28 August 2024

Arvind Fashions

Rating: **Buy**
Target Price (12-mth): Rs.689
Share Price: Rs.535

FY24 annual report analysis; maintaining a Buy

Its FY24 annual report highlighted Arvind Fashions' steps for growth with premiumisation being a core theme across brands. It is focusing on launching high-quality seasonal collections, which lower discounts and aid full-price sell-throughs. Adjacent categories account for >15% revenue of some brands with double-digit growth. It is prioritising expanding its retail footprint with ~150 EBOs added annually and broad base the rollout of innovative retail formats (Club A, Stride). Better stock management and higher retail channel mix reduced gross working capital y/y. The RoCE rose to ~11% (FY23: 10.6%), driven by efficient WC management, better stock control and flexible sourcing methods. Revenue/PAT of the 50% JV PVH Arvind Fashion rose ~22%/36% y/y to Rs12.4bn/1.4bn. We are enthused about the company and expect 12%/22% sales/EBITDA CAGRs over FY24-26. We expect the RoCE to rise to 20.2% by FY26. To reflect the better operations, we raise our target multiple to 13x FY26e EV/EBITDA (from 12x). We retain our Buy recommendation, with a Rs689 TP (earlier Rs632).

PVH Arvind Fashions' profits shoot up. The company's 50% JV with PVH Corp. (incl. the Tommy Hilfiger, Calvin Klein brands) reported 21.6% y/y sales growth in FY24 to Rs12.4bn, led by the focus on premiumisation. EBITDA rose ~35% y/y to Rs2.4bn; the margin, 193bps y/y to 19.1%. PAT grew ~36% y/y to Rs1.4bn. Sales of the 68.8% subsidiary Arvind Youth Brands (incl. Flying Machine) grew ~3% y/y to Rs4.7bn in FY24. EBITDA fell to Rs31m (Rs207m in FY23), the margin to 0.6% (4.5%). Net loss increased to Rs375m (a Rs53m loss). Excl. these subsidiaries, consol. revenue fell 1.7% y/y to Rs25.5bn while EBITDA grew ~19% y/y to Rs2.7bn and the margin expanded to 10.7% (8.8% in FY23).

FY25 focus areas. 1) Product innovation to premiumise brands, investing in ads and re-energising brand salience; 2) focus on expanding the retail network, growing innovative retail formats, digitalisation and growth in adjacent categories; 3) focus on profitable growth through full-price sales, higher comparable growth, lower discounts, operating leverage and cost-optimisation. The company aims to be debt-free in the medium term, led by surplus cash generation from operational efficiencies.

Valuation. We retain our Buy, with a 12-mth Rs689 TP, 13x FY26e EV/EBITDA.
Risks: Keener competition; less consumption.

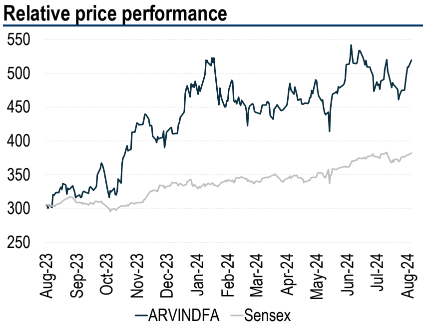
Key financials (YE Mar)	FY22	FY23	FY24	FY25e	FY26e
Sales (Rs m)	30,560	40,695	42,591	46,883	53,212
Net profit (Rs m)	(2,674)	367	806	1,472	2,344
EPS (Rs)	(20.2)	2.8	6.1	11.1	17.7
P/E (x)	NA	100.8	74.3	48.1	30.2
EV / EBITDA (x)	25.6	11.3	13.7	12.9	10.3
P/BV (x)	5.0	4.1	6.0	5.8	4.6
RoE (%)	*(14.4)*	*11.2*	*9.3*	*16.7*	*20.5*
RoCE (%)	*(3.5)*	*10.6*	*10.9*	*16.0*	*20.2*
Dividend yield (%)	-	*0.2*	*0.2*	-	-
Net debt / equity (x)	0.5	0.4	0.3	0.2	0.0

Source: Company, Anand Rathi Research

Key data	ARVINDFA IN
52-week high / low	Rs.600 / 299
Sensex / Nifty	81,786 / 25,052
3-m average volume	$4.2m
Market cap	Rs.69bn / $831m
Shares outstanding	133m

Shareholding pattern (%)	Jun'24	Mar'24	Dec'23
Promoters	35.2	36.8	36.8
- of which, Pledged	8.3	*8.0*	*8.0*
Free float	64.8	63.2	63.2
- Foreign institutions	15.6	15.7	16.8
- Domestic institutions	11.9	10.7	8.4
- Public	37.3	36.8	38.1

Relative price performance



Source: Bloomberg

Vaishnavi Mandhaniya
Research Analyst

Shreya Baheti
Research Associate

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
Net revenues	30,560	40,695	42,591	46,883	53,212
Growth (%)	*59.8*	*33.2*	*4.7*	*10.1*	*13.5*
Direct costs	17,098	20,667	20,371	21,941	24,797
SG&A	11,661	15,798	17,115	18,743	20,831
EBITDA	**1,802**	**4,230**	**5,105**	**6,198**	**7,584**
EBITDA margins (%)	*5.9*	*10.4*	*12.0*	*13.2*	*14.3*
Depreciation	2,330	2,031	2,301	2,502	2,708
Other income	669	503	337	341	344
Interest expenses	1,239	1,210	1,442	1,083	918
PBT	(1,099)	1,493	1,700	2,954	4,302
Effective tax rates (%)	*5.3*	*26.8*	*34.9*	*26.3*	*25.0*
+ Associates / (Minorities)	(307)	(503)	(565)	(706)	(882)
Net income	(2,674)	367	806	1,472	2,344
Adj. income	(1,348)	590	501	1,471	2,344
WANS	132	132	132	132	132
FDEPS (Rs)	-20.2	2.8	6.1	11.1	17.7
FDEPS growth (%)	*NM*	*NM*	*119.7*	*82.5*	*59.3*
Gross margins (%)	*44.1*	*49.2*	*52.2*	*53.2*	*53.4*

