"KDDL Limited Q4 FY 2018 Financial Results Conference Call"

May 15, 2018

MANAGEMENT: **MR. YASHOVARDHAN SABOO -- CHAIRMAN AND MANAGING DIRECTOR, KDDL LIMITED**
MR. SANJEEV MASOWN -- CHIEF FINANCIAL OFFICER, KDDL LIMITED
MR. C. RAJA SEKHAR -- CHIEF FINANCIAL OFFICER, ETHOS.

Moderator: Ladies and Gentlemen, Good Day and Welcome to Q4 and FY 2018 Financial Results of KDDL Limited. 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 the 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. Yasho Saboo -- MD, KDDL. Thank you, and over to you, Sir!

Yashovardhan Saboo: Good Morning to Everyone and a Warm Welcome to all of you for our Q4 and FY 2018 Earning Conference Call. I am joined by Mr. Sanjeev Masown -- CFO of KDDL; Mr. Raj Sekhar -- CFO of Ethos and our Investor Relations partners Strategic Growth Advisors.

I hope that all of you have had the chance to go through our updated Investor Presentation uploaded on the exchanges and on our company's website.

Let us start with the consolidated performance of the quarter FY 2018, which is Q4. Consolidated revenue rose by 34% from Rs. 102.9 crores to Rs. 138.1 crores and growth were contributed by both the manufacturing business and retail arm of our business that is Ethos,

Gross profit grew by 44% from Rs. 39.0 crores in Q4 of FY 2017 to Rs. 56.2 crores in Q4 FY 2018. Gross margin improved by 283 basis points on Y-o-Y basis led by better operational efficiency and subsequent leverage. EBITDA stood at Rs. 13.1 crores for the quarter, up by Rs. 237% year-over-year. Margin improved by 570 basis points Y-o-Y to 9.46%.

Profit after tax after minority interest increased multifold from a loss of Rs. 0.5 crores in Q4 of the previous year to Rs. 6.9 crores in the quarter four of FY 2018, while cash profits nearly trebled Y-o-Y to Rs. 10.2 crores.

Let me give a snapshot of the consolidated performance of FY 2018. Consolidated revenue grew by 11% from Rs. 453.2 crores to Rs. 501.8 crores in FY 2017. The growth in FY 2018 was back ended with H2 being much better on account of the stable regulatory regime and a strong revival in demand. Gross profit grew by 17% from Rs. 171.1 crores in FY 2017 to Rs. 199.9 crores in FY 2018.

Gross margin improved by 209 basis points on a Y-o-Y basis. EBITDA stood at Rs. 44.2 crores for FY 2018, up by 78% Y-o-Y. Margin improved by 332 basis points Y-o-Y to 8.8%. Profit after tax after minority interest for FY 2018 increased multifold from Rs. 1.2 crores in

FY 2017 to Rs. 18.4 crores in FY 2018, while cash profit increased by 137% to Rs. 30.5 crores.

The Board of Directors have recommended a final dividend of Rs. 2.50 per equity share subject to the approval of shareholders at AGM.

Now, we discuss the manufacturing business performance. The global watch industry continued to show signs of improvement which has reflected in our revenue growth. The domestic watch segment revival has been more assertive which is very encouraging.

Revenue from our watch component business grew by Rs. 23 crores in quarter four FY 2017 to Rs. 29 crores in quarter four FY 2018. For FY 2018 revenue grew by 13% Y-o-Y to Rs. 108 crores from Rs. 97 crores in the previous year. We believe that significant opportunities are emerging for growth in the domestic segment for which we will need to expand capacity.

Starting this year, we intend to do this in phases together with technological upgradation including the incorporation of a latest process involving more automation, digital and 3D printing, laser machining and welding. With this, we will ensure not only the continuing growth in profitability of our core manufacturing segment but also ensure that we remain up to date in terms of technology, the expansion project of precision engineering business at Bengaluru (Bangalore) is progressing as per the revised schedule and by the end of the current quarter the existing facilities will be completely shifted and consolidated at the new location.

This segment saw a revenue growth of 26% Y-o-Y from Rs. 6.8 crores in quarter four FY 2017 to Rs. 8.6 crores in quarter four FY 2018.

For FY 2018 revenue grew by 35% Y-o-Y to Rs. 33.4 crores from Rs. 24.7 crores in the previous year. The flow of RFQ's leads and inquiries are healthy, and the order position is strong. We expect the precision engineering business will continue to enjoy healthy growth.

In addition to market expansion and revenue growth, our focus is on improving margins through improving operational efficiencies and with interventions of manufacturing excellence.

I will now briefly discuss the performance of our retail business with us. After a long period of almost two years of regulatory changes and a choppy business environment, we witnessed a significantly calmer H2. We witnessed the revival of demand and this coupled with strategic changes in our business model have yielded very positive results. We believe these are sustainable and reflect the huge potential where this business holds.

