"TCNS Clothing Co. Limited Q3 & 9M FY-21 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the TCNS Clothing Co. Limited Q3 and 9 Months FY21 Earnings Conference Call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes, should you need assistance during the conference call please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Anant Daga, Managing Director, TCNS Clothing Co. Limited. Thank you, and over to you, sir.

Anant Kumar Daga: Thank you. Good evening, and welcome to our Q3 FY21 Earnings Conference Call to discuss operational and financial performance for the quarter. I am joined by Amit, our CFO, and SGA, our Investor Relations Advisors. I hope you and your near ones are safe and healthy. I will take you through key updates, while Amit will share financials for the quarter. Q3 overall has witnessed healthy recovery. October and November saw good traction led by festivities, even though demand in December was somewhat moderated. Demand started picking up in January despite lower discounting than last year, which is an encouraging sign.

Overall, sales continued to progressively recover to 72% of corresponding quarter of the previous year. This is despite any meaningful, primary billing in MBO channel. The offline channels saw some disruption due to COVID, but still recovered over 65% with EBOs and LFS experiencing similar trajectory. A heartening sign has been a fast, sharper recovery in geographies less impacted by COVID, pre-dominantly the Tier-2 and 3 markets.

Many of them have already surpassed pre-COVID levels, clearly demonstrating latent demand and interest in the category. While bigger cities like Delhi, Mumbai and Bangalore are experiencing lower recovery, now with ongoing vaccination, these too should bounce back. Our brands continue to show better absolute sales and recovery rates than most of our peers in ethnic segment across offline formats. Online channel has continued to deliver robust performance in Q3, registering a 65% year-on-year growth on consumer sales. Primary billing was lower in Q3 due to partial stocking up in Q2. Specifically, our brand.com is growing at over 150% of pre-COVID levels. The strong momentum in online sales should continue, though with gradual opening up of offline channels we expect some moderation in the growth rates. We continue to invest in building capabilities to deliver a seamless omni-channel experience to our online consumers backed by best-in-class certified operations. This would be a key differentiator for us in both short and long term.

While MBO secondary sales have been picking up gradually, so far we have not commenced any significant primary billing to the channel. Another key positive going forward is resumption of the MBO primary sales with spring/summer 21 launch. The bulk of rationalization behind us, we are now set to grow this channel once again.

As you would recall, at the beginning of the year, in light of COVID, we set out a five pronged approach for FY21. Preserving the balance sheet strength was the key priority, while retaining the ability to scale up as needed. We intended to focus on controlling costs, conserving cash, engaging our consumers, building organizational resilience and seizing potential opportunities. We have achieved our objectives on key fronts.

Let me provide a quick update on the same. To start with, on the cash conservation front, we are happy to share that we have been cash accretive in Q3. Since our last call, we have been able to add approximately Rs. 40 crores to Rs. 45 crores to our cash balance. Our cash reserves are now tracking close to the level that we started the year with. And as on date, we have roughly Rs. 155 crores in addition to unutilized bank limits. This has been achieved through a combination of working capital reduction, in particular, inventory levels and a positive bottom line. We are on track to build on this balance, even in Q4.

Another key achievement has been in the focus area of cost reduction, where we are well ahead of our targeted saving across all key items. On rentals, we have been able to further increase our projected annual savings to over 35% compared to last year. On employee costs, we are on track to deliver around 20% annualized savings against last year. And overheads too, there should be a savings of over 25%.

Other focus areas for us were customer engagement, organizational resilience, and seizing growth opportunities. Timely readiness and execution on our omni-channel strategy has reaped us significant benefits and has been a huge differentiator. We built capabilities to leverage inventory across channel to be shortlist and sold to our consumers. Our direct-to-consumer initiative has scaled up well and have been institutionalized as a core consumer offering. As I mentioned earlier, our own brand.com is trending at 2.5x growth and already contributing in double digits to the online business. Marketplace, direct-to-consumer business, though on a lower base, grew at 10x over last year and is now contributing close to quarter of third-party marketplace sales. All this gives us confidence to further deepen our investment in direct-to-consumer and omni capabilities.

Now having navigated the pandemic, while preserving the strength of the balance sheet and emerging with a robust cash position, our focus now shifts to growth. Seeing a narrow window to lock in long-term accretive real estate opportunities, we are embarking on an accelerated store expansion plan and will target opening at least 60 to 70 new stores in FY22. This will include upgradation of existing stores, entry into newer markets and newer store formats. We also have visibility of promising growth in LFS channel. We should be able to add 200 to 250 stores therein and play a bigger role given the current flux in smaller brands and labels. As, I mentioned, with MBO channel also picking up again, we are getting ready for strong headway for growth in future across channels.

Despite adverse market conditions, we observed the healthy traction across our new category pilots. Accessories are already contributing to high single digits across many of the pilot stores, We would see a full-fledged launch across LFS and EBO stores and online over the next two seasons.

Pilot range of Aurelia girls also received encouraging response in the festive period, and we intend to expand the range and distribution in MF21. We will now be opening more EBO stores for Elleven, which was paused due to pandemic and will expand Elleven to LFS stores. We'll get a much better read on this by end of festivals.