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
Share capital	530	531	532	532	532
Net worth	7,503	9,096	10,033	12,209	15,436
Debt	5,017	5,977	4,661	3,361	1,361
Minority interest	1,002	1,826	1,891	1,891	1,891
DTL / (Assets) *	452	2,554	2,926	2,926	2,926
Capital employed	**13,973**	**19,453**	**19,511**	**20,388**	**21,614**
Net tangible assets **	5,012	7,131	7,493	7,704	7,708
Net intangible assets	489	406	355	355	355
Goodwill	1,112	1,112	1,112	1,112	1,112
CWIP (tang. & intang.)	-	21	39	39	39
Investments (strategic)					
Investments (financial)					
Current assets (excl. cash)	19,310	20,768	20,192	25,063	27,716
Cash	1,050	2,003	1,680	850	758
Current liabilities	13,000	11,988	11,360	14,735	16,074
Working capital	6,310	8,779	8,832	10,328	11,642
Capital deployed	**13,973**	**19,453**	**19,511**	**20,388**	**21,614**

** includes lease liabilities ** includes RoU*

Fig 3 – Cashflow statement (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
PBT (adj. for int. exp / other inc.)	(1,068)	2,498	3,302	4,037	5,220
+ Non-cash items	1,752	2,063	1,698	2,502	2,708
Oper. prof. before WC	684	4,561	4,999	6,539	7,929
- Incr. / (decr.) in WC	(2,435)	955	31	1,496	1,314
Others incl. taxes	118	433	627	778	1,076
Operating cash-flow	3,001	3,173	4,342	4,266	5,539
- Capex (tang. + intang.)	(166)	360	801	900	900
Free cash-flow	3,167	2,812	3,541	3,366	4,639
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	-	-	626	-	-
+ Equity raised	4,948	54	23	-	-
+ Debt raised	(4,413)	959	(1,316)	(1,300)	(2,000)
- Fin investments	-	-	(4)	-	-
- Misc. (CFI + CFF)	2,878	2,915	1,878	2,896	2,731
Net cashflow	861	954	(323)	(830)	(92)

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

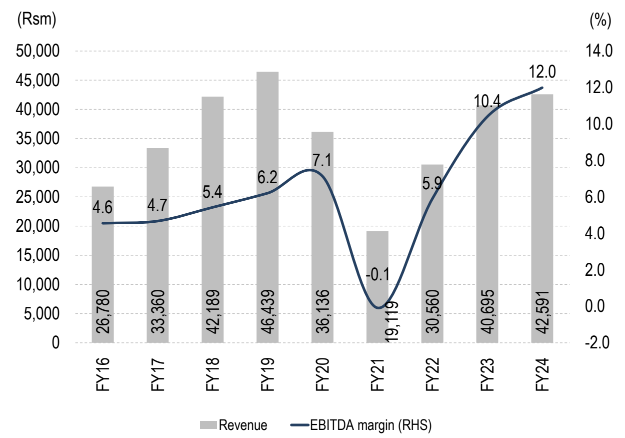
Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
P/E (x)	NA	100.8	74.3	48.1	30.2
EV / EBITDA (x)	25.6	11.3	13.7	12.9	10.3
EV / Sales (x)	1.5	1.2	1.6	1.7	1.5
P/B (x)	5.0	4.1	6.0	5.8	4.6
RoE (%)	(14.4)	*11.2*	*9.3*	*16.7*	*20.5*
RoCE (%) - after tax	(3.5)	*10.6*	*10.9*	*16.0*	*20.2*
RoIC (%) - after tax	(1.6)	*4.6*	*5.3*	*6.9*	*8.7*
DPS (Rs)	-	1.0	1.3	-	-
Dividend yield (%)	-	*0.2*	*0.2*	-	-
Dividend payout (%) - incl. DDT	-	*36.0*	*20.5*	-	-
Net debt / equity (x)	0.5	0.4	0.3	0.2	0.0
Receivables (days)	68	50	55	55	55
Inventory (days)	99	88	78	85	80
Payables (days)	125	91	80	98	94
CFO : PAT %	*(222.7)*	*537.7*	*866.3*	*290.0*	*236.3*

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – ~5%/12% revenue growth/EBITDA margin in FY24



Source: Company

Annual report analysis

Income statement

(FY23/24 figures in the income statement are adjusted for the brands sold/discontinued).