Let me give you a quick snapshot on the regulatory changes and where we stand today. Since, January 2016 all high-value purchases in India above Rs. 2 lakhs are required to furnish a Pan Card. This caused sales to slow down as there was resistance among buyers to furnish Pan

Card details. At Ethos, we responded and lowered the inventory for very high-priced watches and exited a few prices categories and brands bringing our focus to the price category to Rs. 50,000 to Rs. 5 lakhs in the acceptable luxury segment and Rs. 5 lakhs to Rs. 10 lakhs in the high luxury segment. This means that we reduced our focus on price points above Rs. 10 lakhs. It has taken some time to clear the high-priced inventory, but we have passed that. This is reflected in our inventory months which have come down.

The GST rate was announced at a very high 28% in July 2017. This rate was one of the highest in the world for watches. This hampered demand and sales. A lot of sales actually happened in Q1 prior to the GST change.

In November, the rate was revised from 28% to 18% which led to a reduction in the prices of watches. This made India very competitively priced compared to other shopping destinations in the world. This rate revision came at an opportune moment in the middle of the festive season which added a welcome multiplier on our sales. What GST has also done is to reduce our operating expenses in the form of Service Tax, which are now subsumed under the GST rate. This is also visible on reduction in our other expense.

The other change was the recent change in import duty from 10% to 20% plus or higher surcharge so affectability is about 22%. We are lobbying with the Government to relook at this. As an industry, we believe we do not need this protectionist measure and can compete without an increase in basic duties. As a result of this increase, brands have taken a price hike on the watches. However, even after the price increase the Indian watch market environment remains competitively priced vis-à-vis international markets and we do not see customer buying shifting out of India for our chosen priced points.

During the last period of two years, we have embarked on strategy and helps us to grow our business and at the same time become profitable. We believe, we are now in a position which can catapult us to increase our market share in all our locations making us the market leader. Another big change has come from our exclusive brand strategy which has not only yielded profitable results but created a new level of engagement with several Swiss brands. We have been able to better our vendor margins, lower competitive discounting, negotiate a higher share of marketing budget from these brands, all the steps are positively impacting our performance. Our revenue contribution from exclusive brands at the end of FY 2018 is at approximately 13% of the overall Ethos revenue and they contribute approximately 22% of the gross margin. Our goal is to increase the revenue share from 13% this year to around 25% in the next 10 quarters to 12 quarters with corresponding positive impact on margins leading directly to an improvement in net profit.

It is pertinent to mention that the increased share of revenue of exclusive brand comes from a lower share of the very high-priced products as already mentioned earlier. But it also comes from eliminating very low-priced segment that is the segment below Rs. 10,000. Thus, sharpening our focus on the chosen price segments. I may also mention that the price segments we have now chosen to dominate are also the fastest growing and most profitable. We have a full pipeline of other exclusive brands that are keen to part of Ethos and we expect a portfolio of such brands to be continuously reviewed so that non-performers are weeded out high performers get a better share of our marketing and store spaces.

Our exclusive brand strategy has gone a step ahead of where some brand now wants Ethos to distribute watches to other retailers. This is an important step as it allows the brand to be available at multiple points of sale with the pricing control remaining with Ethos. It also encourages the brand to increase its marketing spends which allows the brand to gain popularity and recognition. All in all, it was a win-win situation for Ethos and the brand.

Last quarter, I mentioned to you about our pilot project for the business of certified pre-owned watches. We have commenced this business and are taking small steps to understand the regulatory environment before we commit a larger role in this business. This is an important as it will make Ethos become the go-to destination for watches.

I will now move to give you the financial highlights for Ethos. Billing grew by 33% Y-o-Y to Rs. 112.4 crores in quarter four of FY 2018 from Rs. 84.2 crores in quarter four of FY 2017. For the full financial year, 2018 billings growth was 16% Y-o-Y to Rs. 420.0 crores from Rs. 363.6 crores. The billings growth in H2 for the financial year 2018 was 28% on Y-o-Y basis.

Same-store growth in FY 2018 was 10% versus 2% in the previous year. For H2 in FY 2018, the same store growth was 19%. Thus, we are slowly returning to the same store growth we witnessed in the stable regime of the pre 2016 era.

Gross profit grew by 64% Y-o-Y from Rs. 15.7 crores to Rs. 25.8 crores in Q4 of FY 2018. For the full year, FY 2018 gross profit increased by 17% Y-o-Y from Rs. 73.6 crores to Rs. 86.1 crores. Normalized EBITDA stood at Rs. 7.1 crores for the quarter, up from a loss of Rs. 1.1 crores in quarter four of FY 2017, while for the full year normalized EBITDA increased from Rs. 2.2 crores in FY 2017 to Rs. 18.5 crores. EBITDA margin for FY 2018 stood at 4.5% while in H2 it stood at 8.5%.

Profit after tax for this quarter stood at Rs. 2.6 crores, up from a loss of Rs. 2.4 crores in the corresponding quarter of the previous year, while for the full year FY 2018 profit after tax stood at Rs. 4 crores, up from a loss of Rs. 6.2 crores in the previous year.

For H2, we recorded profit after tax of Rs. 8.7 crores versus a loss of Rs. 1.5 crores in the corresponding H2 of the previous year.

Cash profit increased to Rs. 3.9 crores in quarter four from a loss of Rs. 1.6 crores in the previous year same quarter while for the full year financial year 2018, the cash PAT was Rs. 8.1 crores, up from a loss of Rs. 2.4 crores.

