other investments are now part of ABFS. That is on the structure and update on banking license unless Ajay want to add something more.

Ajay Srinivasan: No, I think that answers Suresh's question.

Sushil Agarwal: And Ashish can you give update on Suresh's other question on fashion and lifestyle.

Ashish Dikshit: As I mentioned in the opening remarks, the largest piece of our profitability improvement is coming from the revenue growth. I agree with the view that the organic sales demonstrate relative stagnation in the economy and in the consumer sentiments, but what actually driving our growth is beyond that. Basically deepening our distribution reach, as you know premium branded apparel industry still is fairly under penetrated. There is a lot of headway. Hence we are continuously expanding and those are the levers which are actually generating operating leverage and attributing largest to both revenue and profitability growth at this point of time.

Suresh Mahadevan: How is the integration of Pantaloons progressing?

Shital Mehta: Suresh, Shital here. So on integration front, I think couple of things which we have started working on is exploiting the synergy benefits with Madura - starting from hiring some of the key talents from Madura which has got on-board of the Pantaloons. Besides both Madura and Pantaloons have started working extensively together as far as real estate acquisition is concerned to strengthen the pipeline of new stores. Third piece which we are working very closely is the product sourcing particularly from the Spring/Summer 2014 and onwards. So there is lot of work happening on improving our sourcing and working together on that front. Last being the introduction of Madura brands in the Pantaloons this festive season onwards in September onwards, we have started and initiated that through test market on a selective basis for select brands in select stores and initial results are quite heartening and therefore we should be able to expand that further as we go forward. So these are the initiatives within last 3-4 months which we started working on and which should start showing results as we go forward.

Suresh Mahadevan: Yes one final follow up. I think last quarter you probably mentioned that Pantaloons may be EBITDA breakeven. How is it doing now given your stellar performance in Madura, I would have assumed that it would have improved in Pantaloons as well?

Shital Mehta: Pantaloons as far as the quarter two is concerned, we have broken even. We have posted a positive EBITDA in Q2 and we expect that we should be able to close the year as well into the positive territory. That said given that we are still into the process of rebuilding the organization and the business, as far as full year is concerned, we should be at the lower end of the industry average EBITDA margin and as we go forward, we should be able to improve on that next year.

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

Abhishek Ranganathan: A question on the lifestyle business. One is if we look at the CAPEX in Madura, it is about ₹ 43 crore if you have done. It includes a significant amount of work in progress or it also includes the CAPEX for collective which we would have done in the first half?

Ashish Dikshit: Collective clearly is included and work in progress is not a significant part of it. This is CAPEX which related to the stores that either are open or pretty much close to opening.

Abhishek Ranganathan: Because our quarterly run rate is actually on a lower side if you look at historically, we would do may be typically in the range of about ₹ 10-15 crore. So this quarter we would have done about ₹ 28 crores -from what I understand. So therefore I am asking is it slightly on higher side in Q2.

Ashish Dikshit: I think it is just as a seasonality of business built in towards the festival so store opening makes lot of sense to actually open store around this time, not only our own store but even franchisees. So to that extent, both the store opening as well as the capital expenditure turns out to be somewhat higher in Q2 than in Q1.

Abhishek Ranganathan: Sure sir and in terms of our volume and realization for Madura, how are we fared there?

Ashish Dikshit: If you look at our growth is about 30% in Q2, about 5%-6% has come through pricing and close to 23%-24% has come through volume.

Abhishek Ranganathan: And if we were to look at like-to-like, it would be largely pricing then in that case?

Ashish Dikshit: I would not be able to break it, but I do not think the entire 7% would be pricing. I think the pricing would be about 3%-4% and probably 3%-4% would be volumes.

Abhishek Ranganathan: Sir on gross margin performance for Madura and Pantaloons, how have we fared. Where we are and where we can be?

Ashish Dikshit: So I will respond on Madura and then Shital can respond on Pantaloons. Clearly one thing that we are achieving in each of our brand is expansion of margins, enrichment of product profile and that is something what is working at percentage level. We are improving our gross margins and which is then obviously multiplying and significantly adding up to the profit improvement in the business. So it goes through pricing levers as well as product mix and finally through the control of discounting and other things which otherwise erode the margins.