- **Revenue from operations** rose 4.7% y/y to Rs42.6bn, boosted by healthy comparable 4% retail growth and a sharper focus on retail channel execution, leading to a 300bp better retail channel mix. Continued investments in adjacent categories (kids' wear, women's wear) and the online D2C channel contributed to this positive performance.
  - In the year, the company sold its beauty retail brand, Sephora, and discontinued other dormant brands (Ed Hardy, Aeropostale). FY23 figures, thus, are restated to reflect this.
  - Its brand portfolio now includes US Polo, Tommy Hilfiger, Calvin Klein, Arrow and Flying Machine, all categorised as power brands.
- The **gross margin** expanded 296bps y/y to 52.2%, powered by 1) higher retail channel mix which is the highest gross margin channel; 2) lower discounts, more full-price sales; 3) decline in RM prices.
- **Employee expenses** rose 6.6% y/y to Rs2.6bn, kicked up by a ~7% rise in salaries, wages, gratuity, bonus, commission, etc., to Rs2.3bn. Employee expenses were 6.1% of sales (6% in FY23). The number of employees rose by 375 y/y to 6,445 (temporary employees rising 823 y/y to 5,201; permanent employees, though, falling 448 y/y to 1,244).
- **Other expenses** grew ~9% y/y to Rs14.5bn (34.1% of sales, 32.8% in FY23). Other major expenses include -
  - Commission & brokerage up ~10% y/y to Rs5.6bn (13.2% of sales, 12.6% in FY23).
  - Contract labour charges rose ~19% y/y to ~Rs2bn (4.7% of sales; 4.1% in FY23).
  - Advertising and publicity grew 38.5% y/y to Rs1.7bn (4% of sales; 3% in FY23).
  - Royalty on sales dipped 1% y/y to Rs1.8bn (4.2% of sales, 4.4% in FY23). FY23 royalty on sales included Rs79.3m of termination fees for one of the discontinued brands.

Fig 7 – Other expenses

Major other expenses	Rs m		Growth	As % of sales		Growth
	FY23	FY24	Y/Y, %	FY23	FY24	y/y, bps
Rent expenses	131	117	-10.7	0.3	0.3	-5
Commission & brokerage	5,111	5,612	9.8	12.6	13.2	62
Repairs and maintenance	324	359	10.8	0.8	0.8	5
Royalty on sales*	1,806	1,787	-1.1	4.4	4.2	-24
Freight, insurance & clearing charge	770	899	16.8	1.9	2.1	22
Legal & professional charges	352	320	-9.1	0.9	0.8	-11
Computer expenses	165	183	10.9	0.4	0.4	2
Conveyance & travelling expense	292	269	-7.9	0.7	0.6	-9
Advertisement and publicity	1,237	1,712	38.4	3.0	4.0	98
Contract labour charges	1,671	1,996	19.4	4.1	4.7	58
Warehouse charges	282	357	26.6	0.7	0.8	15

Source: Company

- **EBITDA** grew 20.7% y/y to Rs5.1bn, led by sourcing efficiency, more full-price sales, lower discounts and a favourable channel mix. The EBITDA margin rose to 12% (10.4% in FY23). This expansion was due to the higher gross margin and operational cost efficiencies. The cost-control steps included efficient management of fixed expenses, optimising store operating costs, shutting down unprofitable stores and controlling overheads to drive efficiencies.
- **Depreciation and amortisation** rose ~13% y/y to Rs2.3bn, led by ~25% y/y rise in depreciation on right-to-use assets of Rs1.7bn. Excl. depreciation on RoU, depreciation and amortisation fell ~13% y/y to Rs553m. The depreciation rate (excl. depreciation on RoU) was 9.6% (11.2% in FY23). The depreciation rate on RoU was 28.4% (28%).
- **Finance cost** grew ~19% y/y to Rs1.4bn, led by ~35%/31% y/y rises in interest expenses on lease liabilities/others to Rs639m/410m. Finance cost, excl. interest on lease liabilities, grew ~9% y/y to Rs803m. Interest expense on loans fell ~30% y/y to Rs154m**.** The implied interest rate (interest on loans + others)/avg. borrowings were 10.6% (9.7% in FY23). The interest rate on lease liabilities was 9.5% (8.4%).
- **Other income** fell 33% y/y to Rs337m on the ~42% y/y fall in gains on lease re-assessments to Rs76m, ~63% y/y decrease to Rs34m in provisions no longer required and the ~26% y/y drop in miscellaneous income to Rs59m. Other income excl. the gain on lease re-assessment and rental waivers dropped ~32% y/y to Rs255m**.** Interest income on financial assets slipped ~3% y/y to Rs93m.
- The **exceptional item** of Rs62m (nil in FY23) pertained to allowance for settlement of old VAT and CST cases.
- **Tax expense** for the year was Rs573m (Rs401m in FY23).
- **PAT (before MI/discontinued losses)** fell 2.4% y/y to Rs1.1bn.
- **Non-controlling/minority interest** was Rs565m (Rs503m in FY23). Minority interest represents share of profits/losses pertaining to two of the company's JVs/subsidiaries, PVH Arvind Fashions Pvt. Ltd./ Arvind Youth Brands Pvt. Ltd.
- **Discontinued operations' profits** surged to Rs305m (against a Rs223m loss in FY23).
- **Net profit** grew to Rs806m (Rs367m in FY23), up ~2x y/y.

- The company declared **dividend** of Rs1.25 per fully paid-up equity share of Rs4. If approved, the FY24 dividend payout would amount to Rs166.5m.

Balance sheet

(FY23 figures in the balance sheet are as of 31st March 2023 and, hence, include the discontinued brands. FY24 figures exclude the discontinued brands).

