

# Investment Idea - TCNS Clothing Ltd

This presentation details the thought process behind why we like this business and why we believe this can be an interesting investment idea. Not investment advice, we do a risk profiling and expectation setting exercise before we sign up any customer

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## Disclosure

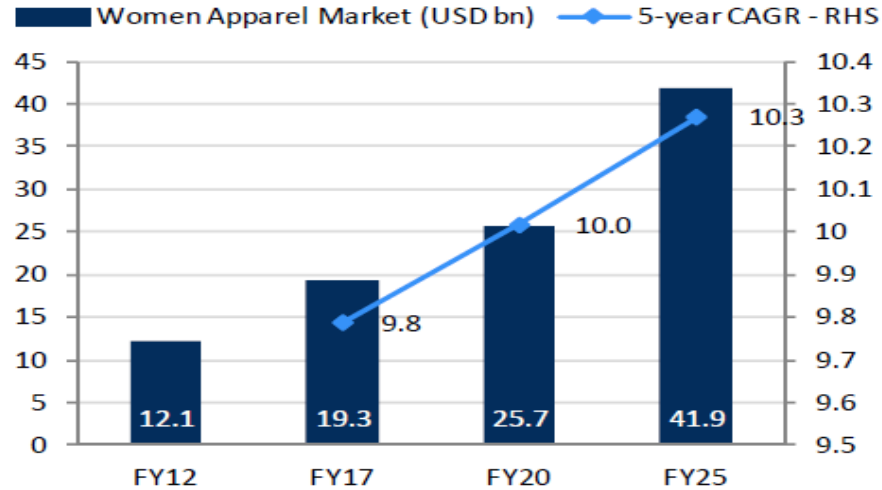
*We are invested into TCNS Clothing, there have been BUY transactions in the past 30 days. Please make allowance for the fact that we are biased in favour of the business, as it should be when you invest into a business. Our BUY price on an average is lower than the current market price*

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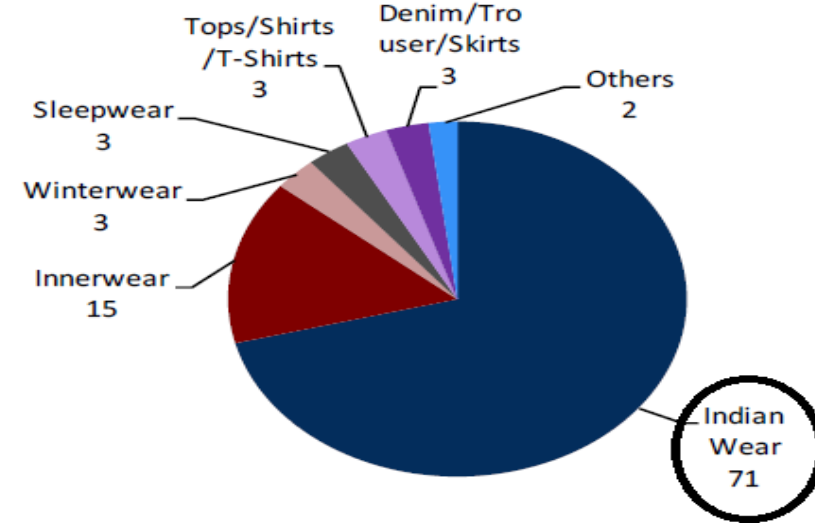
# Setting the context - Market Sizing

## Women apparel market is growing at 10% CAGR



Source: Technopak, HDFC sec Inst Research, TCNS Clothing RHP

## Indian wear accounts for >70% of the mkt



Source: Technopak, HDFC sec Inst Research, TCNS Clothing RHP

## Women's Indian Wear – FY17

Segment	Market Size (USD Bn)	Market Size (INR Cr)
Saree	6.2	~43,000
<b>Ethnic Wear</b>	<b>6.5</b>	<b>~45,000</b>
Others	1	~7,000
<b>Total</b>	<b>13.7</b>	<b>~95,000</b>