We continue to invest in people, processes and infrastructure to support and accelerate growth. As mentioned, we are building strong skill sets in areas of design innovation, data sciences and supply chain. We are making investments in inventory automation, express delivery module and omni-channel capabilities. We are also in process of setting up a future-ready warehouse, which should be fully operational by Q2 of next year.

To sum it up, we will focus on building growth runways and key capabilities while keeping a sharp eye on evolving market situation and pandemic. Now, I will request Amit to take you through key financial highlights for the quarter.

Amit Chand: Thanks Anant. Good evening, everyone. I'll be giving you an update on our financial performance in Q3. Our Q3 revenue was Rs. 238 crores, which translates to a 72% recovery from last year's Q3 revenue of Rs. 329 crores. Our gross margin in Q3 was 61% versus 68% last year. As mentioned earlier also, this is due to skewed channel mix and similar dormancy policy on a lower sales base. However, there is a significant sequential improvement vis-a-vis the first two quarters, and the same should continue building up as business returns back to normalcy.

Under Ind-AS 116 accounting, total rent concessions of Rs. 6 crores has been accounted for in Q3, which has been reported under the rent expenses. The graded salary reductions that we implemented in May are being gradually reversed. We expect full year saving on ERC to be around 20%. Other expenses have also reduced by around 23% in Q3 compared to last year.

The company has generated positive EBITDA in the quarter of Rs. 43 crores versus last year's EBITDA of Rs. 75 crores. Our PBT in Q3 is positive Rs. 17 crores versus Rs. 40 crores last year. PAT is not comparable due to impact of positive tax adjustment last year. On a like-to-like basis, PAT in Q3 was Rs. 13 crores versus Rs. 31 crores last year. We closed 22 stores and opened 9 new stores during Q3. As Anant mentioned, we are now embarking on accelerated store openings, and Q4 should see a net positive addition in store count. Acceleration will start from Q1 of next year. Our 9 month FY21 revenue was Rs. 414 crore versus Rs. 929 crores last year. EBITDA for the 9 months were Rs. 10 crores against an EBITDA of Rs. 203 crores last year. PAT for the 9 months in FY21 was a loss of Rs. 60 crores against the profit of Rs. 93 crores last year.

The strength of our balance sheet is reflected in our cash position, which is around Rs. 155 crores as on date. This is in addition to the unutilized bank limits. We added roughly Rs. 45

crores to our cash balance in the last three months supported by a reduction in working capital and a positive bottom line. We are on track to build on our cash balance further in Q4.

We will now open to questions. Since we are the only listed entity in our segment, we might not be able to share granular details that could be competitive information. We'd request your understanding of the same. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Susmit Patodia from Motilal Oswal Asset Management. Please go ahead.

Susmit Patodia: My first question, Anant, is could you give some details on inventory. How did the inventory move quarter-on-quarter, and how much is fabric, and how much is finished?

Anant Kumar Daga: Sure, Susmit. So while we have not shared all the balance sheet details, our inventory is already about 7% to 10% lower than what we saw in September. In terms of FG and fabric bifurcation, about 20% to 25% is fabric and close to 75% to 80% is FG. And FG also, more than 90% of the inventory continues to be less than a year old. So that's our broad breakup.

Susmit Patodia: Just to understand, because one season was nearly missed. The larger reduction in inventory would only happen when that season comes back right, which is next quarter FY22?

Anant Kumar Daga: So Susmit, when you look at the seasonal basis, it cuts across quarters. So you are right, we blindly didn't carry forward everything from spring/summer 20 to MF20, and this is what we have explained in earlier calls also. And in the first half you didn't see any reduction in inventory. Now those have started getting deployed from December. We have launched our fresh season early. So some part of reduction has happened in Q3 and some part will happen in Q4. But essentially, yes SS20 most of the inventories are being used in SS21. So there the reductions would be there in the H2, both quarters put together.

Susmit Patodia: Okay. And my second question is, you've said that employee expenses sustainably would be down 15% to 20%. Could you just give us a little more color on that, how are you managing, especially the fact that you'll be adding so many stores next year?

Anant Kumar Daga: So, Susmit, when Amit mentioned about 20% odd reduction, it was on an annualized basis. In fact, a larger portion has come in Q2, Q3. In Q4, you will see relatively lesser savings. On the existing employee side, we are reinstating the salaries in graded manner. In front end, we have been able to save cost on two fronts. First, we have tried to variabilize the salary parts of our front-end staff, which would be dependent on sales. Secondly, we have been able to rationalize some staff, given synergies between the two brand stores in the same location and across LFS and EBOs and driving efficiencies more at the front-end space. So that is where long-term savings would continue. Frankly, in back end we are building more capabilities. We are adding people in supply chain, in data sciences, in building omni business. So not much savings would come on there.

Susmit Patodia: And just one last question, if you could give us some details about the warehouse. How would it help in efficiency, speed to market and cost?

