"KDDL Limited Q4 FY20 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day. And welcome to the KDDL Limited Q4 FY '20 Earnings Conference Call. This conference call may contain certain forward-looking statements about the company, which are based on 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 '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Yasho Saboo – Chairman and Managing Director, KDDL Limited, for his opening remarks. Thank you and over to you, sir.

Yashovardhan Saboo: Thank you. Good morning and welcome to everyone for our Q4 and FY '20 earnings conference call. I hope all of you are safe and in good health. I am joined by Mr. Sanjeev Masown – CFO of KDDL, and Mr. Raja Sekhar – CFO of Ethos Limited; and SGA, our Investor Relations advisors.

I hope everyone has had the chance to go through our updated investor presentation uploaded on our website and the exchanges. I will start by giving you a brief on the financial performance consolidated basis for Q4 and FY '20. Revenue for Q4 FY '20 was down by 8.7% year-on-year to Rs. 137 crores, primarily due to zero business operation towards end of March on account of the COVID-19 lockdown. For the year FY '20, it grew by 4.4% year-on-year to Rs. 652 crores as compared to Rs. 625 crores in the previous year. Consolidated gross profits Q4 stood at Rs. 59 crores, down 12.8% year-on-year, while FY '20 grew by 4% year-on-year, to Rs. 275 crores.

Consolidated EBITDA for Q4 was up by 2.2% to Rs. 12.7 crore, and for FY '20, it was up by 17.2% to Rs. 76 crores. The growth in EBITDA has been largely on account of the changes in accounting standards with the applicability of IndAS 116 standards. The new IndAS 116 norms have impacted the accounting for other expenses, depreciation and finance costs for the company. Therefore, consolidated adjusted EBITDA on like to like basis for FY '20 has degrown by 35.2% to Rs. 42 crores as compared to about Rs. 65 crores in the last year. Consolidated PBT for FY '20, stood at Rs. 5.1 cores, while in Q4 there was a loss at PBT level of Rs. 5 crores. Consolidated loss after tax for Q4 stood at Rs. 5.1 crores, while for the full financial year FY '20, the loss stood at Rs. 2 crores.

I will now come to the business wise updates and the impact of COVID-19 on the business. Our manufacturing business revenue for the quarter was Rs. 40.7 crores, down 9% year-on-year. While for the full financial year, the revenue grew by 2.6% year-on-year to Rs. 180.6 crores. EBITDA for Q4 2020 stood at Rs. 5.7 crores as compared to Rs. 8.6 crores in the previous year same quarter. EBITDA for the financial year stood at Rs. 29.4 crores compared to Rs. 31.8 crores in FY '19. EBITDA margins for Q4 stood at 13.9% as compared to 19.1% in the previous year same quarter, while EBITDA margins for FY '20 stood at 16.3% versus 18.1% in FY '19. Profit after tax for Q4 was Rs. 0.5 crores, and for the full year it stood at Rs. 9.1 crores.

Revenue from watch component business stood at Rs. 28.6 crores in the quarter four, down 16% year-on-year. While for the full year, the revenue for watch component business was Rs. 129 crores, similar to the levels reported in the previous year. Precision engineering business revenue for the quarter was Rs. 9.7 crores, an improvement of 10% year-on-year. And revenue for the full financial year grew by 11% and recorded Rs. 43 crores in FY '20. The revenue from watch components was almost stagnant compared to previous year. The exports declined by 4%, mainly due to slowdown in the Swiss market, while domestic revenue of watch components improved by 4%. In the precision engineering business, the company registered a growth of 11% over the previous year, compared to a growth of 14% in the previous year. The revenue growth for domestic market was 17%, while exports improved only marginally by about 1%. Unfortunately, in Q4 of the financial year, the revenues of the business were suddenly impacted due to the lockdown announced by the Government of India in March 2020. We had a sales loss of nearly Rs. 10 crores in the quarter, which affected the overall margins of the company.

The business global economic scenario due to the impact of COVID-19 pandemic will lead to declining revenues for quite some time. And we expect gradual recoveries after that. The first half of the financial year 2020-2021 will witness a significant impact of slowdown. In the second half, we hope that things will be better. The prevailing scenario will also create new opportunities for the company as some of the weak players will surely exit the market. The initiative under Aatmanirbhar Bharat need to be watched very carefully. And we are taking necessary steps to promote further growth and development of the company, taking advantage of the situation arising out of the Aatmanirbhar Bharat initiative.