- **The gross block (tangible + intangible)** fell Rs137m y/y to Rs5.7bn.
    - **Gross tangible assets/property, plant & equipment** fell Rs200m y/y to Rs4bn on deductions of Rs762m made due to discontinued operations. Additions to the gross block in the year were Rs790m (Rs531m). FY24 additions to PPE were largely in furniture & fixtures/leasehold of Rs295m/Rs350m.
    - **Gross intangible assets** increased Rs63m y/y to Rs1.6bn**.**
    - In FY24, the company renewed its **license with Calvin Klein** for a few product categories (initially in 2018 for Rs71.4m). The agreement now is till 31st Dec'28, renewable for five years. The company is amortising trademark license rights till 31st Dec'33 (incl. the renewal period).
    - In 2011, it entered **a license agreement with Tommy Hilfiger** for Rs378m, which has been capitalised as an intangible asset. It obtained an exclusive and assignable license to use the brand trademark to manufacture, import, distribute, promote, advertise and sell the products in India.
- **Other assets (non-current, current)** fell ~16% y/y to Rs4.3bn.
    - **Other non-current assets** fell ~22% y/y to Rs155m chiefly due to a 29% y/y drop in sales tax paid under protest, to Rs115m.
    - **Other current assets** dropped 16% y/y to Rs4.1bn, led by 18%/32% y/y falls in balances with government authorities/ other current assets to Rs1.7bn/Rs495m. Returnable assets (part of inventory) increased 7% y/y to Rs1.6bn.
- **Net working capital days** were 67 (60 in FY23).
    - **Inventory**, which includes garments and accessories, declined 7% y/y to Rs9.1bn. Inventory write-downs considering the nature, age and net realisable value of Rs1.3bn in FY24 were up ~3% y/y. The changes in write-downs were recognized in the P&L as expense. Inventory incl. the returnable component dipped 6% y/y to Rs10.7bn. Inventory days on sales fell to 92 (101 in FY23, excl. sales of discontinued brands). Inventory days incl. the discontinued brands' sales in FY23 were 93.
    - **Trade receivables** rose 16% y/y to Rs6.5bn. Within trade receivables, gross trade receivables grew 11% y/y to Rs10.9bn while the provision for refundable liabilities (deduction from the gross) rose 4% y/y to Rs4.4bn. Trade receivable days rose by 55 (50 in FY23 excl. the discontinued brands' sales; incl. the discontinued brands' sales, 46).
    - **Trade payables** fell 8% y/y to Rs9.4bn. Trade payable days on sales were 80 (91 in FY23, excl. the discontinued brands' sales; incl. the discontinued brands' sales, 84).

Fig 8 – Working capital cycle

(Days on reported sales)	FY21	FY22	FY23	FY24
Receivables	119	68	50	55
Inventories (total)	172	115	101	92
Payables	175	125	91	80
Working-capital cycle	116	58	60	67

Source: Company

- **Cash and equivalents** contracted 16% y/y to Rs1.7bn.
- **Borrowings (LT + ST + current maturities)** declined Rs1.3bn y/y to Rs4.7bn. Long-term debt, including term loans from banks, contracted 65% y/y to Rs106m. In the short term, working capital loans fell 17% y/y to Rs4.4bn and current maturities of long-term borrowings fell 51% y/y to Rs198m.
- **Net debt** was ~Rs3bn (~Rs4bn in FY23), down Rs992m.
- **Other financial liabilities (non-current + current)** increased 9% y/y to Rs1.8bn.
  - **Other non-current financial liabilities** increased 8% y/y to Rs1.3bn, led by a 3% y/y rise in security deposits.
  - **Other current financial liabilities** grew 12% y/y to Rs513m, on the 55% y/y increase in interest accrued but not due on borrowings (to Rs125m) and the 13% y/y increase in payable on capital goods (to Rs116m). Payables to employees fell 5% y/y to Rs211m.
- **Assets/liabilities held for sale** relate to the discontinued brands (Ed Hardy, Aeropostale).
  - **Assets held for sale** were Rs16m (nil in FY23). This refers to Ed Hardy and other discontinued brands.
  - **Liabilities associated with assets held for sale** were Rs328m (nil in FY23). This included Rs212m of trade payables and Rs117m of other financial liabilities.

Cashflow statement

- **Rep. OCF** rose ~37% y/y to Rs4.3bn, led by a ~10% y/y rise in PBT from continued operations, to Rs1.6bn. This increase in OCF was also aided by Rs307m profit from discontinued operations (vs a Rs222m loss in FY23) and fewer investments in working capital due to y/y lower inventory.
- **Net capex** rose to Rs801m (Rs360m in FY23) from store expansions and piloting new retail formats.
- **Rep. FCF** increased ~26% y/y to Rs3.5bn, led by y/y higher OCF.
- **Adjusting for INDAS 116, OCF** increased to Rs2.1bn (from Rs1bn in FY23). FCF increased to Rs1.3bn (from Rs683m in FY23).
- **Under cashflow from investing activity,** the company reported Rs945m profit on the sale of a subsidiary in FY24 (nil in FY23).

Contingent Liabilities

Fig 9 – Contingent liabilities

(Rs m)	FY23	FY24
Claims against the Group not acknowledged as debt	14	60
Disputed demands in respect of -		
Excise / Customs duty	390	390
Sales tax / GST	341	349
Income tax	407	398
Labour regulation	2	2
Bank guarantee on behalf of the Group	4	0
Total	**1,158**	**1,199**

Source: Company

Related party transactions

Fig 10 – Related party transactions

Nature of transaction	Type of relation	Rs m	
		FY23	FY24
Purchase of goods and materials (net)	Enterprise having significant influence by KMP	302	466
Receipt of services, shared services and others	Enterprise having significant influence by KMP	90	90
Rendering of services, shared service	Enterprise having significant influence by KMP	21	8
Remuneration	KMP	111	140
Consultancy charges	Enterprise having significant influence by KMP	15	15
Dividend paid	Enterprise having significant influence by KMP	-	49

Source: Company

Managerial remuneration

- MD & CEO Shailesh Chaturvedi received Rs98m remuneration in FY24, compared to Rs88m the year prior.