Abhishek Ranganathan: You mentioned in response to earlier question that there is under penetration of the premium apparel segment. Have the premium brands grown faster this quarter because last quarter I believe Allen Solly was the fastest growing.

Ashish Dikshit: Allen Solly is pretty much a premium brand. This year democratic nature of growth can be demonstrated by the fact that in H1, we have grown 27% as a business and all the brands of ours have grown in excess of 24%. So it is pretty consistent across the portfolio brands.

Abhishek Ranganathan: And on Pantaloons, we have seen a jump in the employee cost and rent both in this quarter. What would be the particular reason for that?

Shital Mehta: As far as the overheads are concerned, as you would know, we have recruited fairly large number of people. As we recruit people, you would see that this year overhead cost would be on a higher side as far as the previous year is concerned, but it will be still fairly in line with what the industry benchmarks are. As far as the store costs are concerned, particularly the rentals as well as some of the other store costs that have also gone up. As far as rental is concerned, there are more than average number of stores which have fallen into the escalation this year and the minimum wages in couple of regions have also shot up leading to the personal cost going up in some of the stores.

Abhishek Ranganathan: Sir in terms of hiring manpower, have we more or less reached at our requisite levels or we still have some more additions apart from store additions?

Shital Mehta: No, I think I would say that we are just about towards the close as far as our organization building phase is concerned. That is what has happened in the last 6 months and more than 90% of the people are on-board. So it has got very much factored in now.

Abhishek Ranganathan: And sir lastly there is a difference in the sales reported in the BSE filing and the presentation for Pantaloons. If you could help us to reconcile with that sir?

Management: Abhishek, answering to your question we do not find any difference between the BSE filing and presentation. So we will check offline with you where did you get the difference.

Moderator: Thank you. The next question is from the line of Manit Varaiya from Vallum Capital. Please go ahead.

Manit Varaiya: Sir I have two questions. First related to the NBFC. Sir we have seen a flat loan book quarter-on-quarter. So just wanted to know what is the target which we have in mind in terms of book size which we want to reach and how are we going to achieve that?

Ajay Srinivasan: We do not have a target as such for NBFC loan book on a quarter-to-quarter basis. Our approach is, as I said earlier, we want to make sure we optimize the risk return parameters. We are already 1.5 months into running quarter, and we are seeing growth in the book.

Manit Varaiya: Sure, but we have also seen the leverage coming down. So like what would be the optimum leverage which you would be comfortable at?

Ajay Srinivasan: I think we mentioned last time, we are comfortable with leverage between 5.5 – 6 times.

Manit Varaiya: So sir, then in what way would the ROE increase. Because right now we are at around 13.5%-13.7% ROEs and our NIIs are also at 5%. So how the ROE will increase further because our cost is also almost rationalized. So just wanted to understand how would the ROE come up for this business?

Ajay Srinivasan: We will obviously get the scale benefit, and let me ask Rakesh to add his views.

Rakesh Singh: Primarily with the scale benefits kicking in, we should be looking at ROEs of around 15% in the next 2 years' time. We have demonstrated that in past 2 years and as we grow the business and the scale benefit comes in at 5.5 -6x leverage, I think we should be hitting around 15% ROE.

Manit Varaiya: And sir currently what would be your average cost of debt?

Rakesh Singh: Our average cost of debt should be around 10.5% p.a. at this point in time.

Manit Varaiya: Sir my second question is related to the IT business. Now considering that amount of capital employed in the IT business is around ₹ 1,900 odd crore. So just wanted to understand what the plans are for this IT business and any kind of value unlocking can happen in this business. We have been hearing since quite a long time that value unlocking can happen in this business. So just wanted to know your comments on that?

Sushil Agarwal: As we have been mentioning that in this part of business, we are not investing anymore and business operationally has been getting better and better. There has been a free cash flow from this business. Although from strategic point of view as we are not investing, we are constantly kind of exploring possibilities of strategic actions that can be taken on this part of business and as and when we have any concrete action, we will come back to you on this.

Moderator: The next question is from the line of Reena Verma from Merrill Lynch. Please go ahead.