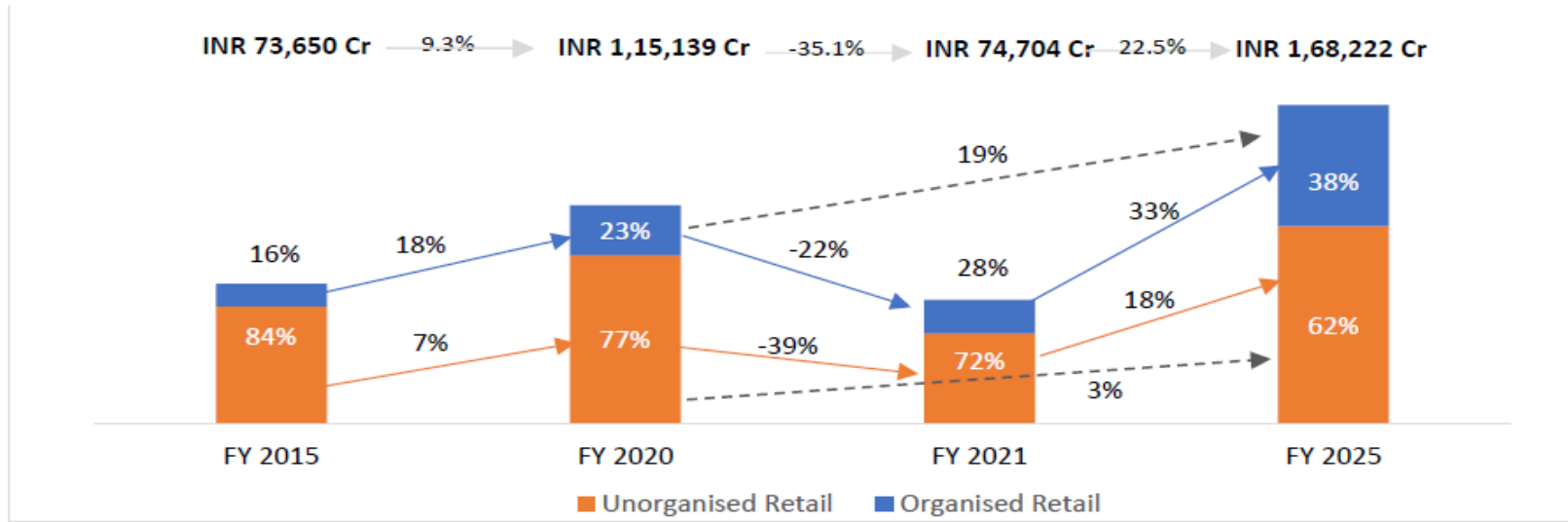


## Women's Ethnic wear market projections in FY17

Segment	FY17	Expected Growth Rate over 5 years
Branded	~10,000	~20%
Unbranded	~35,000	~8%
<b>Total</b>	<b>~45,000</b>	<b>9-10%</b>

**What happened post COVID?**

# Setting the context – Industry Landscape post COVID



Source: Technopak Analysis

Revenue (in Cr)	Revenue (in Cr)							Absolute growth %	
	2017	2018	2019	2020	2021	2022	FY 17-20	FY20-22	
TCNS Clothing	701	997	1,148	1,149	636	896	63%	-23%	
Biba Apparels	543	715	799	750	525	630	38%	-16%	
Fab India	1,322	1,336	1,457	1,565	1,060	1,392	18%	-12%	
Anita Dongre	440	479	512	507	257	416	16%	-18%	
<b>Total</b>	<b>3,006</b>	<b>3,527</b>	<b>3,916</b>	<b>3,971</b>	<b>2,478</b>	<b>3,334</b>	<b>33%</b>	<b>-17%</b>	
Soch Apparels		408	380						
Vedant Fashions	610	760	794	915	542	1,009			

Source: Congruence Advisers research, based on Annual reports & Credit rating reports

## Women's Indian Wear

- Market size fell ~35% post COVID
- Market grew 9-10% as expected over FY17-20
- Organized grew <20% due to consumer slowdown post Demonetization and GST
- MBO channel most affected

## Women's Ethnic Wear

- Top 5 were ~7% of the ethnic wear market in FY17
- TCNS Clothing was the fastest grower till 2019
- WFH dented women's category as not all of it is festive/celebration wear
- FY20 base being surpassed only by H1FY23 ARR
- Expected growth rate for the organized segment from here is > 15%

