Aditya Birla Nuvo Ltd.

Transcript of Q2FY15 earnings call held on 12th November 2014

Management Team:

- Sushil Agarwal – Whole time Director & CFO, ABNL
- Ajay Srinivasan, CEO, Aditya Birla Financial Services
- Senior Management Team, Aditya Birla Financial Services
- Ashish Dikshit, CEO, Madura Fashion & Lifestyle
- Senior Management Team, Madura and Pantaloons

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Moderator: Ladies and gentlemen, good day and welcome to the Q2FY15 earnings conference call of Aditya Birla Nuvo. The call will begin with a brief overview of earnings by the management followed by a question-answer session. We have with us 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 team on behalf of all the participants for taking valuable time to be with us. Participants are requested to focus on the key strategic questions to make sure that we make good use of the senior management's time. I must remind you that the discussion on today's earnings call may include certain forward-looking statements and must be viewed therefore in conjunction with the risks that the company may face. I now hand the conference over to Mr. Sushil Agarwal. Thank you and over to you sir.

Sushil Agarwal: Good evening and welcome to the earnings call of Aditya Birla Nuvo. With me, I have Mr. Ajay Srinivasan – CEO of Aditya Birla Financial Services along with the senior management of Financial Services Business. We also have Ashish Dikshit – CEO of Madura Fashion & Lifestyle Business along with the senior management of Madura and Pantaloons. I will briefly take you through the key highlights of the company for the current quarter, then I will request Ajay and Ashish to talk about financial services and fashion business.

Consolidated revenue of the company on a like-to-like basis excluding IT-ITES business grew year-on-year by 15%, EBITDA is up by 34% and net profit surged by 75%. Earnings from all the business segments have improved year-on-year. Aditya Birla Financial Services gained market share across most of its businesses. Our total funds under management have grown year-on-year by 28% within which equity assets have surged by 54%. Lending book growth continues to be robust and of good quality. We have started operations in the housing finance business. We are expanding our coverage with planned entry into health insurance as the tenth line of business. ABFS is operating at a ROCE of 24% per annum.

Fashion and Lifestyle business continued to expand its customer reach, further strengthening its leadership position. It has registered healthy revenue growth and achieved margin expansion across all the three formats i.e. Madura, Pantaloons, and Jaya Shree. Driven by growth and efficient working capital management, combined ROCE has enhanced year-on-year from 22% to 33% per annum.

Idea continues to outperform industry and gain revenue market share. Strong earnings growth continued, leading to ROCE improvement even on the expanded capital employed. Given the growing cash profit from operations and recent equity infusion, Idea has a strong balance sheet and it is well positioned to support its future growth plans.

Our Manufacturing business posted 30% rise in EBITDA. Agri and Insulator business returned to normalcy, post planned shutdown in the previous quarter and contributed to the earnings growth. In the Rayon business, VFY segment attained its highest ever profitability led by the new Superfine Yarn unit, however, offset by lower ECU realization in the Chemicals segment.

The Company's balance sheet remains strong with the realization of subsidy in Agri business coupled with cash flow from operations, standalone net debt to annualized EBITDA has improved to 1.9 times. During the first half, net debt reduced from ₹ 3,200 Crore to ₹ 2,450 Crore. While working capital is likely to increase in the second half due to accumulation of subsidy in the Agri business, Net debt-to-EBITDA is expected to remain at comfortable level.

With this, I hand over the call to Ajay with a request to hand over the same to Ashish thereafter. Thank you, over to you Ajay.

Ajay Srinivasan: Thanks Sushil and good evening to everyone. I am joined on this call by senior colleagues of from our various Financial Services businesses. I think Sushil has already covered some of the highlights of the Financial Services businesses, but I just had a few points to add and then we are happy to take questions.

I would first say that overall we had a very good quarter. The quarter ended with profitable growth across all our businesses. We saw a strong growth in revenues, in profits, in assets under management, and in our lending books. We gained market share in several of our businesses which is really what we were aiming to do. We entered the Housing Finance business and we have signed an MoU to enter health insurance. I think this pretty much completes our product offering outside of banking and gives us really a broad based range of products and services to the customers we are targeting.

So ABFS today is well diversified and material play in the non-banking financial services space with a broad based product offering and integrated operating model. And has a significant position in each of the businesses in which we operate. I think Financial Services is ultimately a play on economic growth and as the economy picks up, we expect to participate in the growth that financial services as a sector will undoubtedly see. With that, I will hand over to Ashish.