In 2021, our major focus is on reducing costs and overheads in line with the expected decline in revenue. We will also strengthen our digital presence and communications to showcase our new products and features to our existing and new customers. We will continue to focus on manufacturing excellence with a goal of world-class delivery compliance quality, and especially on fast turnaround time. For the current year, the revenue from the watch component business is expected to decline by about 15%, as major markets and countries are under lockdown due to the pandemic. The focus of all economies is on minimizing the impact and providing necessary stimulus for market recovery. This year, the precision engineering business of the company is expected to be around the same levels as previous year. But we do expect to get entry into customers in new segments and markets, due to which we foresee a faster growth in the existing and new segments in the years to come.

I would like to add a few words about our Swiss subsidiary, Estima AG. 2019 was the first year of operations post acquisition. During this year, the company invested in the watch hand manufacturing facility, and upgrading with acquiring new machines and equipment. We also renovated the building and infrastructure to present a world-class setup to potential customers, key management in the company were changed in line with the business requirements. The company also added the facility to supply watch dials, in addition to watch hands, thus expanding the potential of Estima. During FY '20, the company reported revenue of CHF 1.8 million, and a net loss for the period was CHF 1.4 million. This acquisition fits into the strategy of KDDL to expand its foot print in Swiss manufacturing. And we are in a good position to turn around the factory by replicating the strengths and capabilities of Indian operations, and also extending our strong existing customer relationships. The Swiss origin regulations will be the catalyst for the revival and growth of this business unit.

I would now discuss aspects of the business relating to our watch retailing subsidiary, Ethos. Here are the highlights of Ethos on a consolidated financial performance. Our billings for Q4 dropped by 12% year-on-year to Rs. 104.5 crores, while for the year FY '20 it grew by 2.3% to Rs. 524.5 crores. Billings of exclusive brands grew faster at 9% year-on-year to Rs. 22 crores in quarter four, and for the financial year it grew by 40.7% year-on-year to Rs. 117 crores. The exclusive brands contributed 21.2% to the top-line of quarter four, and 22.3% for the whole year. Same store growth for Q4 stood at minus 22%, obviously, due to the impact of the lockdown. And for the year, it was minus 7%. Consolidated revenue for Q4 stood at Rs. 91 crores, down 11.6% year-on-year; while for the year it grew by 3.4% to Rs. 460 crores. Consolidated gross profit for the quarter stood at Rs. 24.7 crores, down 29%; while for full year it stood at Rs. 130 crores, at similar level when compared to the full year FY '19.

Gross profit margin for Q4 stood at 27.1% as compared to 33.8% for Q4 FY '19. For the full year, it stood at 28.3% versus 29% last year. Reported EBITDA for Q4 and for the financial year grew by 62% and 59% respectively. This growth, as also mentioned previously, are due to changes in accounting standards. Adjusting for the IndAS 116 and other items, consolidated EBITDA for FY '20 degrew by 25.1% year-on-year to Rs. 27 crores due to higher expenses primarily from rental charges. Adjusted EBITDA margins for FY '20 stood at 5.9% as compared to 8.2% in FY '19. Consolidated loss for Q4 stood at Rs. 4.4 crores, and for the full financial year it stood at a loss of Rs. 2.5 crores. Stock carrying months at the end of 2020 was of 7.9 months, which is just slightly higher than the previous year. This being on account of the higher inventory in the newer flagship stores that operated for only part of the year.

Ethos was severally impacted due to the lockdown imposed by the government to prevent the spread of COVID-19. All the stores were shut down during the second half of March, which adversely impacted the business. Most of the retail stores are in malls, which were asked to shut down a week before the official shutdown. As of today, about 26 of our 50 stores are operational. Stores are being opened only for a limited time with limited staff to ensure strict social distancing and other measures for security. We are witnessing a gradual improvement in visitor footfalls week on week, and hope to be back to pre-COVID levels by quarter four of this year. The optimism is based on a similar experience in demand shock witnessed by us, due to series of decisions taken by the government in the past, such as a requirement of PAN card, TCS requirements, and the prohibition of large cash transactions. We always witnessed a strong bounce backs in sales post these demand shocks. While the severity of COVID-19 is obviously much higher than other shocks, we do expect the business to recover eventually.