Stock carrying months for FY 2018 improved to 7.5 months from 8.1 months at the end of FY 2017.

During the last quarter, we opened three new stores, the multi-brand stores at Oberoi Mall in Mumbai; the JJ Boutique in Chanakya Puri in Delhi; and a multi-brand store in Indore. I think formally it was done a few days ago. In April, we have launched the Panerai Boutique in Delhi taking our total store count to 44.

I now welcome your questions and participation.

Moderator: Thank you very much. Ladies and Gentlemen, we will now the Question-and-Answer Session. The first question is from the line of Mangesh Bhadang from Param Capital. Please go ahead.

Mangesh Bhadang: Sir, a couple of questions from my side. You mentioned in your opening remarks as well as in the PPT that the second-half performance is sustainable. So, I just wanted to get an idea on the SSG expectation that you have, we can go back to that 12% - 13% SSG or you think that higher SSG is possible? And the backdrop for that is after the reduction in the GST rates we had just custom duty which was also improves. So what do you think was the impact of that on the overall growth or that has been basically accepted by the market?

Yashovardhan Saboo: Okay, are there any other questions, Mangesh?

Mangesh Bhadang: Just one more is how much would be the value of higher the above 10 lakh price inventory in the total inventory of Rs. 200 crores? That is, it.

Yashovardhan Saboo: So Mangesh, the H2 performance, every year the H2 performance is always better than H1 and Q3 is usually the best quarter of all. In the FY 2018, it was more so because we have that brief period of the price reduction that everybody enjoyed for about two months before the import duty was increased.

Mangesh Bhadang: And the base was also helpful.

Yashovardhan Saboo: And the base was also low. However, that said, I think the overall performance is sustainable because it brings into and I am speaking about this in terms of our long-term goal to achieve a 10% EBITDA. You remember, we have tracking from what we spoke pre2016 before the turbulence hit us, we spoke about achieving a 10% EBITDA and at that time we had gone from 3% to 4% and we are approaching 5% EBITDA and 10% seem to be a long way off, right. What H2 shows up and it is not only Q3, it is Q3 and Q4 what it shows us is that EBITDA of 10% is achievable. We are currently in the range of about 6% to 7% EBITDA and over the next two years to three years with the increase in the margin with the increase in operating leverage, we are able to achieve this 10%, it is very credible, it is a very achievable number. Coming now to the question of the same store growth our long-term goal for same-store growth is in the region of about 11% to 12% which compares very favorably with not only the expected growth in the market but in the luxury retail side in general. And your third question was on the…

Mangesh Bhadang: Inventory.

Yashovardhan Saboo: On the inventory. So the inventory of watches above Rs. 10 lakhs at MRP, the stock is between 2% to 3% of the total stock.

Moderator: Thank you. We have the next question which from the line of Rajat Setiya from Vrddhi Capital. Please go ahead.

Rajat Setiya: So sir, you gave some numbers for exclusive brands like 13% of revenue is coming from them and 22% of gross margins is coming from them, right?

Yashovardhan Saboo: Yes, correct.

Rajat Setiya: So this 22% is the gross margin that these watches are making or this is the contribution of gross margin of the whole company is coming from…

Yashovardhan Saboo: 22% of the total gross margin is earned by the company. 22% comes from exclusive brands, so 13% share of revenue. 22% share of gross margin.

Rajat Setiya: Yes. So, going by these numbers, I think the gross margin for exclusive brands is coming around 40% so that is correct?

Yashovardhan Saboo: You know there is a range of gross margins across different brand but broadly yes, that is correct.

Rajat Setiya: All right. And sir, gross margin for the company as a whole I mean the Ethos gross margin in this quarter have come around 26.5 percentage points and my question is do you think these are sustainable going forward?

Yashovardhan Saboo: Certainly. You know why I am saying this is please compare this with the gross margins that existed pre2016.

Rajat Setiya: Yes.

Yashovardhan Saboo: We are getting back on track. We expect gross margins to gradually go up as the share of exclusive brands increases, but we are not projecting a dramatic increase. We are seeing the numbers we are seeing the share of exclusive brands going up, we are seeing that they contribute higher gross margin. So, after that, it is basically arithmetic to check that when an exclusive brand becomes 25% of the overall revenue and the margin structure is not likely to change if anything is going to improve what is going to be the overall increase in margins. And that is what we have said, we believe that as we grow larger we will get some better leverage for negotiating terms with the brand and we will get operating leverage, so these are three things that will lead to the overall goal of EBITDA 10% being achieved.

Rajat Setiya: So, sir, basically on a blended basis exclusive brands are generating 40% gross margins, so that means some of the brands or some of the watches would actually be generating probably 45% - 50% kind of gross margins, right?

Yashovardhan Saboo: Some of them could be.

Rajat Setiya: Okay, all right. So, the next question is around inventory. So, although this year has been better than the last two years, so where do you think we can actually improve our inventory levels going forward?

Yashovardhan Saboo: I think, our focus is not only inventory, but our focus is really month of paid stock. And we believe that over the next two years to three years our inventory levels which is currently at about 7.5 months our goal is to bring this down to about 6 months of inventory, we believe that is possible.

Rajat Setiya: You are calculating your inventory days on the cost of goods sold?