Fig 11 – Managerial remuneration

Name	Designation	FY23 (Rs m)	FY24 (Rs m)	Growth y/y (%)
Shailesh Chaturvedi	MD & CEO	88	98	12

Source: Company

Subsidiaries’ financials

- **PVH Arvind Fashion Pvt Ltd (Tommy + CK)** reported 21.6% y/y revenue growth to Rs12.4bn, led by the focus on premiumisation. EBITDA grew ~35% y/y to Rs2.4bn in FY24 and the margin, 193bps y/y to 19.1%. PAT grew ~36% y/y to Rs1.4bn. The working capital cycle shortened to 61 days (65 in FY23), driven by lower, 91, inventory days (108). Receivables days fell to 17 (19) and payable days, to 47 (62).
- **Arvind Youth Brands Pvt Ltd (Flying Machine)** reported ~3% y/y revenue growth to Rs4.7bn in FY24. EBITDA declined to Rs31m (Rs207m in FY23); the EBITDA margin dipped to 0.6% from 4.5% in FY23). Net losses were higher at Rs375m (a Rs53m loss in FY23). The company has embarked on a brand transformational journey through various steps to improve profitability. The working capital cycle fell to 169 days (185 in FY23), driven by lower, 118, inventory days (144); receivables days reduced to 93 (107). Payable days reduced to 42 (66).

Fig 12 – Subsidiary financials

(Rs m)	PVH Arvind Fashion (TH+CK)					Arvind Youth Brands (Flying Machine)			
	FY20	FY21	FY22	FY23	FY24	FY21*	FY22	FY23	FY24
Revenue	6,753	4,718	6,606	10,191	12,387	2,640	4,141	4,582	4,724
Growth (%)		*-30.1*	*40.0*	*54.3*	*21.6*		*56.9*	*10.7*	*3.1*
EBITDA	747	191	926	1,745	2,360	-171	350	207	31
Growth (%)		*-74.4*	*384.2*	*88.5*	*35.2*		*-304.2*	*-40.7*	*-85.3*
Margin (%)	*11.1*	*4.1*	*14.0*	*17.1*	*19.1*	*-6.5*	*8.4*	*4.5*	*0.6*
PAT	31	-324	615	1,005	1,365	-439	105	-53	-375
Growth (%)		*NA*	*NA*	*63.4*	*35.8*		*NA*	*NA*	*NA*
Working capital days on sales	**154**	**168**	**67**	**65**	**61**	**218**	**127**	**185**	**169**
Inventory (+ returnable asset)	127	126	95	108	91	167	161	144	118
Debtors	93	123	37	19	17	160	118	107	93
Payables	66	80	65	62	47	110	152	66	42
Working capital (Rs m)									
Inventory (+ returnable asset)	2,343	1,625	1,724	3,008	3,098	1,209	1,826	1,804	1,524
Debtors	1,729	1,587	675	532	590	1,158	1,334	1,344	1,206
Payables	1,225	1,040	1,179	1,720	1,608	793	1,720	831	547

Source: Company * *from 27th Feb'20 till 31st Mar'21*

- Adjusting the company's consolidated financials for its above two subsidiaries' financials, gives us a broad performance of the US Polo and Arrow brands. The two brands combined reported a 1.7% y/y revenue decline in FY24 to Rs25.5bn while the EBITDA rose 19.2% y/y to Rs2.7bn. The EBITDA margin expanded 187bps y/y to 10.7%. PAT declined to Rs76m (Rs140m in FY23). The two-year revenue/ EBITDA CAGR was 22%/127% over FY22-24.

Fig 13 – Consolidated financials, excl. subsidiaries

(Rs m)	FY22	FY23	FY24
Revenue	17,093	25,922	25,480
Growth (%)		*51.6*	*(1.7)*
EBITDA	526	2,277	2,714
Growth (%)		*333.0*	*19.2*
Margin (%)	*3.1*	*8.8*	*10.7*
PAT	*-*	*140*	*76*
Growth (%)		*NA*	*(46.2)*

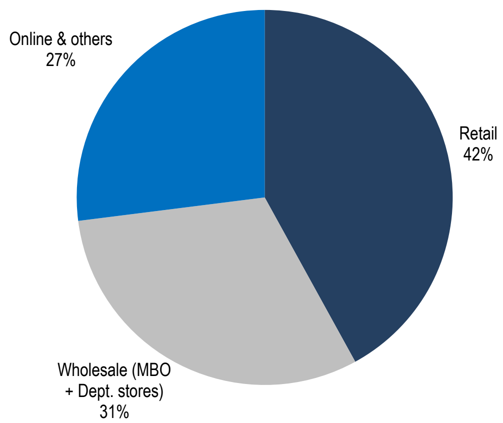
Source: Company, Anand Rathi Research

Key highlights: Management Discussion and Analysis

- Retail sales in India slowed in FY24 as people splurged on other segments, driven by post-pandemic revenge spending. Inflationary trends dampened consumer sentiment, leading to cautious spending on discretionaries. Further, delayed weather patterns directly hurt seasonal merchandise collections and consumers' spending behaviour. The company focused on growing its brands and increasing marketing spends, expanding its retail network, product innovation, entering adjacent categories (kids' wear, women's wear) and the online D2C channel, thus contributing to the positive performance.