Ashish Dikshit: Thanks Ajay. Good evening everyone. Overall, quarter 2 and H1 of this year has been fairly good for Madura as you can see from the results. We have grown by about 25% this quarter in terms of revenue, our EBITDA has improved by about 37% and EBIT by 51%. This growth and profitability has come amidst slightly challenging circumstances as the overall intensity of competition has significantly increased primarily driven by hyperactivity in the e-commerce space and subsequently followed by department stores and other large players in the market. As a strategy, we have continued to stay focused on what our strength is, which is substantially investing in our brands, continued investments in our products & distribution, and that has really led to profitable growth that the company has seen over this quarter and much of H1. Overall conditions have been fairly stable while it has turned from somewhat negative situation in last year towards the end, to slightly positive scenario, but it has still not seen the kind of optimism that was expressed in the beginning of the year.

In terms of Pantaloons performance, it has been a continued journey of turnaround and improved performance. For both the quarters, the business has grown at about 13%. Pantaloons has also shown very healthy like to like growth of close to 9% in quarter 2 as well as in H1 and profitability has improved from practically nothing in the second quarter last year to ₹ 31 Crore at about 6% EBITDA margin.

So overall, it has been a good performance by both the business in Apparel and Lifestyle. As I said, the conditions continue to remain challenging from competitive intensity point of view, but our businesses are both focused on not just driving growth but enhancing profitability and that is what we have done in this part of the year. Back to you Sushil.

Sushil Agarwal: Thanks Ashish. We are open to question and answers session now.

Moderator: Thank you very much sir. Participants, we will now begin with the question and answer session. We have the first question from the line of Sumit Choudhary from Standard Chartered. Please go ahead.

Sumit Choudhary: Just a couple of questions. One on the CAPEX, I think you have mentioned in your presentation that you are planning to spend around ₹ 400 Crore in the year. If you could split out which segments of the business would you be spending the CAPEX on and second, if you could talk about your net debt situation because we have seen the net debt reduced, but as you said, you are expecting the working capital situation to deteriorate as you enter into the end of year on the Agri side. So if you could talk about what is your thought on what could be the net debt position by the end of this year?

Sushil Agarwal: On the CAPEX side, it is actually CAPEX across all the businesses which include Jaya Shree, Agri, Madura, Rayon and Insulators. The larger amount is in Madura as we have been expanding our EBOs and in Jaya Shree where we are expanding linen yarn capacity. In manufacturing businesses, it is primarily maintenance capex. And regarding second question of subsidy, in last couple of years if you see the trend, first half has always seen reduction in net debt on account of realisation of subsidies. Then it starts accumulating till the March end and March generally has been the peak. Last year, it was around ₹ 1,180 Crore, prior to that it was even higher and this year again we expect the trend to continue. It depends on government's own balance sheet and in my view based on past few years' trend, from current levels, there should be an increase of atleast ₹ 400-500 Crore. That is the kind of increase we should assume at least in the Agri business.

Sumit Choudhary: Okay, so I guess the net debt should go back to ₹ 3,000 Crore odd.

Sushil Agarwal: Plus there will be capex and investment requirements for the next half which will be partly met by cash flow from operations.

Sumit Choudhary: Okay and just a question to Ashish on the retail side, I guess we have heard a few of your competitors talk about a very soft festive season this year in branded apparels. It seems that they are not expecting any bounce back even in November and December. So I was wondering if you could share your thoughts on what you have seen in your brands and second, if you could also talk about like what has the like-to-like sales growth been in the last quarter for Madura?

Ashish Dikshit: Okay, so I guess both questions are very intimately related. As I had mentioned in my overview, fundamentally, we have seen relatively lesser economic upturn than what we had anticipated in beginning of the year. Most players and industry as a whole was looking forward to a much quicker rebound in the economy than what has been the case. That is specifically as far as last two quarters are concerned. I think our average like-to-like for the half year is about 3%, it was about 5-6% in full price seasons and about -1%,

-2% or flat during the end of season sales period, some of which is a reflection of how the conditions in the market are and reflects the overall economy. Some of it is also an outcome of the choice that we have made in the extent of discounting and promotion warfare that the industry went through. To that extent, we are reasonably healthy from profitability point of view, but it impacted like-to-like sales growth which on half yearly basis, is about 3%. Coming to festive performance which is closer to Diwali in October, November and December, I think our own sense and experience so far is that quarter 3 is perhaps going to be even tougher, primarily driven by as I said a very large set of promotions, offers and stuff largely led by e-commerce players but to some extent also countered by large department stores. Our own view has been so far to stay away from that game to the extent that we can and we should. We will perhaps go along and watch what the impact of it on overall industry is, and then take a call whether we need to more aggressively participate in it. As of now, I anticipate Q3 to be a more challenging quarter.