Anant Kumar Daga: So a couple of things on the warehouse side. One, right now our warehousing operation is divided into multiple locations, which individually are running at a suboptimal level. So, consolidation of that to a more organized setup would definitely have its impact in visibility and in efficiencies that a more organized warehouse can get in, number one. Number two, a lot of our future plans revolve around direct-to-consumer initiatives and new product categories. And keeping that in mind, we need a warehouse which should be ready for all this. So there are very innovative models, which we are trying with third-party online spaces, then we are looking at re-hauling our own express delivery mechanisms. So this is where the new warehouse will play a significant role, in building newer capabilities, in ensuring better efficiencies. And in long term, there could be some cost savings also on this.

Moderator: Thank you. The next question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: Anant, three questions from my side. First, when I check with you that is it the discounting this year started early and generally, January is a month where the EOSS run into or starts with. So is the demand that you're seeing sustained in Jan driven by discounting, I just wanted a sense first on the trends because I see the gross margin improvement has been good. So your thoughts on that first?

Anant Kumar Daga: See, last year also, EOSS started in December. And this year also, the start date was very similar. So two things, first our January recovery rate has been better than December. And second, on discounting front, after a long, long time we have seen lower discounting both in December and in January. So, it's a healthier trend. Now there are two things to my mind that has helped us. One, we have been able to launch the season very early. So a good proportion of sales is coming through fresh articles. Second, with buyers being more serious, lower discounting also worked. So first trend in January is better than December stand-alone. Second, the discounting has been lower than earlier.

Nihal Jham: That's helpful, Anant. And during Q2, one thing you had mentioned is that, obviously one of the reasons that we were seeing an increase in inventory because we were building up fresh stock for SS21. So is it that when we are entering SS21 and you mentioned that you're carrying over some stock from SS20 what would be the approximate breakup between the fresh and the carryover inventory?

Anant Kumar Daga: So Nihal, frankly this entire year has become a slight mix of various seasons put in together. So not only spring summer 20 got carried forward to spring summer 21; also some part of monsoon festive was also carried over. Because, see, we had non-festive stories already carrying forward from SS21 some MF20 non-festive stories also got carried. So I don't have that particular number, but between both seasons put together, atleast 20% to 25% got carried forward.

Nihal Jham: Sure. My apologies, what I was specifically referring to is that approximately what will be the proportion of the stock that the customer will be seeing for the first time. That's more what I was getting into. So even if SS20 would be?

Anant Kumar Daga: So see, spring summer 21, at least 80% to 85% of the stock would be fresh, which the Customers would be seeing first time. Apart from that core categories always continue throughout the year.

Nihal Jham: Sure. Just one last question, Anant. On the MBO channel, as we understand, obviously, that the issues with liquidity that you had faced last year, did the channel generally seem to be more or less sorted with. And we used to do, on an average, more than Rs. 100 crores per annum when things were normal. Now that you plan to start billing to this segment, is it that you expect that kind of a run rate to start with, or you going to be cautious and just initially try building up gradually, just your thoughts on that?

Anant Kumar Daga: To start with we'll be cautious. And now, the focus will be on credit quality. So the run rate that we used to have, I don't think we're going to hit it right away. But hopefully by festive, which is end of next year Q2, when we launch the next seasons and all, things should come close to that, because apart from the broader market, the kind of rationalization we did last year and the fact that we have not really built any primary sales through this channel this year, despite decent recovery in secondary sales, we should be in a good position.

Moderator: Thank you. The next question is from the line of Jignesh Kamani from GMO & Company. Please go ahead.

Jignesh Kamani: Just wanted to continue on the inventory part. If you talk about sales, as you mentioned, 70% to 80% of the last year spring-summer may look fresh. But from the customer mindset, if you take about the inventory manufacturing, that is still more than one year old or probably 11 to 12 months old. So how is the consumer mindset while address to this, so still they're happy buying you can say, even though fresh inventories, but buying a one year old merchandise, particularly at a lower discount over the fresh material full price?

Anant Kumar Daga: So see, what we have seen atleast in this EOSS is that the percentage of fresh sales is very, very healthy, it's one of the healthiest that we have seen in last few years. So there's definitely appetite for fresh season product also. Having said this, there's always discount seekers who would go after price. And for them, to buy an old inventory, there are many, many channels available.

Jignesh Kamani: So, if we talk about last spring/summer collection, which looks fresh to the consumer because it was not launched last year, but in manufacturing date it will be one year old. So when consumer is buying, probably he may know he's buying one year old product. So just want to know from the consumer mindset?

Anant Kumar Daga: No see, typically this is a bigger mindset issue with intermediary. So when you bill something like this to a dealer network, they have an issue with the date of manufacture. For consumers, frankly the stock is fresh and then it's not such a big challenge. And when we say we have forwarded a lot of SS20 merchandise, a lot of that was just at fabric stage also. So we have been able to manufacture them later with a more current dating label also. So it's not that everything that got carried forward was all FG with old manufacturing dates. So a lot of fabrics also got pushed out. So if you see, historically our fabric proportion to entire inventory was always in excess of 30%. Right now, it's just 20% to 25%.