- **Channel mix**. The share of the retail channel grew 3% y/y, led by growth in early teens. The online B2B channel saw a sharp drop due to inventory de-stocking, thus ensuring better consumer experience and tighter control on discounts. The retail channel accounted for 42% of FY24 overall revenue, followed by the wholesale channel at 31% and online and others at 27%.
    - The company transitioned from an online B2B wholesaler to a marketplace B2C model, where it controls inventory and merchandise assortments. This approach gives it full control over pricing, visibility and discounts. This shift in the online channel dented the company's revenue during the year. However, the transition to a B2C marketplace would lead to better long-term results. The company is investing in its own website and launching a dedicated website for US Polo.

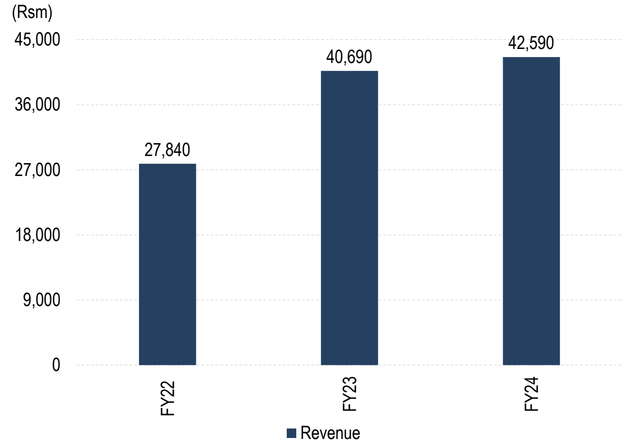
Fig 14 – The retail channel brought 42% to overall sales in FY24



Source: Company

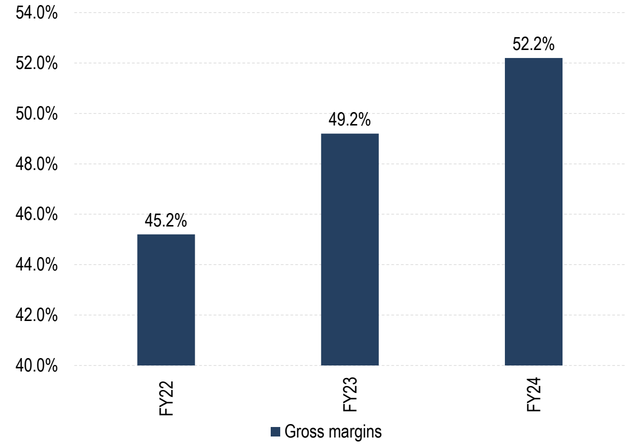
- **RoCE** improved, led by efficient working capital management, better inventory control because of ARS, an agile supply-chain and flexible sourcing methods to facilitate purchase of market-appropriate products in closer alignment with seasonal launches.
- **Financial highlights (comparable for continuing operations)** -

Fig 15 – ~24% revenue CAGR over FY22-24



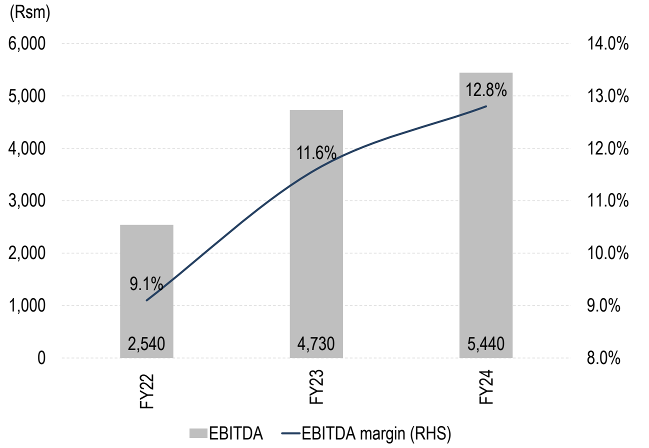
Source: Company

Fig 16 – ~52% gross margin in FY24



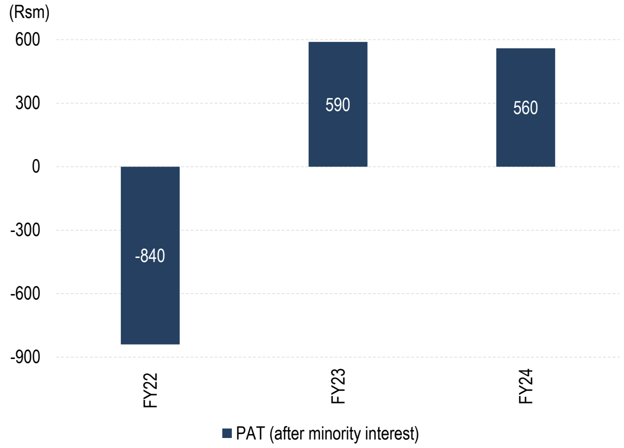
Source: *Company*

Fig 17 – ~46% EBITDA CAGR over FY22-24



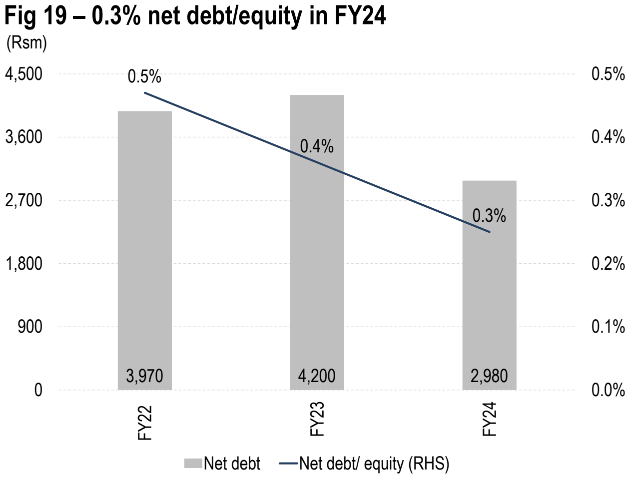
Source: Company Note: EBITDA includes other income