We have used the lockdown period productively to devise a new strategy at Ethos after extensively studying the market condition, store locations, assessment of our cost structure and also the direction of business aspects in our line of business. Let me highlight this point by point.

First, the cost optimization strategy. As we all know, rental costs form a major portion of our total expenses at Ethos. We have been in continuous negotiation with mall owners for rent reduction to optimize rental cost. With respect to other overhead costs, we have deferred CAPEX and other expenses, all that can be delayed in the medium-term to prudently conserve cash. We are also looking at other overhead expenses, including manpower cost, to reduce them and get better efficiency.

Second, on store optimization strategy. We have done an in-depth performance assessment of all our stores. We will be closing down the stores, which are unlikely to contribute meaningfully to overall profitability in the future. We have already closed five stores in the last three months. With this, the total store count is 50 as of today, down from 55 at the start of the year. Our focus will continue to be on improving the profitability of the stores rather than expansion in this year.

Third point is on digital strategy. Our ecommerce website, ethoswatches.com, continues to have a large number of visits even during the lockdown period. And surprisingly, we witnessed very good bookings for our premium watch segment, for which deliveries were started after the lockdown eased. This is a sign of a market shift and development as customers start accepting the idea of buying even luxury products through ecommerce platforms. This enables the luxury watch market to expand to customers who did not have access to luxury retail stores, and also gives ethos with its strong digital presence a great advantage over the competition. We have the most advanced digital communication and ecommerce capabilities in the country for any luxury product. With the change in customer behavior, we will be better positioned to leverage these capabilities and increase market substantially. These three strategies, cost optimization, stores optimization, and digital communication will help Ethos to become fit, lean and ready for future growth.

One other important point that I would like to highlight is the fact that most important Swiss brands will prefer to focus on maximizing their resources and attention on their top markets, including USA, China and Europe. And they will want to reduce resource deployment in smaller markets such as India. The company is well positioned to capitalize on this opportunity by offering these brands faster growth without the brands having to deploy their own resources in marketing and personnel. Thus, Ethos will be in a strong position to negotiate attractive deals for distribution and exclusive retail arrangements. The company has proven marketing resources and sales capabilities, and a proven track record of managing several Swiss brands exclusively in India. We continue to build layers of complimentary verticals for our watch retailing business. After sale service offering backed by strong technician and watch expert team, as well as the steadily increasing pre-owned watch business points to this fact, and our goal remains to make Ethos the customer's first choice for luxury watches in India.

Exclusive brands and house brands are an important part of our strategy. And we are happy to report that our partnership continues to gain traction. We have about 32 brands on exclusive basis across all price points, which help us to offer a differentiated product to customers and a great buying experience. I now welcome your questions and participation.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. We have our first question from the line of Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: Sir, we understand that there is an impact of economic slowdown on almost all the segments. But particularly in precision engineering, which are the segments where we can say recovery could be much faster for the demand and which are the segments where we are disappointed from the demand side of precision engineering? And are we seeing some kind of inquiry, probably the components which were imported from China or something where the customers may start developing domestic sourcing and enquiries from such kind of orders?

Yashovardhan Saboo: Vikram, so I personally believe it's still a little too early to take a judgement as to where we are disappointed and where we are not. We have to recognize that pretty much up to June most factories were closed. And whether it's our customers or the customers of our customers in the precision engineering business, there has been a delay in the forecast for the business for the year. So, if people don't know exactly what sales are going to happen, it's difficult to get any forecasts. So I think the right time to answer this question is probably going to be after a month or two. Because it's only now that most of our customer factories, at least they are open, they are starting to forecast. And we are starting to get some forecasts on what kind of orders will come, will be revived, what will be continued to be delayed. I don't think there will be much of preferential that one segment is going to boom, while other segments are going to be delayed. I think it's going to be pretty much similar across all segments. But we will come to know this only in the next two months or so.