Jignesh Kamani: Sure. Second thing, with this lower discounting in December, Jan, so have we lost out to a competitor, because when I look at the discounting by the competitor, it still continues to remain aggressive?

Anant Kumar Daga: No. So Jignesh, we don't get any syndicate data on this. But whatever reports we get from our multi-brand partners, including large-format stores and online guys, our brands continue to do equally well and better despite lower discounting. Hypothetically, yes, if I would have increased discount, my sales would have been higher. But, given the way we have planned our inventory and the alternate channels that we have, I don't think there's any point going beyond that. Most of the customers are very serious right now and marginal disutility of additional discounts is very, very high.

Jignesh Kamani: Sure. And how much fresh inventory we bought in last three months, just to understand if consumer is looking for some kind of fresh inventory, whether we have enough freshness in the store or there might be competitor might have better edge over there?

Anant Kumar Daga: We are one of the first guys to have a decent sale of fresh stock. So, in EBOs would be at least 40% to 50%, which is fresh stock. In LFS, it would be 30% to 35%. In terms of sales, it would be tracking somewhere around 25% to 30% between the two channels.

Moderator: Thank you. The next question is from the line of Vikas Jain from Equirus Securities. Please go ahead.

Vikas Jain: Sir, my first question is in terms of the stores that we had closed. This time we had closed just around 22 stores. So what would be the number of airport stores that we have closed this time, and what would be a net airport store that we have currently?

Anant Kumar Daga: I'll just get back with the exact number, but we started the year with about 26 to 28 stores. And right now, we are less than half of that. And among the stores, the ones that are left are slightly bigger, which are also important from a brand-building perspective, and we have been able to get good rental deals out there.

Vikas Jain: Sure. And Sir, with your commentary that Q4 onwards things look buoyant, and we have seen a good demand recovery. Do we expect further closure of the stores, with overall demand looking good, so will we continue to further bring down our stores, or will now we add going ahead?

Anant Kumar Daga: I'll just tell you first the philosophy with which we are closing stores.. The stores which we don't think can make money, where we are not getting good rental deals, and where WDVs are lower, we are just going ahead and closing those stores. We believe, in market today, we are seeing opportunity to open fresh stores at lower discount with better real estate. And that's the reason we say we'll be embarking on an accelerated store opening plan. So there could be many instances where in the same market we are closing down one store and opening another. Now as we speak, the recovery has not been very homogenous across markets. For example, there are a few markets, in Northeast, like Assam, Nagaland, which have already crossed pre-COVID sales in Q3, while there are some bigger cities, especially Delhi, Mumbai, where the sales are still at 55% to 60% level of pre-COVID levels.

So out in these markets, we are still renegotiating for rentals. And we still want deals. Now a lot will depend upon what kind of rental renegotiations we are able to do, even going forward. Otherwise, wherever we feel that we can get a new real estate, and we can save on rent, we'll close those stores. Right now, by the look of it, it doesn't look like on this path we have more than 10 to 15 odd stores to close, but this is an evolving situation.

Vikas Jain: Correct. Sir, and next question on the cost part. So first, on the rental front, what I believe that the FY21, we achieved a substantial 35% kind of savings. But going ahead in FY22, where probably the demand would normalize, would we return back to our earlier contracted rental agreement where the rent would be returning to probably at around FY20 levels, what would be your comment on this?

Anant Kumar Daga: Yes. Most of the stores will revert back to FY20 levels. There are two silver lining to this, one that we have closed in the process many, many high rent-to-sales ratio stores, so that should help overall rentals. And second, the deals now we'll be locking in probably could be slightly more accretive from a long-term perspective. But for existing stores, where we choose to carry on the business, most of them will return to normal rental. We'll still have a few concessions, but those would be far lesser than what you have seen in FY21.

Vikas Jain: Right. And similarly, on the salary or employee cost front, there also we'll be largely returning to the similar run rate, quarterly run rate for FY22 of what we had in FY20?

Anant Kumar Daga: Yes. So employees also, especially with the new initiatives and all that we are building, should get back there. Overheads, we might have some savings, but most of the overheads that we had, where we were able to reduce for all sales window onetime off, so those again would inch back. So, I don't think one should take too much cost saving from a long-term perspective in overhead and ERC.

Vikas Jain: last question since you've guided for significant store addition starting FY22, so any CAPEX number that you would plan to attach to this?

Amit Chand: Yes. So on the store front, we should be doing about Rs. 20 crores to Rs. 25 odd crores worth of CAPEX in the next financial year.

Vikas Jain: Right. And a large part of the new store addition will be the Elleven brand, or it would be a proper balance?

Anant Kumar Daga: No. So right now, in these numbers we are just counting about 7 to 10 pilot Elleven stores, balance would be regular. And once the Elleven brand model stabilizes, those additional stores would be over and above the 60 to 70 count.

Moderator: Thank you. The next question is from the line of Anuj Sehgal from Manas Asian Equities Value Fund. Please go ahead.