Fig 18 – Rs560m PAT (after minority interest) in FY24



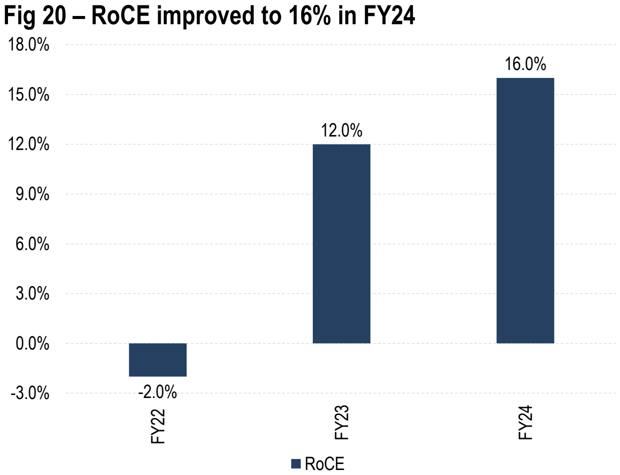
Source: Company

Fig 19 – 0.3% net debt/equity in FY24



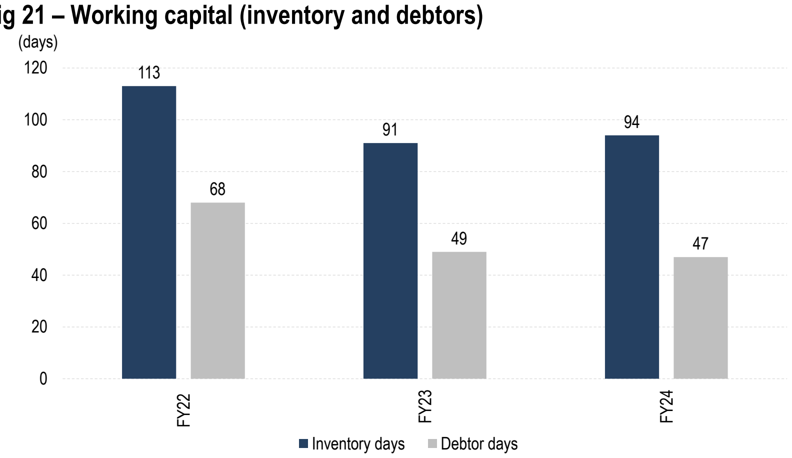
Source: Company

Fig 20 – RoCE improved to 16% in FY24



Source: Company Note: Reported RoCE by the company

Fig 21 – Working capital (inventory and debtors)



Source: Company

- **Premiumisation.** The company's key focus continues to be on premiumisation across brands via launch of superior products aligned with global trends. It is focusing on premiumisation by expanding to adjacent categories and delivering exceptional experiences.

- **Sephora divestment.** The company divested its beauty & cosmetic business, Sephora, to Reliance Beauty & Personal Care. The proceeds were used to repay debt and scale up its five marquee brands. This divestment positioned it as a pure-play branded fashion company. It also discontinued other dormant brands (Ed Hardy, Aeropostale).
- **Extending to adjacent categories.** The company expanded to adjacent categories: footwear, innerwear, kids' wear and women's wear. These categories brought Rs6bn to revenue, accounting for >15% revenue of some brands with double-digit growth. Management says this segment is poised for even higher growth and greater contribution to overall revenue.
- **Brand-wise highlights**
  - **US Polo.** Winterwear saw strong sell-throughs, while investments in bottomwear are yielding robust results. A brand website for US Polo was also launched to enhance its digital presence. Also, adjacent categories, an athleisure line, footwear and kids' wear have been successful. The introduction of women's wear also gained significant traction.
  - **Tommy Hilfiger** retained its strong affinity to premium products despite the market slowdown, driving superior sales growth and profitability. The 'Tommy Tailored' line and handbags received an encouraging response. Winterwear offerings also saw good offtake.
  - **Arrow** saw steady y/y revenue growth, led by growth across channels, despite challenging market conditions. Its super-premium '1851' line and 'Auto Press' wrinkle-free shirts' line reported robust sell-through rates. Significant marketing investments, along with various initiatives over the last two years resulted in better brand performance.
  - **Calvin Klein.** The company's strategic focus on premiumisation has driven a strong financial performance, marked by industry-leading full-price sales.
  - **Flying Machine** embarked on its transformational journey in FY24 with a fresh brand identity and a new logo, design and brand positioning, resulting in more full-price sales. It further focused on upgraded product designs and rapid expansion through distribution channels. Its brand extension to footwear also saw a good response.
- **Store network.** 146 EBOs were added in FY24, taking the total to 931, spanning 450+ cities in India. Total retail area was 1.07m sq.ft. with 58,000 sq.ft. (net) added in the year. Besides, it is present across 9,000+ MBOs and SiS across department stores and the online channel. The focus is on expanding EBOs in untapped markets to enhance brand accessibility and its retail footprint.
  - The company piloted innovative retail formats in FY24 incl. a) 'Club A', a premium format where all brands are available under one roof; b) 'Stride', a multi-brand footwear and accessory EBO exclusive to brands; c) 'Megamart', a factory outlet model for all brands, an alternative to the online channel to sell old-season merchandise. These formats are ready for broader rollouts.