Yashovardhan Saboo: Correct.

Rajat Setiya: All right. And sir, there is a sharp increase in operating expenses in this quarter in Ethos any particular reason is there one-off?

Yashovardhan Saboo: You are comparing to what?

Rajat Setiya: I am comparing it to last quarter.

Yashovardhan Saboo: That means quarter three?

Rajat Setiya: Yes.

Yashovardhan Saboo: Okay. Sekhar, I am going to let you answer this one please come in on this. I think one effect is the issue of share of marketing expense received from some of the brands but Sekhar, can you answer that, please?

C. Raja Sekhar: Yes. I think the biggest increase has been compared to the previous year has been the exchange rate loss that we had incurred in the last part of the year. In the entire year we had to incur the loss of about Rs. 2 crores and of which the last quarter in itself is about Rs. 1.2 crores that is one of the primary reasons why the expenses seem to be going up compared to what they were last year.

Rajat Setiya: All right. So basically, so if I look at quarter three number this number was OPEX number which was around Rs. 9 crores and now it has moved to Rs. 14 crores. So Rs. 1 crore you are saying is because of FOREX and some of that is because of add spent contribution that came last quarter from exclusive brand, is that what you are saying?

C. Raja Sekhar: Yes.

Rajat Setiya: Okay. And what is our policy around FOREX hedging?

C. Raja Sekhar: As of now, we are keeping them open. So, we are not hedging unless we avail buyers credit benefits. So, if we take a foreign currency loan to repay our vendors, our policy is to hedge them. Other than that, at the Ethos level, we are keeping them unhedged.

Rajat Setiya: Now that our basically INR is depreciating so that is going to hurt us again, right?

C. Raja Sekhar: Right. So essentially, what you need to understand is how really the exchange rates impact the P&L of the company. At one point where the exchange rate becomes volatile, it does impact the bottom-line in the short-term but if the depreciation is more permanent then the depreciation is really compensated by way of higher MRP's. An example in the last year when there was custom duty increase and also the rupee had depreciated, the MRP's were increased for many of the brands. Going forward, we also see the same thing happening if the rupee depreciation becomes permanent or if it finds the new level then brands normally seek to compensate the retailers by increasing the MRP's and it actually turns out to be a win-win situation for everyone because not only do we get compensated for the higher exchange rate but when a customer does a comparison for prices across the globe, India still remains competitive despite the increase in MRP's so that is normally the policy that is adopted and that is one of the reasons why we have always kept the exchange rates unhedged.

Rajat Setiya: So if I understand correctly. So, while there will be a hit in terms of FOREX losses but the MRP's will increase and our gross margin will increase accordingly…

C. Raja Sekhar: We will get compensated for it.

Moderator: Thank you. The next question is from the line of Jeetu Punjabi from EM Capital Advisors. Please go ahead.

Jeetu Punjabi: So two questions, one, the manufacturing side what is the total CAPEX you expect to put to work over the next year and a half two year that is there and also what kind of revenues, do you think you get over that CAPEX, right? Let us say a couple of years now what kind of revenues could that business be generating, if you put that CAPEX in**?** The second question is on the retail side, I can ask that later if you want?

Yashovardhan Saboo: No, please go ahead.

Jeetu Punjabi: Okay. The second question is really what are the trends you are seeing in the retail business in the sense you are alluded to a pick-up happening and you alluded to good demand-side trends coming and usually it is second-half phenomena but based on the first-half is there anything that different or giving you more confidence from the trends you are seeing early today?

Yashovardhan Saboo: Okay. So on the manufacturing side, I presume the bulk of your question was focused on the watch component side On the watch component side actually as I mentioned in my speech Jeetu, we are now experiencing a pretty strong revival of demand in the domestic segment which is a very welcome sign because this has been languishing for almost three years to five years and whether it is a phenomena linked to this Make in India, exchange rate, I think it is a combination of various thing and the market itself also reviving and we do know that some of the large international groups are looking at developing India as a sourcing base as an alternative to China. So lot of our plans and investments is somehow also linked with the plans of these larger groups. We are in touch with them. We do know that we will have to expand capacity. I am not going to be able to give you any exact figures because the definite specific project has not really been put in place. But you know very-very ballpark figures,. I believe that the watch component business has the capability of adding Rs. 50 crores to Rs. 60 crores of turnover over the next two years to three years and I believe in the modernization and increase in capacity we probably will need to invest about something around Rs. 20 crores to Rs. 25 crores. But that Rs. 20 crores to Rs. 25 crores is good not only for this but what we also do is leap frog and get into some of the new technologies that we believe are important for us in the future. We have not invested the same in the watch component business over the last three years - four years. The bulk of CAPEX in previous years was actually was going into the precision engineering business. So that is as far as the watch component business is concerned. So, in nutshell, we believe a lot of the growth is going to happen out of domestic demand revival, it seems it is going to be a robust growth and we are in touch with the respective parties and we will be tailoring our plans according to that. On the retail side, demand-side trends, we have divided our world into quarters which end in December and March, it is not the way our consumers work. So if we take March and April, right these are post March and April are post-season month even January is the last month of the season February survives because of some weddings and some stuff like that but March and April are definitely postseason and in March and April we see a continuation of the robust demand. So obviously it is anyone's guess is it a flash in the pan but I do not think it is because you know March and April typically are really slog months, but we have seen a good growth. We have seen a good growth.