# Setting the context – Channel dynamics

	Channel margin	Inventory	Display potential	Footfall conversion
EBO	None for owned/ c. 20-30% for franchised	On-books for owned EBOs	Very High – Large no. of SKU's	High
LFS	High (30-45%)	On-books for Consignment, Off-books for SOR	High – Large no. of SKU's	Medium
MBO	High (25-35%)	Typically Outright Sale – Off books	Low	Varied
E-commerce	High (40-60%)	Typically Outright Sale – Off books	Difficult to control	Uncertain

Source: Avendus Report, Women's apparel 2016

EBO store count	2017	2018	2019	2020	2021	2022
TCNS Clothing	381	465	541	595	551	600
Biba Apparels	250	314		381		436
Fab India	232	275	298	327		
Anita Dongre	280					233
Soch Apparels	99	126		133		135
Vedant Fashions		450	500	600		607

Source: Congruence Advisers research, based on Annual reports & Credit rating reports

## Points to note

- MBO channel was hit badly after 2017
- Online channel salience crossed 10% after 2020, at 16-20% as of date
- EBO offers the highest control for the brand, COCO model can be balance sheet heavy, FOFO is lighter
- LFS demands higher credit period
- Revenue recognition methodology differs across channels based on whose books hold inventory
- >50% of revenue from EBO followed by LFS and then online channel
- All players wound up many EBOs in 2021, optimized on lease expenses
- EBO expansion back on now
- Brand experience, cross selling much easier to pilot in EBO's before replicating across LFS and SIS
- Online channel demands discounting
- MBO channel still below 10% salience for most players

# What are the challenges in this segment?

## **Women's segment in any market is far tougher than the men's segment**

In innerwear – Women's segment is 2x the men's segment but has very few > 500 Cr brands while men's segment has > 10 brands

Price sensitivity is much higher since decision making is more nuanced, especially in apparel

Higher number of SKU's in women's segment makes inventory management a much bigger challenge, requires more working capital

Range of designs, colours & fabrics needed are much higher; men's segment is more simple in terms of customer preferences

On an average, within the same market the men's segment has higher margins, lower debt and better unit economics

## **Competitive Intensity is very high in the women's ethnic segment**

Ethnic wear other than celebration/occasion wear is a price sensitive segment, also doubles up as regular office wear for many

Strong competitor brands like Biba, Global Desi, Soch & private labels from online retailers and LFS stores

Designs that are well accepted by the market get replicated quickly by competing brands & unorganized market

Rollout outside of Metro and Tier 1 cities at existing price points has not been easy in India. Each micro market has different tastes

Managing EBO's well isn't easy, lot of attention to detail is needed to run 200+ stores well enough

## **Negative effects of the online channel becoming more prominent**

Online channel salience moved to 15% from below 5% for many players between 2020-22 across categories

Selling & Distribution expenses are much higher for online and LFS channels, concentrated buying centres are more demanding

Brand pull tends to be lower when a catalogue of options is presented online, willingness to pay a higher price comes down too

D2C brands with digital only customer acquisition model tend to bring down price points for the entire market through discounting

Discounting is always ON in the online world while it is more seasonal in the offline world

# How do Consumer businesses grow TAM

## Page Industries Timeline

1997 – Jockey for Her  
2004 – Jockey socks  
2005 – Jockey Brassieres  
2011 – Speedo  
2015 – Own B2C ecommerce website, tie up with online retailers  
2016 – Towels  
2018 – Speedo apparel range, Jockey woman  
2019 – Jockey junior range

*Source: Page Industries Investor presentation, Nov 2022*

Branched out into dedicated EBO for women's category  
LFS and MBO rollouts over time in Metro and Tier 1 cities  
Online focus since 2015  
Now focusing on penetration to Tier 2 towns and below

Start with and dominate a niche, expand into adjacencies using existing channels, launch newer channels over time, expand geographical foot print

## Marico

Built personal grooming portfolio (Set Wet, Livon, Zatak) through acquisitions in 2012 and relaunched brands in 2015-16  
Brand expansion of Saffola into foods category  
Foods expected to clock 1,000 Cr annual revenue in some years  
Penetrating into chemist network within urban India as part of a distribution expansion drive

*Source: Public media reports and annual reports*

## Asian Paints

Dominant player in decorative paints  
Now has the largest painting service across 600+ locations  
Foray into waterproofing solutions  
Foray into home décor solutions  
Foray into kitchen solutions  
Foray into Bathware & sanitaryware