Fig 22 – Brand-wise store count

Brand	FY19		FY20		FY21		FY22		FY23		FY24	
	EBOs	Cities	EBOs	Cities	EBOs	Cities	EBOs	Cities	EBOs	Cities	EBOs	Cities
US Polo Assn.	368	155	394	163	376	163	391	172	405	173	351	151
Tommy Hilfiger	97	35	93	38	96	38	98	39	98	41	95	38
Arrow	290	108	286	122	267	122	212	112	226	110	190	94
Flying Machine	263	134	252	138	279	138	270	111	250	150	154	112
Sephora	19	9	24	12	24	12	25	13	26	13	Exited	
GAP	16	10	18	10	NA	NA	Exited		Exited		Exited	
Unlimited	107	54	82	36	74	32	Exited		Exited		Exited	
CK			71	32	69	32	76	32	72	34	77	33

Source: Company

- **Core competencies include** a) a strong brand portfolio, b) robust design and sourcing capabilities, c) multi-channel distribution, d) an asset-light approach to building and growing the business and e) processes/systems designed to enhance operational efficiencies. The company's transition from a sale or return (SoR) inventory model to a consignment-based model has helped control inventory, faster stock turns and better analysing customer responses and trends, resulting in a more efficient and profitable supply-chain.
- **Ensuring operational rigour, profitable growth.** Launching high-quality seasonal collections helped to better sell-through rates and lower discounts. This also reduced the gross working capital cycle y/y, led by agile inventory management and a better retail channel mix. Further, the shift from online B2B sales to a B2C marketplace and transition from SoR to a consignment-based model in the retail channel would drive operational efficiencies.
- **Outlook**
  - The company will continue to drive product innovations to premiumise brands, along with substantial investments in advertising and re-energizing brand salience. It will focus on expanding its retail network, growing innovative retail formats, digitalisation and growth in adjacencies in FY25.
  - It will continue to focus on profitable growth through better full-price sales, higher comparable growth, lower discounts, operating leverage and cost optimization.
  - It plans to add 150 EBOs a year through the FOFO model.
  - Surplus cash generation, thanks to operational efficiencies, would be utilised to repay debt. The company aims to be debt-free in the medium term.
  - It plans to move toward brand-specific vendors (a mix of brand-specific and multi-brand vendors now), which would help in maximum capacity utilisation at dedicated manufacturing lines.

Valuation

We maintain our Buy rating with a higher TP of Rs689 (earlier Rs632), 13x FY26e EV/EBITDA (12x FY26e EV/EBITDA).

Fig 23 – Valuation summary

(Rs m)	FY26e
EBITDA	7,584
Target multiple (x)	13.0
Enterprise value	98,597
Gross debt	8,179
Cash balance	758
Market cap	91,176
No. of shares (m)	132.3
TP (Rs)	**689**
CMP (Rs)	535
Upside / (downside) %	28.8

Source: Anand Rathi Research. Note: Debt includes lease liabilities

Fig 24 – Valuation parameters

	FY22	FY23	FY24	FY25e	FY26e
P/E (x)	NA	100.8	74.3	48.1	30.2
EV / EBITDA (x)	25.6	11.3	13.7	12.9	10.3
EV / Sales (x)	1.5	1.2	1.6	1.7	1.5
RoE (%)	*(14.4)*	*11.2*	*9.3*	*16.7*	*20.5*
RoCE (%)	*(3.5)*	*10.6*	*10.9*	*16.0*	*20.2*

Source: Anand Rathi Research

Risks

- **Keener competition.** On the entry of foreign brands, keener competition in India could be a key threat.
- **Lower consumption.** Lethargic consumer sentiment and constrained discretionary spends could dent revenue growth.

Appendix

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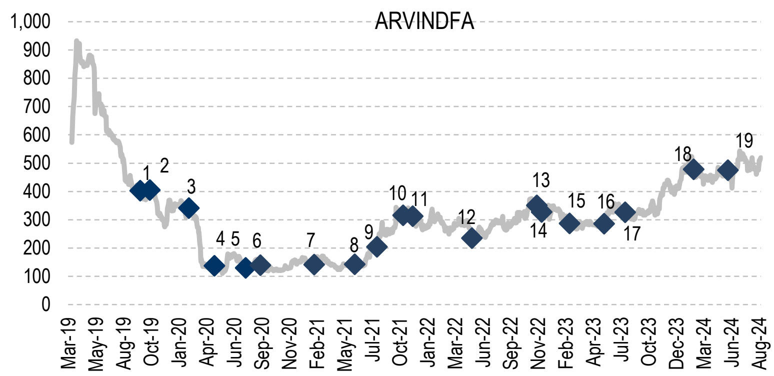

	Date	Rating	TP (Rs)	Share Price (Rs)
6	3-Sep-20	**Hold**	166	144
7	5-Feb-21	**Hold**	164	144
8	3-Jun-21	**Hold**	165	148
9	8-Aug-21	**Hold**	242	213
10	18-Nov-21	**Buy**	427	315
11	13-Jan-22	**Buy**	470	299
12	31-May-22	**Buy**	453	266
13	15-Nov-22	**Buy**	516	366
14	22-Dec-22	**Buy**	567	333
15	15-Feb-23	**Buy**	526	291
16	31-May-23	**Buy**	545	285
17	12-Aug-23	**Buy**	544	314
18	14-Feb-24	**Buy**	633	472
19	23-05-24	**Buy**	632	478

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Compliance officer-Deepak Kedia, email id - deepakkedia@rathi.com, Contact no. +91 22 6281 7000

Grievance officer-Madhu Jain-email id- grievance@rathi.com, Contact no. +91 22 6281 7191

ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.