Sumit Chaudhary: Interesting and just on the e-commerce, if you could just talk about your relationship with these online players. Do you use them as another wholesale channel for you or like in which case and are you agnostic or how does your relationship work with e-commerce channel?

Ashish Dikshit: See, we have relationship with all the key e-commerce players, but we have actively chosen at this point of time to remain pretty small in terms of the size of the business that we aspire to do with them. It is easy to scale business but as you have seen what is the cost of that growth and its consequent impact on rest of the channels and overall stability in the market, which is something that we are concerned about. As the leaders in the industry, we also believe that lot of our actions will perhaps determine how many other players in the industry play this game out. So I would say that the relationship exists, it is cordial, but it is minimal at this point of time. We will have to watch and see how they grow their business and what is the level of stability that they bring to their business model before we look to expand it.

Sumit Chaudhary: Okay, and just lastly I guess on the insurance side if you could talk about what kind of NBAP margins you are seeing and what kind of outlook do you see there?

Amit Jain: NBAP margins continue to be in the range of 14-15% and the outlook continues to be same. We do not feel that it is going to significantly change given the product mix and the outlook on the product mix.

Moderator: Thank you. We have the next question from the line of Saumil Jhaveri from DMZ Partners. Please go ahead.

Saumil Jhaveri: I had two questions on the Pantaloons business. The first one is that this has been the second quarter with our group merchandise in the stores and I want to get a more qualitative update on how you see traction playing out on that front and combined with that, what kind of apparel growth rate would be for this quarter, the first half. And the second one is a little bit more big picture qualitative and that is as we continue to strengthen this business, how do we see a sort of competitive edge or a moat being developed around this franchise which differentiates our relative positioning and offering.

S. Visvanathan: This is Visvanathan here. See this is the first time, after last year we have introduced our private labels in the system with our own merchandise and with our own design. There has been good response as we continue from the like-to-like growth that has happened in this quarter and our focus is to continue to strengthen this private label brands and going forward, keep increasing it as a total proportion without impacting the assortment and offering in the stores thereby improving the profitability for this. We have seen good response to the new merchandise that has hit the stores. Obviously, we are learning from some of the feedbacks that we have got and going forward in the next season, there will be further improvements, and we expect this to continue to generate additional profits for us in terms of margins.

Saumil Jhaveri: Kind of just broader picture, wanted to get a sense on how we are developing a edge or a moat around our franchise which differentiates what we do from what our peers do or what the value proposition elsewhere.

S. Visvanathan: I think we will get back to you on what is happening on this.

Moderator: Thank you. We have the next question from the line of Pritesh Chheda from Emkay Global. Please go ahead.

Pritesh Chheda: Sir, just want to understand what kind of distribution expansion have we planned in the branded apparels and accessories business in the current year and the next year and how much of the growth that we have generated in the first half is the function of the distribution expansion?

Ashish Dikshit: Quick response on the second one that is the simpler one. See, a larger part of our growth has come from our organic growth across the channels. In terms of absolute distribution expansion, we have added net of 90 stores that you see in terms of net increase of stores from March end to September end. On a base of about 1600 stores, you can understand that the impact of the new store opening is now beginning to be a smaller share of our business and therefore a larger part of the growth has come from growing the channels and increasing the revenues.

Pritesh Chheda: Okay and so which means if we have grown about 25%, let us believe that about half of it is on account of store expansion or store addition in the first half.

Ashish Dikshit: No, not really. If you look at our net store addition is 90 stores on a base of 1600 stores. And therefore to that extent, it is a very minimal growth that is coming from expansion. In fact the largest part of our growth is coming from our wholesale channel, which has grown around 30% in H1. Our retail channel has grown cumulatively by about 18%. Of retail which is about 41% of our business in H1, the stores that existed at the beginning of this year have contributed incrementally to about 15% out of that 18% growth and about 3% of that incremental growth is from the stores added this year.

Pritesh Chheda: And if you could give your channel mix, how much would be wholesale distributor driven, how much should be EBOs?

Ashish Dikshit: Our exclusive retail is about 41% of sales in H1 and wholesale is 43%

Pritesh Chheda: Exclusive retail means EBOs?

Ashish Dikshit: Yes, these are consignment stores which are EBOs. And our wholesale is about 43% in which MBOs is around 26% and department store is close to 17%. We have about 8-10% which comes from depletion channel sales which is factory outlets and other value stores that we use to liquidate our depletion merchandise and there is a small share which comes from exports to Middle East.

Pritesh Chheda: So you do not have a distributor driven number?

Ashish Dikshit No.

Pritesh Chheda: So all of it is direct supply and there is no distributor in between.