As far as your second question, which is related to response from businesses, to buy more from India. We already see some positive signs of this in terms of RFQs, both from Indian customers as well as for export customers. We feel this is related to the fact that there is some kind of a sentiment to reduce buying from China. It is still at RFQ level, but we believe there is a definite trend. And over the next couple of months I think this will develop into a real momentum.

Vikram Suryavanshi: Okay. And sir, currently some stores are open, so how is the mix of online and stores mix between these two currently? And now we will move on to almost festive season in second half, so what is the indication from mall owners in terms of opening the stores before the festive seasons?

Yashovardhan Saboo: Vikram, so you would recognize that actually nobody can really predict with much accuracy. Say until May end, everybody was pretty sure that in June all malls will open. When the third lockdown was announced in May, that was already a disappointment and we were like, "Why is this happening?" Then June came, some malls opened, some malls didn't open. As you know, today Bombay nothing is open, Pune nothing is open, Nagpur nothing is open, Chennai nothing is open, Gurgaon nothing is open, Guwahati it opened and closed down again; Telangana, there is a problem there, we are hearing that in Hyderabad there may be a second lockdown.

So, as of now, today it is very difficult to expect any mall owner to give any firm date. They give a firm date and then it goes, suddenly the state takes another decision. And we don't blame anybody, because everybody is taking the decision in the best interest of public at large and so on. So for example, in July we were pretty sure that in July all malls will be open. But as we stand today, almost 50% remain closed. Our airport stores, which were successful for us, we have had to close the airport store at Bangalore duty free, because the lease came to an end and it's very uncertain how duty free stores are going to behave. Similarly, our domestic store at Bombay Airport, we decided to short close the lease because airport shopping is going to remain difficult, its going to remain weak, and the costs are very high with 24 hour operation. So we are having to take decisions as we go along. Is it likely to improve? I think it will improve, there is not only a pent up demand, people want to shop, so I think there will be an improvement, but it's difficult to predict.

Your question was also about online versus physical shopping. I think we are seeing a change in consumer behavior which is along expected lines. Safety becomes of primary importance. So, browsing and product discovery, product exploration is happening more and more on the net. Just like you and I are now shopping for our daily necessities also on the net, using ecommerce more, even so for same way for luxury products, we see an increase in visits, we see an increase in dwell time on our website. So a lot of product discovery will shift online, it is already happening. And stores of course will remain important for eventually the customer experience for look and feel. And therefore, we will have growth in sales, but I think there will be a shift, the more product discovery on the net, and probably leading to more sales through the net as well. So I just want to point that what this also means is that our strategy can shift towards more emphasis on digital communication, more offering on customer experience on the net, probably fewer stores, great store experience, delivering the same sales from fewer stores and more digital presence.

Vikram Suryavanshi: Okay. And the last question is like, obviously, are we having some concern on supply side because of supply chain disturbances? Because if you say demand comes back in third or fourth quarter, is there any chance that some of the models may not be available because of the supply shortage or supply chain disturbance, is that concern? Or how is that you are handling?

Yashovardhan Saboo: See, as of now there are some supply side constraints, because many of the factories producing watches, like many other products, they went into shutdown. There is also logistics, so shipments from overseas flights coming in, customs clearance, there are some difficulties there. However, I think these are pretty temporary, over the next couple of weeks these will be sorted out. So I don't expect that these are going to last until the second half of the year. I think from September, October onwards, we should start to see much smoother operations.

Moderator: Thank you. We have next question from the line of Patrick Samuel from Gravity Securities. Please go ahead.

Patric Samuel: My questions are really focused on Ethos. So just wanted to understand what is the SSG for Ethos in Q4 and also in FY '20? The other questions are that, do we plan to close more stores further going ahead in this financial year? And if yes, then what is the number that we have in mind? And lastly, the rental cost of our stores, what is the current cost for that and what is the amount that we are paying on it currently? Thank you.