Anuj Sehgal: I had a question on your channel-wise revenue split that you've shared. So you mentioned that 23% of your revenue is coming from online and others. So can you help us understand what does online and others exactly include, and does it also include the WhatsApp sales and the O2O sales that you have and then secondly, again specific to online sales, you mentioned that your own brand website has grown 150%. And even at the marketplaces, you've seen 10x growth from your direct sales. So where is this growth coming from, is it largely coming from Tier-1 cities or are you also seeing that same growth in Tier-2, Tier-3 cities and then lastly, given this whole experience with COVID and change in consumer behavior, the new store opening targets that you have, how does that account for the whole sort of consumer behavior towards online shopping and just want to hear your thoughts as to how you're thinking about e-commerce in general and online as an overall strategy?

Anant Kumar Daga: So hi Anuj, let me first start with the last part of your question. So if you look at online, we have always seen it as an opportunity. Even from the early days, whether it was launch of our own site or getting on to models like fashion and you, we were amongst the early adopters. We believe that with price parity, this channel, is an addition to our existing channels. We don't see, frankly, it as a competition, as long as we are able to manage parity. Now, if you look at this channel right now, it's contributing to about 23%, in midterm, about three years' time, it should anywhere between at least 1/4 to 1/3 of the total sales. And we ourselves, as a company, are trying to push this. See today, whether it is online guys or offline guys, both are trying to get a slice of both channels. So online guys are opening offline stores. Offline guys are going online, because everyone understands that, ultimately, the way these businesses compartmentalize online and offline, this is not how the consumer will see it. It will be only channel play. And we being early movers in online and having a huge backbone of almost 550 stores of our own in offline, the way we are thinking about this business is taking an omni-channel approach. And that is where a lot of processes, systems, new warehouse, we all are building that. So that's one, the way we are looking at this segment, per se.

Second, when you talk about where the growth is coming from. So bigger cities also are contributing decently to the growth, so are the smaller cities. Yes, there are some pockets which have done better. But that again is mirroring more or less what offline trajectory we are seeing. So in terms of growth, again, it's not like any particular territory or particular in is a big call out. It's overall coming from various segments.

Third, when you say what constitute online and others. So other is a very small business. So we do some exports to some markets. And second, we have also started institutional sales channel, which is corporate gifting, which is very, very small right now. So those are the things which falls under this segment.

Anuj Sehgal: Right. So fair to say that a large part of online and others is actually online sales?

Anant Kumar Daga: Yes.

Anuj Sehgal: And then just to elaborate on that point, as you rightly said, omni-channel is the way to go because the consumer in her mind doesn't see any difference. So you also mentioned that omni-channel fulfillment is live on both your own website and third-party marketplace. So is it possible to give us a sense that of the online business that you have, how much of it is where you are enabling omni-channel, the customer is ordering online but picking up from your store your physical stores?

Anant Kumar Daga: So Anuj, this is right now in the pilot phase with the third-party people also and us. There are a lot of system integrations that were required, and there were a lot of processes. So we are building that. In fact, next week is when we'll be full-fledged launching it in over 50 stores. Right now, the stores where we have experimented it with, it was about a 45 day, 50 day experimentation. There, we were seeing, already seeing about 4% to 5% of contribution coming from omni. That's a very small pilot, so maybe by next quarter, we'll be able to give a thorough number on this. But my guess is it should be at least a high single-digit number to start with.

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

Ankit Kedia: Sir, apologies if I'm being repetitive, I joined a bit late. I just wanted to know from when could our SSSG turn positive, given that in a couple of your statements you mentioned markets like Delhi, Bombay, Bangalore, continue to be at sub 60% of pre-COVID levels?

Anant Kumar Daga: Ankit, frankly, I don't think any of us have any definite answer to this. The way we see it could be quarter or two. It could be around festive, it could be earlier than that, it all depends upon how the macroeconomics and the COVID situation turns out to be. What, I can share with you is what we are seeing on ground. So for example, today we understand that the reason why people are not coming, could be one is like shrunk wallet size. Second is of course, a limitation of occasions where fashion is just not a need-based category also. It's also an aspiration category. So obviously, with occasion usage being really restricted, that's the second impact. And third finally this whole fear of COVID, of people venturing out. So what we saw in Q3, the gap up between Tier-1 and Tier-3 markets was tremendous, it was not so much in Q2 and Q1. Which means markets where COVID impact was lesser, people still came out and spent. So, for example in our Tier-3 markets, our recovery rate in Q3 at least +85%. So that is very, very encouraging. Now, with vaccination drive on, with number of cases coming down, with things opening up, it could be any of our guesses to know when people would start coming out again and shopping. One thing is for sure that, in April, May, June, we have a lot of weddings. And if things get more opened up, we should see a healthy revival there. But it all depends upon how soon things will open up. So that could be anyone's guess.

Ankit Kedia: Sir, with that being the case, how has been our inventory buying then, so are we planning to do 80% of pre-COVID inventory buying for the spring summer '21 season or we are growing 100%, and we might just carry forward, again the old inventory next year. So how is that back-end being placed now?