Ashish Dikshit: Yes. So only one of our brands which is Peter England has a distributor model and that effectively has about less than half of its sale coming from the distribution channel. So in totality if you look at company as a whole, distributor is less than 10% of our overall revenue.

Pritesh Chheda: And sale of consignment should only be applicable in EBO and departmental stores?

Ashish Dikshit: Mostly EBO.

Pritesh Chheda: Only EBOs. Okay and what would be your targets for distribution expansion for the next 2 years?

Ashish Dikshit: So we look at close to 200-250 stores on an annual basis which is what we have been doing last couple of years.

Moderator: Thank you. Our next question is from the line of Prashant Tiwari from Athena Investments. Please go ahead.

Prashant Tiwari: I have two questions actually. One is for employee expense going down, where is it happening exactly in which businesses and why and another is one for insurance profit has gone down in the first half. Can you please explain why is that happening?

Sushil Agarwal: So I will pick up the first question and may be Ajay or Amit can pick up the second one. Overall expense reduction by and large is on account of the exit of IT-ITES business. So in previous year or even previous quarter to some extent was reflecting those expenses which is not there in the current quarter. So that broadly talks about the expenses and Amit you want to pick up the other one.

Amit Jain: Yes sure. So the profit in insurance is going down mainly because of two reasons, one the share of the high margin in-force book which we wrote before 2010, that share is reducing and the new book has a lesser margin. And second, the new business growth which has been on the negative side in the last couple of years that is also impacting the profit numbers.

Prashant Tiwari: Why is this there a margin difference in the old book and new book?

Amit Jain: The old book was built with the products which were sold in the earlier regime before September 2010. All the new products which came post September 2010 there margins were lower than the earlier book since IRDA capped the charges.

Prashant Tiwari: Why would the margins for new products would be lower like?

Amit Jain: So regulation has changed in September 2010 and we launched new products.

Prashant Tiwari: So these regulations require higher expense on what side?

Amit Jain: No, so regulations led to complete overhaul of products and capped the charges which insurers can levy in a policy. Maybe in the interest of other callers we can take it offline where I can explain to you how the products structure changed.

Moderator: Thank you. We have the next question from the line of Ritesh Bhagwati from Fortune Interfinance Limited. Please go ahead.

Ritesh Bhagwati: Can I get a sense of revenue breakup between branded apparels versus private labels? That is the first question and second thing is like what kind of percentage are we looking at going forward like is there going to be a shift in the revenues from branded to private labels for the Pantaloons?

S. Visvanathan: Yes, it will continue. The share of private label and in house licensed brands is about 52% approximately in first half. And share of Madura brands is about 9%. Other branded apparel is slightly less. So going forward, I think based on the kind of assortment that we need to have in the stores and kind of service that we want to give, it will be decided based on that but I believe private brand labels would increase a little bit more in the offering.

Ritesh Bhagwati: Okay, so we expect the margins also to improve as and when the composition.

S. Visvanathan: Yes, that has been the trend. When you have to introduce a private label, the margins on it are definitely better than traded brands.

Moderator: Thank you. We have the next followup question from the line of Sumit Chaudhary from Standard Chartered. Please go ahead.

Sumit Chaudhary: Just a couple of questions. In the event FDI and insurance has opened up, what would be the ramifications for your insurance business, would you consider a sale or an IPO or how are you thinking about that event?

Sushil Agarwal: I think on the earlier calls we had mentioned couple of times that Sun Life, our JV partner who owns 26% today, they always have shown interest to increase their ownership as and when the law changes and FDI is allowed up to 49%. And it would be kind of secondary sale as of now because we do not think the operating company per se needs capital and we have a strong solvency already built in there. And the last point is, this ownership transfer will happen at the then prevailing market valuation of the company.

Sumit Chaudhary: Okay, fair enough, alright. And sir if you can comment on whatever news which keep coming up in the media about your retail business, any timelines or any thoughts on when you can give us some more concrete update there?

Sushil Agarwal: So as I had mentioned during the last call that the company keeps on evaluating opportunities across businesses in the ordinary course and it is little bit premature to share any detail on such matters unless there is any material development and obviously will immediately share with you in case there is any material development in this direction.

Moderator: Thank you. Participants that was the last question. I now hand the floor back to Mr. Sushil Agarwal for closing remarks. Thank you and over to you sir.

Sushil Agarwal: Thanks everyone for participation. You can reach Romi and Saket for any further clarification. All the results would be available on the website. Thank you again. Thank you so much for participation.

Moderator: Thank you very much. Ladies and gentleman on behalf of Aditya Birla Nuvo Limited that concludes this conference call. Thank you for joining us. You may now disconnect your lines. Thank you.