Yashovardhan Saboo: Okay. So let me answer the SSG question first. SSG for the year as a whole minus 7%, and for the quarter was minus 22%. Regarding stores, as I mentioned, we have already closed five stores, there are likely to be a few other closures. We are not really sure because this also depends on a few things which will emerge. Number one, what are the new rental arrangements, from some malls and locations we have got, I would say, reasonable relief. From others we are still negotiating and the position is that if we don't get reasonable relief, the stores will not be viable and we may prefer to close them, especially in cities where we have already got other stores. So the goal is really that if in a city we have got, let's say, five stores for an example, and one of them we are not able to make viable anymore, then we are seeing how we can achieve the same sales with four stores, of course, supported by the internet. So it's difficult to say exactly how many stores might be closed during the course of the year. I believe there will be a few, not too many. But if I were to hazard a guess, maybe another three to four stores maybe facing closure during the year. But this will depend how things progress over the next two months or so. And your third question was about rentals. So the overall rental is about 6.9% of our sales for mature stores.

Patric Samuel: Okay, 6.9% of your sales. So that is what we are paying currently, is what I presume?

Yashovardhan Saboo: That's the average for last year. The average is a mix of several things, because for example, at airport stores the revenue share is much, much more. In their other store like luxury stores, either the revenue share is much lower or there is no revenue share, it's only a fixed rent. The 6.9% is an average figure that I have given you.

Moderator: Thank you. We have next question from the line of Jitu Punjabi from EM Capital Advisors. Please go ahead.

Jitu Punjabi: Yasho, I just wanted to understand two questions. One is in the journey of normalization, let's talk about the retail business to begin with. I understand the key points you said including digital and the cost side and whatever. So, I presume that inventory that you would be holding right now would be very low in the context of what your historical inventory is? Or are you still holding the same levels of inventory?

Yashovardhan Saboo: Well, so Jitu, I want to understand where exactly your question is going or what is the objective. So, when we close the year we have a certain inventory, right, we have not purchased anything in the last three months obviously, so nothing coming in. So to the extent of sales in the last three months, which have been meagre, our inventory has gone down. That is true, inventory has gone down. In terms of number of months sales has been lower as well.

Jitu Punjabi: So you can't help it. Okay, so the other linked question is, how do you see the roadmap for normalization over the next, let's assume by January we should be 80%, 90% of normal, I don't know, I am just taking the number up on a per store sale basis or whatever say numbers would be back to sort of normal. So what is the roadmap to normalization? Do you see rent waivers being very significant in this journey? Do you see much greater digital sales as a percentage of total sales in this journey of normalization? And do you see anything that you are doing completely different than this path to normalization?

Yashovardhan Saboo: So, Jitu, let me answer this question. In the road to normalization you may not see much change, and I believe normalization will go into quarter four of this year. When we started of June, July that things will become okay and from quarter two we can expect a recovery, we all know that is not happening. Quarter four, today there is news that a vaccine may come out by December. I think all indications are that this will continue till quarter fourth, and next year will become okay. So let me tell you, so our thought is we need to last through this year and we need to use the next nine months of this year to plan a fabulous bounce back in FY 2021-2022. And I think the shape of what 2021-2022 will look like would be very different from what the past has looked like. And this will be the year of that transition.

Let us start with rentals. Yes, we will get rental relief from the mall. Whether it will be significant or not depends on one perspective. From our point of view, nothing will be significant enough. But the mall owners, they have strength also, they have commitments as well, so we will reach some kind of a middle ground what they can give and what we can live with. Most of the malls, I would say, have taken a reasonable position on this and we are helping each other. Some of them we have already concluded some negotiation and some we are still in the talks. So, you will see that there will be a reasonable relief in rent, whether rent will fall equal to or will stay the same as percentage of the sales, I don't not know, depends how sales will be at the end of the year. But what does it mean for next year? I believe that overall, our goal being to keep the same trajectory of sales growth with fewer stores. What this means is that rental cost as a percentage of sales will show a decline in 2021-2022 as compared to the past, I can say this with confidence.

Then digital sales. The fact that with fewer stores we will show the same sales also points that there will be much more sales happening through the digital framework. Whether it will be pure ecommerce or internet led sales which will happen at a store, we cannot say at the moment. But we are planning and investing in what we are calling the white glove service. Which means a sale is negotiated and discussed on the net, and then the luxury watches are delivered at the doorstep of the customer through a white glove service, completely secure, held secure, in all ways, that is something which we will start in the next three months. So I think it will have an impact. We will have the same sales from fewer stores and a larger percentage coming through the digital or digital aided platform.