Anant Kumar Daga: Ankit, we have done a lot of stuff around to manage this demand-supply fluctuation and build a responsive supply chain. It will be a very, very long answer, maybe we can also connect offline. But just let me give you a gist. So the entire model of coming closer to season and doing a short replenishment cycle, this is what is helping us to reduce our upfront buys. So today, because of this, I don't need to take a call on whether I have to buy 100 or 90. I can still buy 70 and quickly replenish the best selling style in next 23 to 30 days. So, that is the kind of flexibility we are building, number one. Number two, we have also strengthened our core range. So we have now something called timeless and forever classics, which again is contributing as a never out of stock situation. So that can be easily carried forward. Thirdly, As we explained to you, most of our business is all about commercial new styles, which are broken down into festive and non-festive style., we always have a range or two. that can be easily carried forward to next season. So we'll always have that one range, wherein probably you will see inventory on our books. But there's no risk of obsolescence there. It can be launched as first launch of monsoon festive instead of last of spring summer. So putting these together, we are trying to manage at least 15% to 20% gap up in demand and supply that happens.

Ankit Kedia: And sir, how has our inventory been for competition if you have done some analysis, have they also carry forwarded last year's spring summer inventory this year and is it a level playing field for everybody or they went for deep discounting and tried to liquidate the inventory?

Anant Kumar Daga: So there has been two kind of approaches, frankly. There are a few people who have been able to put more relevant inventory, and those are the guys who had a healthy cash balance and no pressure on working capital. But those have been very, very few. Most of the guys have carried forwarded their old inventory and most of them have again discounted very heavily. Unfortunately, it would be out of my place to say, give you a particular number or more definite trend because we don't have any particular data. But this is what has been seen in the market, and this is what we hear from our partners.

Ankit Kedia: Sure. And sir, my next question is on the gross margins. What has been the provisioning in this quarter at the gross margin level. And do you think we can go back to the old gross margins given the, your ambition of doing 25% to 30% share in online, and that will continue to be impacted. While in the past, you have always said that online gross margins are the same as the company average. But what we are seeing in numbers say some different picture?

Anant Kumar Daga: So Ankit, the small correction out there. Maybe we have not communicated rightly. But gross margin, there's always a difference in online versus other channels. What we meant was bottom line performance because online doesn't have ERC, doesn't have rental. So all the costs is above gross margin. So at gross margin level, definitely there's an impact of online. And this is what we have mentioned in the first two quarters also, when gross margin drop was significant. It was because of the skewing online sales. So that's one part.

Second, as you see, already offline sales have started picking up, and in the long run, the share of online will settle at a more reasonable level. There could be some impact in gross margin, but again, that won't be as significant as what we have seen. Coming to long-term gross margin. See, we think the margin structure of 64% to 66% is very, very attainable. If you look at this quarter also, despite higher provisioning, which your question was, it's about 3.5% to 4% on quarterly numbers because the sales base has been lower, and our dormancy provision policy has been same. This obviously will come down with sales picking up. So, once business gets back close to normalcy, you'll also see gross margin inching back to pre-COVID levels. As of now, we don't see that as a big challenge. One should be aware that, there has been sharp increase in fabric prices. Now while we are mostly covered for this season and we are taking lot of steps to mitigate most of this in next season, there could be some impact if you don't take a MRP increase, but that's a call which we'll take after seeing fabric prices for another month or so. But overall, long-term perspective, gross margin structurally there are no changes.

Ankit Kedia: And sir, if I can ask, squeeze in one more question. One of your competitors just acquired majority stake in a luxury ethnic wear brand. With our wishful now contributing around 5% to 6% of our revenues, while it may not be luxury, but at a premium range. So how is that market shaping up now, and what's our vision for Wishful for next three to five years?

Anant Kumar Daga: So Ankit, that market is very different. We are nowhere even close to that with Wishful. So, it's just not comparable, frankly. Wishful has a market of its own and obviously last year, because of COVID, because of occasions going down Wishful, frankly, couldn't get a chance to do whatever was required. So, that's a separate thing altogether, but the brand that you are, the business that you are talking about is a very different business. There's no connection, honestly.

Moderator: Thank you. The next question is from the line of Kamlesh Kotak from Asian Markets Securities. Please go ahead.

Kamlesh Kotak: Just to continue on the previous participant's question on the competition. Do you see there is any structural change in terms of the competition, especially from the unorganized part as we see. And is there anything that has now been seen as the new normal for us from the market positioning?

Anant Kumar Daga: So see, the real picture will emerge only this season. There are a lot of small labels and brands who are organized in a sense and unorganized in another. Those guys had inventories, so they carried on with their inventories last season in large-format stores and MBOs. What we have heard is few of them are struggling to connect fresh merchandise, and hence, they are right now liquidating old stocks. Picture will be slightly clearer in next three to four months, once the old inventories have been sold off. The sense we are getting from our partners is they are looking at us to fill some gaps, which they believe the long tail of brands then create. And we could already see a couple of smaller labels being out of large format portfolios. But probably this season will show us a better picture. There would be some consolidation, there would be some shift to more established players who have the ability to supply and scale up with these partners. So yes, that should happen, but we'll get a clearer picture this season.