Moderator: Thank you. We have the next question which from the line of Gaurav Somani as an Individual Investor. Please go ahead.

Gaurav Somani: My first question is after the imposition of Customs Duty starting February, just wanted to understand have we seen any fall in our daily run rate, I understand it is a seasonal business but has there been any material impact because of that? And secondly, if you can throw some color on the addressable market size which we are targeting and probably this share of Ethos in the next three years to five years, where do we see ourself the market size which you can capture? And lastly, there was a notification on the demerger of the Ethos business, if you can provide some update on that? That is, it.

Yashovardhan Saboo: Gaurav, can you just repeat your first question? Sorry, it was about Customs Duty, right? And the impact of Customs Duty, right?

Gaurav Somani: Yes, and run rate.

Yashovardhan Saboo: Just let me answer this thing about Customs Duty. You know what happened is that with the revival of with the increase in Customs Duty, of course, the burden increased there was a direct increase in the import burden and the prices came back to the levels that they were before November. So what I want to underline is that prices in India have generally been competitive otherwise, we would never have sold expensive watches in India. What happened after GST going down from 28% to 18%, all the brands dropped their prices because of you know the Anti-Profiteering Provisions. Ethos was the first to announce a drop of 7.8% across all our brands even before the brands did that. That created a situation where for most brands India was 8% to 10% cheaper than anywhere else in the world. And of course, that contributed to the great sales that we had in Q3. In Q4, when this happened, and the prices went up and that was towards the second-half of Q4, it is difficult to say what was the impact of that because at the same time the season also ends in February - March. But as I mentioned the answer to the last question, we saw a pretty robust March as well despite the price increase. So I would like to believe, it has been taken in the stride and of course, some people miss the boat by not buying when the prices were very-very competitive but prices are still competitive compared to the rest of domain. We have to accept, and we have to be conscious that Dubai has imposed VAT tax for the first time. So suddenly Dubai is more expensive. Discounts in Singapore which was 18% - 20%, today you cannot get discounts in Singapore. So in the shopping destinations outside India the prices has actually gone up, India is remaining very-very competitive. So I do not think there is has been the very big impact of that. What was your second question? if you may please repeat that?

Gaurav Somani: Yes. Sir, my second question was more with the change of strategy which we have, and we are looking to target the watches more in the Rs. 2 lakhs to Rs. 5 lakhs segments, what is the addressable market size which you are looking at, at the moment and probably what can be our share say three years to five years down the line?

Yashovardhan Saboo: See, we were always focusing on that price point. It is not that we were not focusing on that price point. It is just that our focus has now become much more sharper in terms of our brand portfolio, in terms of our marketing efforts. We are basically looking at focusing in this price point between Rs. 50,000 and Rs. 5 lakhs and in the high-luxury segment, in the Rs. 5 lakhs to Rs. 10 lakhs, I would have to go back and get back to you on the exact market prices in these segments. But overall, we estimate that our current market share in the size, in the price point above Rs. 10,000 MRP is approximately 13% and our goal is to step this up to 22% by 2021. And the last point was about demerger. As was already announced, there has been a given direction to the management of Ethos and we at KDDL are obviously aware about that is to work out the option and come up with a definite action plan to go through with the process and complete it within 18 months and the first month of that is getting to be over. So, I know that the Ethos management is working pretty hard.

Gaurav Somani: Sir, any fund infusion into Ethos, fundraise by the company will happen post demerger only or it can happen earlier?

Yashovardhan Saboo: Look, we believe with this revival in demand coming up and our aggressive goal now to increase the market share, we believe there is very-very important. Opportunities are now emerging not only with our exclusive brands but also with our core brands. And in order to sort of grab those opportunities, we might have to expand faster than what was originally planned in terms of store count and also in terms of the size of stores. So one thing, which I have not mentioned is that we are changing our strategy to focus a lot on the top 8 cities and in these cities to create flagship stores much larger than we have seen of Ethos up to now. We believe these strategies are very important for us. The first such large flagship stores have already been signed on for Hyderabad. It is a store with a size of more than 4,000 square foot that will make it India's largest watch shopping destination. And in order to cater to that, we will probably need to consider some fund infusion before the demerger.

Moderator: Thank you. The next question is from the line of Vineet Bhatt as an Individual Investor. Please go ahead.

Vineet Bhatt: So a few questions from my side. The first one is continuing with the question asked by the previous investor. How much CAPEX are we looking at doing in Ethos in the next say three years - four years and I am coming to that because say if and I want to understand the dividend policy as well because we have increased our dividend policy, we have increased our dividend this year, right? So would not it be prudent to perhaps conserve capital and infuse that into Ethos so some comments on your dividend policy? That is question number one. The second thing was about the margins in the Eigen and the watch dial business. So I think, in the past we have actually guided for close to 15% EBITDA margin in Eigen and the watch dial business being slightly higher. We are seeing that the EBITDA margins are improving quite well in the last few quarters. So, any guidance on that, how much do we expect the watch dial business to do going forward? And the third thing was on the repeat billing. So we see that in this year I understand that the repeat billings went up considerably because we had to take care of a little bit of stock clearance as well so how much is a sustainable level and how much are we attempting to reach in the repeat billings going forward?