**Category expansion within adjacencies**  
**Increase channel coverage**  
**Geographical expansion into newer regions**



**Increase the TAM (Total Addressable Market)**  
**Increase customer LTV (Life time value)**  
**Incrementally lower customer acquisition cost (CAC)**

# TCNS Clothing – Historical Financials

All numbers in INR Cr	2018	2019	2020	2021	2022	H1 FY23
Revenue	997	1,148	1,149	636	896	627
Gross Margin (%)	65.65%	66.03%	64.98%	57.23%	65.44%	68.10%
Employee Expenses (%)	12.40%	12.52%	13.72%	19.03%	16.74%	15.15%
Other Expenses (%)	37.67%	38.11%	35.04%	37.58%	38.73%	40.67%
S&D Expenses (%)	20.58%	20.80%	23.42%	25.09%	25.96%	27.27%
ASP (%)	3.36%	3.27%	3.59%	2.12%	4.60%	
PAT (%)	9.84%	11.46%	6.04%	-8.65%	-0.52%	1.66%
Borrowing	-	-	-	5	-	-
Gross Block	76	91	86	79	97	
Working Capital Days	98	108	122	202	148	
Market Capitalization - FY end		4,916	2,018	3,918	4,700	3,450

Business has always been asset light due to outsourced manufacturing, has high gross asset turns

Working capital cycle of 140-160 days is par for many branded garments businesses in India

Revenue has clawed back to pre COVID level only recently

FY21 saw optimization on rent, employee expenses and market development spends. FY22 has seen a normalization

Expenses right now are higher than pre COVID levels while revenue is only now starting to surpass past levels

Online channel increased to 200 Cr p.a. from 85 Cr (<10% to 16% of revenue) which has higher S&D expense along with LFS

# What attracted us to this business?

## Historical

- Baseline category growth rate expected to be 15%+ over the next 4-5 years
- Minimal competition from MNC brands unlike other segments like athleisure, western wear, footwear etc
- Barriers to entry in the form of sourcing network, ability to spread brand expenses over 1000 Cr+ revenue, good channel management
- Proven expertise in managing channel expansion well without stressing balance sheet (some players have botched up EBO expansion)
- Debt free balance sheet with healthy unit economics (18%+ EBITDA margin)
- Asset light manufacturing setup with in house design team, business model does not need capital to scale up production


## Recent

- Category expansion across bottom wear, footwear, jewellery, cosmetics increasing the TAM. FY23 target of 100 Cr ARR exit for the new categories combined (will be 7-8% of the current revenue)
- Clear roadmap for omnichannel fulfilment with necessary supply chain investments
- EBO expansion back on track after a 2 year COVID impact, this channel has the lowest Selling & Distribution expenses
- Higher base of operating expenses depressing current EBITDA margin, revenue surpassed pre COVID level only in Q2 FY23
- Our research indicates that cross selling is working well within the COCO Project Rise EBO's (tracking 1.5x pre COVID revenue rate)
- Price hasn't gone anywhere after the overpriced IPO (in our opinion) of 2018




# TCNS Clothing – Recent category expansion

**2012**





**Reinterpreting Fusion Wear**  
Palazzos and slim pants added an edge to fusion wear.

**2011**



**Fashion At Fingertips**  
Among the first brands to have its own e-commerce portal.

**2009**

**Aurelia Brand Inception**  
Birth of the ethnic jewel for suave women.

**Aurelia** launched in 2009 is today a 500 Cr+ brand with 250+ EBO and multiple channels

Own e-commerce portal today accounts for 25% of the online revenue (16% of total revenue in H1 FY23)

Bottom wear brand **Elleven** expected to close FY23 at an Annual Run Rate of 45 Cr. The largest organized players in this segment are Go Colors (~600 Cr revenue, market cap 6,200 Cr) and Lyra from Lux Industries (~400 Cr revenue). 17 EBO's and 40 in Shop in shop format stores