And the third part which will be the differentiated offering. So strengthening our exclusive brands, of course, we will continue to offer the best selling best known brands, but there will also be a differentiated offering of exclusive brands. There is a lot of digital communication which is happening in terms of webinars with watch collector, representatives of foreign brands. We are not able to do physical events today, but we are doing digital events for watch collectors who are interested in particular house brands with the representatives. And this is showing an immense traction. So I believe even the way we communicate and interact is going to change a lot in the future. All of these are things which are planned in this transition period and will have a significant impact from 2021-2022 onwards.

Jitu Punjabi: Okay. Do we have the same path to normalization on the manufacturing side?

Yashovardhan Saboo: So, manufacturing actually will be a little different. We expect a faster normalization on the export market and slightly slower on the domestic market. I believe, on the export market most of our foreign clients, Swiss brands, are looking at a 30% to 40% reduction in production during this year. So, obviously, their purchases will be down similarly. But as they have opened again, they are now planning for next year, that means calendar 2021. This year they have already sort of washed off this year and said that, "Look, there is going to be a 30% fall, we can't really do much about it, but let's plan for 2021 onwards." And the planning for 2021 has already started, so we expect that from quarter three of this year we will start to get the orders for that recovery of next year. So I believe the recovery in manufacturing segment will happen a little bit faster, especially for the export side. Domestic market, Titan is our biggest customer, Timex is a customer, that will depend on how fast the domestic market itself revives.

Assuming that the market itself will revive in quarter three, as in the production will start revising in quarter three, so we may start to hit normalcy from quarter four onwards on the domestic side.

Jitu Punjabi: And tell me something, the final question is, anything that you are thinking completely lateral for the business relative to what you did? So kind of say that this is a brand new thinking that come out in the COVID and we will do this completely differently, or something completely new?

Yashovardhan Saboo: Jitu, that thought is there. Obviously, when we are going through a crisis of this magnitude, all kinds of important thinking does take place, we have had the time for that. And we know that the world will change after this and how can we anticipate that. It's a little early to share, because we are having to divide our time between two things. We are either thinking long term, which means where our company and where our businesses are going to be three and five years from now. And the only other extreme we are thinking of, what is going to happen three to six months from now, right? So we are having to divide this thing. I must say that right now a lot of the thinking has been on three to six months, because also things are changing frequently, every two weeks the situation is changing. But there have been systematic thought going into where our businesses are going to be three to five years from now, what is going to be the impact of Aatmanirbhar? How exchange rate is going to impact our business? What businesses are likely to grow in India? How manufacturing is likely to grow in India? How can we do more for our customers in other parts of the world? Is there going to be a move to derisk manufacturing from China to other countries, how can we take advantage of that? How can we use our knowledge of specific processes to get into products or services that may be completely different but use the same knowhow and skill and experience that we have? So I think a lot of the thinking is going on. And once we are stabilized and we know that this year is secure, I think there will be a lot of thinking happening on the other side as well.

Jitu Punjabi: Okay, understood. Thank you. And one quick question. What is the status of that pre-owned business that you had started, has that started at all?

Yashovardhan Saboo: That is going on. Please see, in fact, there is now a dedicated website for that, it's called Second Time Zone, www.secondtimezone, please go to that. It is there and it is growing steadily. Because we rely on buying watches and selling watches, so because stores are not open and there was a lockdown you can't even buy watches, there are a lot of people wishing to sell watches, but if we don't buy we can't sell further. So now with the opening up this business is going to grow. Look at the website, it's actually doing well.

Jitu Punjabi: Okay. And the margins there must be much higher, right, I had assumed? So, you are seeing good traction over there?

Yashovardhan Saboo: Well, the margins typically may not be higher, because you are buying and selling. If you will offer a very cheap price, the seller is not going to sell a second hand watch. And if you charge a very high price, he is not going to buy one. So it's not the market. But the fact is that our turn can be faster, the demand is great. So we can buy a watch, and we can sell a watch without actually investing in the capital.

Jitu Punjabi: I mean, I don't know whether there is a number to this, but what percentage of revenues or sales will be from here, from this part, what number of watches would be pre-owned versus new?

Yashovardhan Saboo: That's still very, very small, it's still very nascent. But what I can tell you is that in other countries where pre-owned business has have been there prevailing for some time, typically in some businesses 15% to 20% of the business could come from pre-owned watch sales.