Yashovardhan Saboo: Okay. So, the first question was about how much investments is required in Ethos? Okay, so let me answer that. We believe that Ethos requires to get to its goal over the next couple of years an investment probably a fund infusion of about Rs. 50 crores. Your question was what is our dividend policy? I think, our dividend policy has been pretty consistent and therefore, we think it is right to keep to this consistent dividend policy. Our profit after tax nearly doubled, it increased by about 80% compared to last year which is reflected in the dividend increase as well. That is a decision that we believe is consistent with our past practices. As far as EBITDA margins are concerned, you know the watch component business that typically has an EBITDA margin of (+20%) we believe this EBITDA margin is going to continue to remain at that level. I must say that in the watch component business we have enjoyed this margin. Of course, we would like to try to increase it. But in the manufacturing segment, the (+20%) EBITDA is something which is not very common. On the precision engineering business, the EBITDA margin which is currently in the range of about 11% to 12% is expected to go up as we are acquiring scale, this is a business that depends on scale. We are acquiring customers, there is a lot of learning curve happening, I believe the sustainable EBITDA margin for the precision engineering business is probably going to be in the 17% to 18% range.

Vineet Bhatt: Yes, sure. So my question was that this year we saw a considerable increase which I am guessing is because of the stock clearing that was aiming for. So what are the sustainable level and how much are we targeting? And in addition to that we are focusing on our price segment a lot more shopper now right so will that also an effect on repeat billings and how do we see this going ahead?

Yashovardhan Saboo: Sir, I think our repeat billings has increased because of several reasons. One of them, of course, you are right is because of the clearance sales that happened in June. However, it is also very-very intimately related with our marketing campaign and we have a database with whom we are corresponding very-very regularly. We have a loyalty program which is extremely active, is extremely engaging and that is also contributing to the high repeat sales. I do not believe there is going to be a significant fall in repeat sales. Although of course, we do not have to do the clearance sales in the same measure as we did last year. So there might be some fall in repeat sales but I do not think that fall is going to be very-very substantial.

Vineet Bhatt: Sure, sir. I just wanted to understand a little over the strategy for the larger store sizes, so one, could you please help us understand the economics of a larger store size and how you see that going ahead? And second, in the last Conference Call, you also mentioned that KDDL in the future would also strive to cater to the luxury clients in whole and not just in watches. So is this also we have in mind that we will have a larger store size, so that we can perhaps have a section on some other luxury segment except for watches in the future and that will be easier for us to do if we have a larger store size?

Yashovardhan Saboo: Okay, Vineet, that question requires almost an hour to answer completely. But let me try to do it very briefly. There are other people on the queue. Larger store size essentially integrates with our strategy of the omnichannel platform. People do not need to come to stores to conduct transactions, people do not need to come to stores to get information. They need to come to stores to get an experience. Most of the information gathering, the research is now done on the internet and our platform, our website is by far the best platform in India among the best in the world. So, we find people, we find customers coming to our website attracted to our website, researching on the website, engaging with our watch consultants online. But when they come to a store, they want the experience, they want people telling them watches, they want to look at a lot of brands, a lot of watches, they want to take their time, it does not matter if they have to drive 15 minutes extra to get the place. But when they come to the store it is an occasion. It is an occasion to enjoy watches to be introduced to what is the latest, what is the best, what is trending, what is classic, what is collectible and so on. For that you need to have a store that is able to deliver that experience which becomes a destination, a destination cannot be a small store. A destination has to be a flagship store. So fundamentally that is the reason that is the argument for a large store and we find that stores in which we have iconic brand which are large, which are in places which are destination, we find that we to actually transform in terms of figures. You asked about performance figures, yes, the investments are larger, but we know that the traffic is larger and the cost as a percentage of turnover are significantly lower. So while it is difficult to predict right now but I believe that for example, rent and manpower cost alone as a percentage of turnover in large stores can be as much as 2% to 4% points different from our average. The other point which is very important for large stores is, large stores continue to grow and show a large growth over a long period of time. A small store often reaches a saturation in four years - five years - six years and then after that you need to do a lot of things to continue the same store growth. In a large store, because it becomes a destination, traffic continues to come, you continue to renew the store, get a new brands, get a new products, spin stories, create excitement on your marketing campaigns, it works a lot. We believe it will be a game changer for the luxury business. Your last question was we might add other things in the luxury segment but frankly, I think there is a such a huge opportunities with watches and to grow our market share from 13% to 22% which is our goal we are really focusing a lot of our time on the watch business.

Moderator: Thank you. Next question is from the line of Harshal Mukadam from Vibrant Securities. Please go ahead.

Harshal Mukadam: My first question is that with the strong expansion plan in Ethos in the next two years to three years, do you foresee any kind of pressure on the margins because initially there will be upfront costs involved, right? So that is question number one, should we assume that in the short-term margins might be a depressed because of expansion? Number two, have we added new brands, exclusive brands at Ethos in the last two months - three months, if you comment on that? Thirdly, do you still the timeline for the value unlocking, so that was 18 months. So do you still foresee that timeline will be adhered to? Thanks.