Kamlesh Kotak: Sure. Second thing you also discussed about finished goods management and raw material management with inventory software and systems in place. Can you just elaborate on the same, is it launched across the channel partners, and what has been the cost incurred in that, and also you mentioned about warehouse setting up. So how much CAPEX there would go in the location part of it, if you can help us understand what this?

Amit Chand: Yes. So let me start with the second part of the question. So we would be investing about Rs. 8 crore to Rs. 10 crore in the new warehouse that we spoke about.

Kamlesh Kotak: Sorry, I missed it. Any location you highlighted?

Amit Chand: So we have already taken, signed up this particular warehouse. It is in Haryana in a place called Pataudi. So that's about the warehouse. In terms of the investments that we've done into managing different systems, to manage our FG fabric inventory better, should be in the range of about Rs 3 crore to Rs 5 crore, over a longer period of time.

Kamlesh Kotak: Have you already started rolling out those systems across our channel or?

Amit Chand: We are at a pilot stage. Hopefully, in the next month or so, we should be able to roll it out in a gradual manner.

Anant Kumar Daga: So just adding to what Amit said. Inventory optimization model is right now being piloted for brand W. The express delivery model is already institutionalized, it's more about processes. And the way we are thinking of time lines and setting up the back end for that, so that's not system dependent or that doesn't entail any CAPEX.

Kamlesh Kotak: Okay. And lastly, where we see the branding and marketing spend from here on from the next season and beyond, are we looking at significant rationalism there or it will continue the way or it will go up, how you see that?

Anant Kumar Daga: So this season, we'll step it up, but the festive is the time when we'll get it back to pre-COVID levels, a full-fledged campaign. But this time the focus would be more on creating impact on social media platforms and doing slightly more target based marketing kind of stuff and better storytelling at stores.

Kamlesh Kotak: Okay. But any ballpark percentage, as a percentage of revenue, how much we are planning to spend?

Anant Kumar Daga: So see post in festive we'll return back to the earlier levels that we were doing, about 3% to 5%. But right now, on a lower base, percentage won't frankly give a clear picture.

Kamlesh Kotak: Sure, okay. And finally, if you were to see from just a directional point of view without diluting the numbers, how has been the trend in January compared to the festive season, which we had seen last quarter, is it slightly showing some traction or how it is shaping up?

Anant Kumar Daga: Okay. Let's not look at the quarters together because there was an impact of Diwali also. And November frankly, we were as a company more than pre-COVID level versus last November. If you look at December and January, January trends offline and online is similar. Offline is better.

Moderator: Thank you. The next question is from the line of Susmit Patodia from Motilal Oswal Asset Management. Please go ahead.

Susmit Patodia: So just in the context of Tier-2, Tier-3 doing much better, would you be able to give us what top 5 or top 10, whichever metric you look at contributed a year ago cities, and what it is now?

Anant Kumar Daga: Sorry, Susmit. I didn't get your question. Could you please repeat?

Susmit Patodia: I'm saying, what would be the top 5 or top 10 city contribution a year ago and what would it be now?

Anant Kumar Daga: Across or you are talking about Tier-3?

Susmit Patodia: No. Top 5, top 10 cities, whatever you look at?

Anant Kumar Daga: Okay. So Susmit, we'll have to share that number at probably later because I don't have that handy. But just to give you an idea, Tier-1 cities have recovered to 55% to 60% odd, Tier-2 was about 70%, and then Tier-3 was about 85%. So this was the kind of recovery rate. Maybe we can get back on with particular details.

Susmit Patodia: All right, okay. And just one more interesting thing that you pointed out at the beginning was a cash generation of Rs 45 crores. Did I hear that right for this quarter?

Anant Kumar Daga: Yes. Since last call.

Amit Chand: Yes. So if you remember last call, we mentioned that we had Rs 110 odd crores of our cash reserves. And that number is today around Rs 155 crores, so that's the Rs 45 crores that we are talking about.

Susmit Patodia: So just to understand, at Rs 240 crores sales, if you're generating Rs 40 odd crores of cash, this is like a new normal and is this sustainable?

Anant Kumar Daga: So Susmit, a big part of that is also working capital release, which we had planned for second half. So, there, you'll again see working capital reduction happening in Q4. So there would be that number. Now whether Q4 cash would be 45, 30 or 40 that we have to see. But working capital release will happen.

Susmit Patodia: No. What I meant to ask actually was Anant, that in FY22, does the cash generation for the same top line of FY20 is now significantly higher than in the past?

Amit Chand: No. It won't be in FY22. So this Q3, obviously we have a larger part of this cash coming from working capital reduction. And as we mentioned, it is primarily from the inventory front. Now once the lower base of working capital gets established at the end of Q4, every subsequent quarter we won't see a similar reduction. You will obviously see the cash reserve addition

Susmit Patodia: Got it. And just one more last thing, your gross margins are down 670 bps year-on-year, while EBITDA margins are down only 450. So this is, a little bit of this is also coming because of e-commerce, as you are saying that gross margins are lower, EBITDA margins are higher?