**Footwear** now available across 180+ stores. Jewellery line across Project Rise (large format, flagship) stores


**W Beauty** (cosmetic line) available across 50+ stores

**Folksong** collection available across 60+ stores

**Aurelia Girls** collection available across 220+ stores


*Source: TCNS Annual Report 2022*

**2022**




**Launched W Beauty**  
Extended the top-to-toe offering for W consumers.

**2021**




**Supply Chain 2.0**  
Automated Inventory Management System.

**2020**



**Launched Foot Apparel**  
W forayed into the footwear market.



**Brand Elleven Launched**  
First exclusive brand store of Elleven opened.

# What other investments is the management making?

## Channel expansion (capex of 25-30 Cr per year since 2016)

Store Count	2015	2016	2017	2018	2019	2020	2021	2022	H1 FY23
EBO	235	305	381	465	541	595	551	600	648
LFS	565	794	991	1,469	1,623	1,944	2,123	2,204	2,479
MBO	748	960	1,109	1,522	1,428	1,114	1,011	1,058	1,123
Online %		7%	10%	9%	11%	10%	28%	21%	16%

### Sourcing and Supply Chain *(Source: Annual report and investor presentations)*

- Integrated Warehousing – Ability to serve new age delivery models and new product categories, 3<sup>rd</sup> party operations
- Inter Store Transfer & Real time sales – Omni channel distribution, slow moving articles to top stores, improved stock availability across regions
- Automated Replenishment – Across all EBO & LFS, Product Lifecycle Management and ML based decision making

### Store Modernization *(Source: Annual report and investor presentations)*

- **Project Rise** – One Stop shop, large store format showcasing all offerings (2000-4000 sq ft) in metros. Company owned
- **Project Bharat** – Retail expansion in Tier 3 & Tier 4 towns through the franchisee route

### Recent hires related to category expansion *(Source; LinkedIn)*

- CMO - Ex Reebok, TAG Heuer (hired in 2021)
- E-commerce Lead – Ex Amazon, Rivigo (hired in 2021)
- Sourcing Head for Footwear & Handbags – Ex Reliance Brands, Future Group (hired in 2022)

# Qualitative research – what did we find?

## **Store visits (Bangalore, Mumbai) to Project Rise stores over the past 3-4 months indicate that**

- Merchandise display following the category expansion drive was revamped in these stores towards the beginning of 2022
- Front end staff has been trained to showcase all the categories at the appropriate time to every walk in
  - Cosmetics yet to see any significant traction as of September 2022
  - Bottom wear collection seeing the best response across all of the newer categories, it appears to be an easy sell as a mix and match option once the primary garment choice is made
  - Footwear and Jewellery traction is getting better but not at the same pace of bottom wear
- Billing amount per fruitful walk -in is trending 40%+ higher in these specific stores

***Visiting 3-4 stores isn't sufficient enough to draw too many conclusions!***

***Prima facie, management is walking the talk from the annual report and investor presentations by making the necessary investments across many areas***

We also visited competitor stores nearby, none of them had the category range that TCNS flagship stores offered though the collection of ethnic wear was equally good

What stood out in the stores was - Good lighting, spacious displays with minimal clutter and attentive salesmen who were ensuring that every new category (footwear, jewellery, cosmetics, bottom wear) was highlighted to each walk-in

## Recent financials – Yet to hit the revenue inflection point

All numbers in INR Cr	Q3 FY20	Q4 FY22	Q1 FY23	Q2 FY23
Total Revenue	336	247	283	352
Gross Margin (%)	67.80%	68.80%	68.85%	67.35%
Employee Expenses (%)	12.76%	17.50%	17.02%	13.53%
Other Expenses (%)	32.80%	43.16%	38.22%	38.74%
S&D Expenses (%)	23.1%	27.7%	26.7%	27.6%
EBITDA Margin (%)	22.2%	12.9%	13.4%	13.6%
PAT (%)	9.3%	-2.5%	0.88%	2.17%

*Q3 FY20 reported PAT was 55 Cr due to tax writeback, the above PAT number is normalized for 25% tax rate*

- Gross Margin has been steady around pre COVID level
- Selling & Distribution expenses % higher since online channel revenue is at 16% from 10%, EBO share at 41% from 45%
- Employee expenses have normalized after the optimization drive of FY21, higher by ~18% in an absolute sense from FY20
- Other expenses still higher by 600 bps, 400 bps due to S&D Expenses and rest due to higher freight & rent expenses
- Depreciation and finance cost as % of revenue each higher by 100 bps each
- Fixed operating expenses are higher by 35-40 Cr for H1 FY23 annualized over FY20