Yashovardhan Saboo: In terms of expansion and pressure on margins, I think the expansion for it to have an impact of margins it always depends on how many stores compared to how many stores you have already. I do not expect that to be too much pressure on margins overall as a result of this expansion. New brands I know we have added a couple of brands or some brands are just about to be added I know we have added Christina which is brand in the price point around Rs. 20,000, very-very well-known brand part of a Spanish group, and extremely popular internationally. They are sponsors of the Tour De France the best-known international cycling tournament. We have also signed on Junghans. Junghans is the economic German brand made in the black forest area. So you know that the German watchmaking was extremely well known let us say about 30 years - 40 years because as you know Germany is known for fine engineering and there were several brands in Germany that were well-known they are getting a huge revival and we are participating to actually bring some of these economic German brands into India and they are very much sought-after by collectors. So we already had NOMOS as an exclusive brand and you know if you are interested in watches you surely know NOMOS. We have brought in Junghans which is an iconic brand which has been there for a very long time and a new brand which is called MeisterSinger. The interesting thing about this brand is, it is a brand that has watches with only one hand. So it denotes the time with only hand. And the philosophy of denoting the time is very-very interesting. These are niche brands, but they help us to make Ethos as the destination for watch buyers, watch collectors and anybody who gets passionate about watches. I know that there are one or two other exclusive brands that are being signed on or have been signed on but still being brought in. But as I mentioned there is a continuous pipeline and we are renewing brands. So it is not only that we are adding brands. From time-to-time we are also taking decisions to delete some brands which are not performing up to the mark. And your last question was about the timeframe of 18 months we are pretty much on track on that. I do not see any reason to change that.

Harshal Mukadam: I want to confirm the primary capital which you need at Ethos you said Rs. 70 crores, is it correct?

Yashovardhan Saboo: Yes, we are looking at Rs. 50 crores.

Moderator: Thank you. The next question is from the line of Sheyas Shah from Maitri Financial. Please go ahead.

Sheyas Shah: Just wanted to understand whether what are the number of new stores opening that are expected over the next three years and what would be the store size?

Yashovardhan Saboo: Okay. Over the next three years including this year, we are looking at an expansion of about 24 stores to 25 stores that is our plan. Of these, about 7 or 8 are to be these large flagship stores. They are obviously focused on the largest 7 cities - 8 cities and the rest are multi-brand stores and the usual format. In these, we are planning to add a couple of Tier-II and Tier-III cities that are not yet on our map.

Moderator: Thank you. The next question is from the line of Hiren Parikh as an Individual Investor. Please go ahead.

Hiren Parikh: I just wanted to know about your precision business and which industry do you cater to, first? And the second is regarding the servicing of watches, what kind of business growth you expect in that because normally servicing is high margin business? And regarding the export portion of your watch components other than the domestic one?

Yashovardhan Saboo: So let me answer the last question first which is the export of my watch component business. We export about put together we are probably at about between 60% and 65% of our business is export in watch components. I am going to let Sanjeev, answer the question on the segments of the precision engineering business.

Hiren Parikh: The servicing portion, I mean normally the watch is with servicing. So I think that is a high margin business if I understand rightly.

Yashovardhan Saboo: Yes, it is an important part of our business and we are relying not on only our own service centers, but we are relying on getting arrangement service centers to be able to get the best service technicians to work for Ethos. So we do not really see that as a very large growth area not in terms of numbers and margins that is not we are going to move the needle. But I think in terms of ensuring that the Ethos customer gets the best service from the day he starts to think about buying a watch to post-purchase service, I think that is very very important, it is a vital part of that. So I think more important than the numbers is that Ethos must continue to offer the best service guarantee to its customers. As far as the segments for the precision engineering business over to, Sanjeev.

Sanjeev Masown: Basically, you are interested in knowing the segments which we service from precision engineering business?

Hiren Parikh: Yes, I just wanted to know about your precision business and which industries you are going to cater to?

Sanjeev Masown: Yes, in precision engineering business we service to the electrical and electronic segment, auto ancillary, aerospace, defence, instrumentation, consumer durables, etc. So there is a wide segments which we are catering, and our focus basically is more to move in the segment like aerospace and defence where entry-level barriers are there and it is a time-consuming exercise. Presently our customer base is very wide and we have customers from almost all the segments and we are seeing healthy growth in all the segments

Hiren Parikh: And how much time will it take to really sort of growing this business like a year or two down the line?

Sanjeev Masown: We have been growing in all the segments and we believe that this growth will continue from all segments. As a focus area, I am saying our main interest and focus is on moving into the aerospace segment and to achieve a significant part of our revenue it may take three years to four years.

Hiren Parikh: Right, sir. And just to I mean to add one more thing since you are having an exclusive brand in Ethos is marketing, do you explore business with them to your component business because of your exclusive connections with the brand?

Yashovardhan Saboo: So let me answer that again while we believe that both businesses need to stand on their own feet and they need to be justified on their own business. But obviously, the fact that there are some brands which we are dealing, we are buying their watches leads to a relationship and then to want to buy our components and vice-a-versa. We have supplied components they are keen to sell in India. So obviously it is a synergistic kind of relationship. But the important point is also to say that both businesses need to be justified on their own spend.