Reena Verma: Just two small questions from me. Firstly Ajay can you please share with us your outlook on the life insurance market and also you mentioned that you have started to see growth recovery in the NBFC book. If you could just add some color there in terms of which of the segments are perhaps likely to sustain this growth that would be very useful and my second question was to Mr. Agarwal on the overall margin drivers for the second half for the next 3-4 quarters. I think perhaps in second half typically for last 2 years, ABNL tend to see margin compression in H2 relative to H1. Are there any drivers in place to reverse the trend or you think that is the nature of the Company? Thank you.

Ajay Srinivasan: So Reena on the outlook for life insurance, I think as you are aware we have a completely new range of products that has been launched from October. So we are in the process of putting them into the markets, which is why I said that embedding those products in the market is our first priority. My sense is that it is difficult to call growth at this time given it is going to be a completely new range of products and whole host of training needs to be given. So we do not expect growth for this business for the next 6 months. Your second question was on the NBFC book. We have 4 segments in the NBFC book. We have security based lending portfolio, corporate finance portfolio, property based lending portfolio, and infrastructure finance portfolio. I think other than the security based lending portfolio which is to some extent dependent on markets, all the other three segments should continue to see growth in this quarter.

Reena Verma: Including the Infra book?

Ajay Srinivasan: Yes.

Reena Verma: And may I just ask you, so on the life insurance side since new product introduction seems to be the focus for now. Does it mean that whatever you are reporting in terms of profit metrics, these are the new base metrics for evaluating performance going forward, the 2Q metric?

Mayank Bathwal: Reena, Mayank here. I think that you will start seeing from Q3 more than Q2 because Q2 still had most of our existing products being available for sale. From your perspective if you want to really see the profit signature coming in from the new set of products, I would suggest track Q3 more closely.

Reena Verma: Mayank I am sorry, perhaps I am a bit slow to get this, but the drop in PBT that you reported, is there likely to be a further pressure there because this new product introduction?

Mayank Bathwal: So let me explain the drop in PBT in Q2. So there were a couple of extraordinary items, which we did expect and they were in line. So we had about ₹ 20-22 crore of one-time reserving impact. Our traditional book is building. So that was more of a one-time. I do not expect that to happen every quarter. About ₹ 10-12 crore of difference vis-a-vis previous quarter was due to change in product mix, some of our ULIP products, some very successful ULIP products were closing from October onwards. So we did see an uptick in the ULIP mix in Q2 and ULIPs typically have a slightly higher strain than the traditional products. Again with more traditional sales happening from Q3, I expect that not to be as high as we saw in Q2 and hence some positive strain coming in from Q3 on that front. The one that we did expect to happen was the fact that with ULIP structure changing, the charge structure changing, the in-force book could not really grow as we typically knew it would because of the fact that new business growth has been under pressure for the last couple of years. So there the reduction in in-force profit was in line with what we had expected when we started the year and which will continue for some time till we start seeing growth coming back. So that was rationale for why our profits fell in Q2. So going forward, I do not expect the new products to have a very different strain than our existing product. I am saying same category to category. Our new traditional products will have similar profit signature in the year one as our existing ones have and with ULIP mix falling, I do expect overall strain to be a little lower than what we had so far. Does that answer your question, slightly longish, but just to give you a full context.

Sushil Agarwal: Reena to answer on second question on H2 margin being lower than H1, if you recall that the trading of imported fertilisers, which was seasonally higher in second half, used to have an impact on margins and that was one issue which we addressed by discontinuing the same. Rest if you see, Mayank has already explained on life insurance and Ajay talked about NBFC and rather in second half in fashion and lifestyle business because of festive season, we should see a better second half and on agri also, volume should be better in second half. Telecom should continue to do better.

Reena Verma: Right. So basically the coming second half is unlikely to have that old margin pattern.

Sushil Agarwal: Yes, I would think so.

Reena Verma: And in terms of topline, I Know Ashish referred to the fact that markets are tough, but are there any particular businesses that you are worried about relative to what we have seen in the first half?

Sushil Agarwal: Not really Reena. I think we have to be in sync with what is happening in the economy. So I think that we have to respect.

Moderator: Thank you. The next question is a follow up from the line of Abhishek Ranganathan from Phillip Capital. Please go ahead.