***Operating expenses are higher due to investments into growth, revenue is only now surpassing pre COVID level***

***Can incremental revenue move the needle disproportionately on earnings in FY24 and FY25?***

# Summarizing the investment thesis

- Category expansion is likely to contribute materially to the revenue over the medium term
- New categories are unlikely to dent unit economics from the current level since they are all sub scale currently
- Operating expenses base has moved higher but revenue is set to surpass pre COVID level only from H2 FY23
- As EBO & offline channel come back to earlier level of revenue contribution, S&D expenses may moderate from current level
- At a revenue base higher by ~15% from current levels, earnings may come back to the pre COVID level of FY20
- Operational efficiencies can deliver earnings growth disproportionate to revenue growth from here

## What are the risks worth pondering over?

1. Urban consumer spending dipping after the highs of Q1 and Q2 across categories. ***What if the current buoyancy turns out to be short lived revenge spending and not a secular trend?***
2. The business getting stuck in a loop of making investments for growth without allowing enough time for the earnings to get better. For e.g. aggressive EBO expansion and technology investments that prevent earnings from getting better significantly
3. Lack of anticipated improvement in EBITDA margin due to any of
  - geographical expansion into Tier 2 & below cities diluting margin due to lower realization
  - newer categories being dilutive to unit economics for the overall business
  - Online channel continuing to grow fast but at high discounting
4. Entry of a new, well funded, irrational player to the category who is in a hurry to gain market share
5. Risk of promoter and management change (speculation in the media), stock supply overhang due to this

# Valuation & other perspectives

## Top stories

**THE ECONOMIC TIMES**

TCNS Clothing rallies 11% amid reports of Reliance Retail, Nykaa eyeing promoter stake

1 day ago



**Inc42**

Nykaa, Reliance Looking To Acquire Promoter Stake In TCNS Clothing

18 hours ago



While this is speculation at this point of time, if the new promoter (if any) does not respect financial discipline, it will constitute a clear SELL in our opinion

Our thesis is also based on the current management being allowed to operate the business on a status quo basis, any change there will also trigger a revaluation of our thought process

## Valuation Benchmarking

Business	Market Cap	FY22 Revenue	Pre COVID ROCE %	Pre COVID WC days	Pre COVID OPM %	FY22 OPM %	FY 22 PAT %	Price to Sales (4x Q2 FY23)	5 Year Rev Growth	Q2 FY23 YoY growth%
Page Industries	51,000	3,886	~55%	~60	~20%	20%	14%	10x	19%	16%
Vedant Fashions	32,500	1,009	~35%	~150	~35%	48%	31%	32x	11%	24%
Go Fashion	6,100	401	~20%	~150	~30%	30%	9%	9x	29%	48%
Bata India	21,500	2,388	~30%	~60	~28%	18%	4%	6.5x	-1%	35%
Lux Industries	5,000	2,273	~25%	~150	~18%	21%	14%	2.2x	19%	2%
Metro Brands	22,000	1,343	~30%	~70	~28%	31%	16%	12x	8%	46%
VIP Industries	10,000	1,290	~30%	~90	~16%	11%	5%	5x	1%	56%
<b>TCNS Clothing</b>	<b>3,600</b>	<b>896</b>	<b>~30%</b>	<b>~100</b>	<b>~20%</b>	<b>10%</b>	<b>-1%</b>	<b>2.5x</b>	<b>5%</b>	<b>47%</b>

## Appendix – Sources to read

**Technopak Advisors** – Reports on Women’s Indian wear segment within Retail sector; 2016 and 2022

**Philip Capital** – Retail Sector, A new dawn; 2019

**TCNS DRHP** filed with SEBI

**HDFC Securities** – Who’s moving the retail flywheel? 2019

Credit Rating reports of unlisted competitors like Soch Apparels, Biba Apparels, Fab India

- Read all the reports
- Triangulate data points from various sources on trends & growth rates
- Verify these with bottom up company specific insights and credit rating reports
- Come to your own conclusions on the category and the business
- Ask yourself – how can the earnings profile change once revenue moves higher by 20-25% from current level

***The best investors have a 25%+ error rate over a 5 year period. Needless to say, we can be wrong too***

***Ideal investment horizon for this business – 4 to 5 years***

Please write to us at [info@congruenceadvisers.com](mailto:info@congruenceadvisers.com) for a copy of this presentation