Hiren Parikh: Yes, that I understand does it help you like you know in your component business like in some way or the other.

Yashovardhan Saboo: Right.

Moderator: Thank you. We have a follow-up next question which from the line of Rajat Setiya from Vrddhi Capital. Please go ahead.

Rajat Setiya: So I have a question around the demerger of Ethos. So after the demerger, will it be an automatic listing for Ethos?

Yashovardhan Saboo: Rajat, that seems to be the most the simplest and most direct kind of structure to go for. However, it is not the only structure, there are a couple of other options which I think the board will examine and present to a particular option probably to shareholders. But yes, the direct listing of Ethos seems to be the most direct and simplest process to adopt.

Rajat Setiya: What could be the other option, sir?

Yashovardhan Saboo: Again, I am not an expert on this but as I am told and we are sort of seeking legal opinions and business opinions on that. One issue is that foreign direct investment (FDI) in multi-brand retail is not really sure what is the actual position on that. So that is going to be one consideration that as we kept in mind and to all the structures which are possible because I said I do not want to sort of presuppose anything when we are already starting to work with experts to give us the options and then we will take a decision going forward.

Moderator: Thank you. The next question is from the line of Harshal Mukadam from Vibrant Securities. Please go ahead.

Harshal Mukadam: My question is on Eigen. So, I think, this quarter we grew by around 26% is that correct?

Sanjeev Masown: Yes.

Harshal Mukadam: Also, we had guided that the growth could be stronger than that. So is it like a one-off thing or should we assume this growth to be going forward?

Sanjeev Masown: No, the growth in the coming quarters and next couple of years will be definitely much stronger than this.

Harshal Mukadam: On the standalone balance sheet there is work in progress of around Rs. 20 crores if I am not wrong.

Sanjeev Masown: That is of this expansion project.

Harshal Mukadam: Okay. But we have envisaged total Rs. 30 crores in this correct, in the Eigen?

Sanjeev Masown: And some part was already capitalized in the previous year so that is not the part of CWIP.

Harshal Mukadam: So this entire CWIP is related to Eigen, is it correct?

Sanjeev Masown: Major part is related to Eigen, there is some part of the other businesses also.

Harshal Mukadam: Okay. And this should get into or should start functioning by this financial year by the end?

Sanjeev Masown: We are targeting by second-half it should be fully functional and as Mr. Saboo has already shared in his speech by the end of this quarter we will be shifting our existing facility to a new location.

Moderator: Thank you. The next question is from the line of Jagdish Geddam as an Individual Investor. Please go ahead.

Jagdish Geddam: I would like to know regarding the operating leverage that is going to played out when the sales are going to be increased. So just wanted to know like what is the percentage of operating leverage we are talking about let us say in the next three years or four years?

Yashovardhan Saboo: Jagdish, welcome and I presume you are talking about Ethos, right?

Jagdish Geddam: Yes. I am talking about Ethos, yes, right.

Yashovardhan Saboo: Correct. So in operating leverage in Ethos, we expect mainly the benefits, mainly the benefits to come from rentals and from backend expenses. And we believe that these two expenses as a percentage of overall cost will lead to an improvement in margin of between 1.5% to 2%.

There will be a marginal benefit also coming from frontend personnel expense and few of the other things but the bulk of the benefit is really going to come from back-end expenses and the retails.

Jagdish Geddam: Okay. So my point here is like if we are going to sell the watches like which are of the price range of the higher price range, are we looking at some kind of operating leverage there or like is it only we are looking at the backend saving part?

Yashovardhan Saboo: No, I do not understand your question. What do you mean by operating leverage on high-end watches, it is not very clear to me?

Jagdish Geddam: So it is like the profit margin we are going to make while selling maybe a 50,000 watch is different from the profit margin we are going to make while selling somewhere around Rs. 2 lakhs or Rs. 3 lakhs watch, okay. So what I am trying to understand here is if the sales of the high-end watches are going to be increased, are we going to see improvement in operating profit margin?

Yashovardhan Saboo: So I think what I have would say that it is not necessarily true that a more expensive watch has a higher gross margin than a less expensive watch. It really depends a lot from brand to brand because what happens is that the higher-end watches sometimes you have to negotiate higher margins. But that said, what also happens is that expenses like rent on higher priced watches are lower. So overall, the gross margins across price points are pretty much similar after you account for the cost of rent and so on. When we were talking about operating leverage, it is not really based on a price point of watches. Our operating leverage as the leverage I get because of my costs of doing business increase lesser than my revenue increase. So as we are growing faster I believe that our sales and revenues are going to increase faster than my costs especially my rent and backend expenses and to a later extent, my running expenses and frontend manpower expenses and that is what is going to give me the operating leverage.

Moderator: Thank you. Ladies and Gentlemen, as there are no further questions from the participants, I now hand the conference over to Mr. Yashovardhan Saboo for closing comments. Thank you and over to you, sir!

Yashovardhan Saboo: I would like to thank all the participants at this Conference Call and wish you all the best. We close the call now. Thank you very much.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of KDDL Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.