Abhishek Ranganathan: I have couple of follow up questions. One is on the like-to-like store growth of the Pantaloons is still low at 3% and if you look at our industry peers, they have actually delivered double digit like-to-like growth. This is I think second consecutive quarter where we are lagging behind significantly. What would be the efforts which we are going to take or which we are already put in to catch up?

Shital Mehta: Abhishek first on the like-to-like, I think one of the key reasons why our like-to-like is low is essentially the merchandise and product availability and the portfolio optimization. So once we took over in the month of April, we have started working on that, but as you would know in this apparel category, whatever you do it takes almost 12 months before results start coming in. So essentially our efforts have been put in and are happy to inform that it is absolutely on track, but that effort will see results only starting Spring-Summer ‘14. What we are seeing currently is the Autumn-Winter ‘13 which is the work which was done almost a year back and that is an area which we continue to face challenges and that is one of the most fundamental reasons why we are seeing what we are seeing in terms of like-to-like growth.

Abhishek Ranganathan: Sure sir and lastly on the working capital, we have seen that how Madura has attained its working capital levels. One is we are near optimum levels of capital employed and working capital in Madura and second is with respect to Pantaloons, where do we see ourselves let us say once a new system comes in and Spring-Summer inventory comes in, would we be in a similar position as Madura with regards to working capital?

Shital Mehta: With respect to working capital I do not think we are off the mark as of now. Our current working capital broadly is in line with what the industry standards are and having said that in terms of overall working capital as a percentage of sales it is little less than 10%. So having said that, I am sure as we go forward, things would improve, but per se on inventory perspective in terms of number of days, we are at 4 months of inventory. So that is not really too much off the mark.

Abhishek Ranganathan: I understand, could we really squeeze up in turn because considering that we are not getting a like-to-like turnover and considering that we are also not getting the optimum sales per square foot because of the inventory constraint which we have. Intuitively speaking, our working capital turn should actually improve significantly come next year.

Shital Mehta: That is true. To that extent, NWC as a percentage of sales will for sure improve as our sales improve, but what would also happen is that currently we are having the issue of inventory not being available as well. As we put the right inventory, even inventory level would go up to some extent, but overall on a turn basis, there should be an improvement as we go forward.

Moderator: Thank you. The next question is from the line of Varun Ahuja from UBS. Please go ahead.

Varun Ahuja: I have got couple of questions. First one is more of clarification sir. If I recollect correctly that you mentioned that your net debt to EBITDA would not reduce from here. So it is more because of your further increase in working capital in agri business and more investments in H2. Second question is on the ITeS business, it seems there is a very strong dollar revenue growth 13% YoY, any specific color on that and lastly sir I would like to know the CAPEX how much we have achieved as of the total plan? Thank you.

Sushil Agarwal: Regarding first question, I was saying we got promoter infusion of ₹ 671 crore in second half which is in the month of November and we do have some investment happening in NBFC business depending on what kind of book growth the NBFC business will achieve, but currently based on the original plan, we should have another ₹ 175-200 crore investment in NBFC in

H2 and there is a balance CAPEX which will be incurred in H2 and I did mention that in second half, we expect some kind of an increase in subsidy level which might push up the working capital levels. These would be met sufficiently out of the promoter infusion and cash flow from operations. So broadly I do not see too much of a change at a debt level which is currently around ₹ 3,000 Crore depending on what actually would be actual subsidy outstanding and investment in NBFC business. Second question regarding IT-ITeS business, the 23% growth in revenue is broadly on two accounts. About half of the growth is on account of the rupee depreciation and half is on account of increase in business from existing and new customers. So the constant currency growth of 13% is largely due to business growth.

Moderator: Thank you. As there are no further questions, I would like to hand the floor back to the management for closing comments. Please go ahead.

Sushil Agarwal: Thanks for joining the Earnings Call. Thank you so much.

Moderator: Thank you. Ladies and gentlemen on behalf of Aditya Birla Nuvo, that concludes this conference call. In case of any further query, you may please get in touch with Mr. Romi Talwar, Investor Relations, Aditya Birla Nuvo or Mr. Saket Sah, Investor Relations, Aditya Birla Group. Thank you for joining us and you may now disconnect your lines.