Anant Kumar Daga: So some impact of that is in gross margin. It's correct.

Susmit Patodia: And also then flowing up in the EBITDA margin, right?

Anant Kumar Daga: Yes.

Moderator: Thank you. The next question is from the line of Jignesh Kamani from GMO & Company. Please go ahead.

Jignesh Kamani: On the supply chain and sourcing side, 90% to 100% sourcing have been right now from Delhi and NCR. So we were trying to develop a supply chain system in the UP, HP and other market. So any development there?

Anant Kumar Daga: Yes, from that we have come a long way. So right now, close to 25% of our manufacturing capacities are outside Delhi, NCR.

Jignesh Kamani: And any cost reduction because of that because, there is a government incentive on the labor cost and everything in the UP, Bihar and HP and other region?

Anant Kumar Daga: So see, there are a few reasons for that. One is, obviously, there are some schemes also available. Second, the labor cost is significantly lower and in our business that is in fabrication, that is one of the biggest costs. And third is simply derisking. So we didn't want to have the entire concentration in one place. So these are some of the objectives. Apart from this, there's a huge social impact of all these initiatives. So wherever we have been able to place these units, we have been able to do some meaningful work around that also.

Jignesh Kamani: So any color, what kind of sourcing advantage you will have from the non-NCR doing 5% cost reduction and 10% cost reduction anything you want to?

Anant Kumar Daga: I won't like to quantify that because that's not what too many people are doing. But a simple thing is the, forget about everything the labor cost arbitrage itself is meaningful.

Jignesh Kamani: And any feedback on the Elleven branch, though it is I can say launched and then COVID has hit, but any initial feedback from the consumer, anything you can. And how can scalability of this?

Anant Kumar Daga: Yes. So typically, what we do is whenever we take a new project, our first test is product customer test and then second is channel test, and then we scale up operations. So for example, in footwear, we have been able to launch in our 40 top stores. We have seen tremendous traction. So this season, we are launching in LFS, doing a channel test, and then we can build it up. Unfortunately, for Elleven, we took the EBO route and finally, we could open only 3 EBOs. And we don't have too much those EBOs, we are seeing customers coming, we have seen repeat customers coming. But see right now we have launched an LFS. We'll open a few more stores, it will be too early for me to talk on Elleven, because it was a EBO route, it got completely on the back burner. So give us some time maybe in the next 4 to 6 months, we'll have much better answers on Elleven.

Jignesh Kamani: And last question on the store opening. On the base of close to 590 stores, the 60 to 70 store when lease rental are pretty attractive right now and considering strong balance sheet, can we be a little bit more aggressive or right now we can say because of the market, we want to open only 60, 75 next year. Is there a probability of +100?

Anant Kumar Daga: So the answer to that is, we definitely have a scope of going more aggressive. Right now, once we look at Q1, Q2, our confidence will grow and then scaling up won't be a challenge. But right now, there is a limited visibility that we have, however we are reasonably confident that despite a weaker than expected recovery we'll be able to do as much. But if things start getting built up better in Q1 and Q2, definitely you will see a bigger number there.

Moderator: Thank you. The next question is from the line of Shivaji Mehta from Nippon India Mutual Fund. Please go ahead.

Shivaji Mehta: What proportion of our gross margin impact would be on account of the cotton yarn spreads being at all-time high levels?

Anant Kumar Daga: So see, right now, there is no impact because we have got fabrics much in advance and all the stocks that we have in our stores were all made earlier. So this season, the impact is frankly very, very low. And as of now, whatever the stocks are there, it's nothing. For monsoon festive, first of all we don't use only cotton fabrics. So we use multiple fabrics, and there's an arbitrage that we have there, because most of the styles, they can lend to as well to different fabrics. So, if you speak about cotton itself for a brand that is 100% cotton, it would be at least 12% to 15% increase, but thankfully cotton is a small part of our range, especially in festive. So that impact would be slightly limited. Whatever impact of fabric prices is something that will come only in monsoon festive and there also it's right now at all-time high. People expect it to come down in near future. So we'll assess the complete impact.

Shivaji Mehta: Sure. And if so this spread, say it will change for the next one to two quarters, or would we be able to pass it on fully, or do you expect that we'll have to take a bit of hit?

Anant Kumar Daga: So first of all see, there are a lot of mitigation measures, which we will do so obviously, the total impact won't be as high as it looks. Number two, if beyond that, it continues to go up, everyone will have to take a price increase, and this will be across the market. So, relative pricing of all the brands would have to go up.

Moderator: Thank you. Due to time constraints, that was the last question. I now hand the conference over to Mr. Anant Daga for closing comments.

Anant Kumar Daga: Thank you everyone. We take this opportunity to thank you for joining on the call. We hope we have been able to address your queries. For any further information, please do get in touch with us or SGA, our Investor Relations Advisors. Have a nice evening, take care and stay safe. Thank you.

Moderator: Thank you. On behalf of TCNS Clothing Company Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.