Jitu Punjabi: Okay, so it could be as large if you were to take the form?

Yashovardhan Saboo: In future there is a lot of potential for that, true.

Moderator: Thank you, sir. We have next question from the line of Saurabh Ginodia from SMIFS. Please go ahead.

Saurabh Ginodia: Sir, my first question will be with respect to rentals in whatever stores we have been able to manage for rental renegotiation, in those stores what kind of rental relief have we got? And secondly, have we been able to convert any of these fixed rental into revenue share?

Yashovardhan Saboo: Sir, we have got rental relief, in some cases it has been a waiver for the period of the lockdown, in some cases it has been a reduction by 50% or 75% for the period of the lockdown. And in several malls where we have concluded, there is also a relief for some months after the lockdown is over. So, that is the range of reliefs that we have got in the mall that we have concluded negotiations. And as I mentioned, in some malls the negotiations are still going on. In some malls where we are concluded, for this period there has been a term that it is semi-based on revenue share, which means that if revenue goes above a certain percentage of previous year, then the relief becomes less. So for example, if you said that, let's say in the month of September if the revenue is at least 80% of last year's revenue, then the rental will be 90% of the normal rental, otherwise it will be 60% of the normal rental. So, there some of the relief is connected to the actual recovery in sales, if the recovery entails is there then we will pay full rent or nearly full rent, but if say recovery is not there then we will not pay the same rent. So, there is a relief based on recovery and what revenue we generate, in most of the cases that is true.

Saurabh Ginodia: Okay. Sir, my next question will be with respect to, I just wanted to get some understanding from your side with respect to, are we doing anything differently to provide contactless experience to the customers at the store?

Yashovardhan Saboo: When you say contactless, the product is a contact based experience, so you cannot really completely make it contact free. But of course, all the security is being provided. So whether it is in terms of visors, masks, gloves, sanitization of the product all of that is being provided. So there is a very, very safe transaction protocol, which is practiced in all our stores that are open now.

Moderator: Thank you. We have next question from the line of Ankit Agarwal from Arc Capital. Please go ahead.

Ankit Agarwal: The first question is, what is the company's total gross debt and the cost of debt as of now? Then what are the fixed expenses that we have to incur per month?

Yashovardhan Saboo: Are you talking about KDDL manufacturing or you are you talking about Ethos or consolidated?

Ankit Agarwal: Consolidated, yes.

Yashovardhan Saboo: The consolidated debt is about Rs. 180 crores.

Ankit Agarwal: Okay. And the cost of debt, sir?

Yashovardhan Saboo: You mean the weighted average interest rate?

Ankit Agarwal: Yes, the finance cost, right.

Yashovardhan Saboo: I think it will be between 10% to 10.5%.

Ankit Agarwal: And Sir, what are fixed costs that you are incurring per month?

Yashovardhan Saboo: Let me tell you this separately for KDDL and Ethos, because businesses are completely different, we do not really monitor it. So for Ethos, the retail business without counting any temporary waivers in rent and so on, it's about Rs. 10.5 crores per month. And for KDDL, we have around Rs. 10 crores per month. But anyway, if you are trying to extrapolate the numbers, how the situation will look like for the running year, this number may not be relevant because as the business has come down because of the COVID, we have been doing a lot of cost rationalization. And the absolute numbers of the whatever numbers we are sharing, this is of the last year or of the previous quarter. So Ankit, Rs. 10.5 crores as a fixed cost base in Ethos, and Rs. 10 crores in KDDL are based on pre-COVID numbers, as I mentioned in my speech. We are working pretty hard to bring down the cost base through all kinds of rationalization. So it's probably not correct to extrapolate that to this year. But these are the actual numbers as they stand pre-COVID, and we are looking at a significant reduction during the course of the year.

Ankit Agarwal: Okay, got it. Sir my next question is, what is the current demand scenario with respect to our watch components business?

Yashovardhan Saboo: Ankit, as I mentioned that the watch component business on the export side we expect the demand to revive by quarter three of this year. And on the domestic side a little bit later. It's not that there is no demand, some fresh orders are coming in. But a real assessment will be possible only after about two months or so.

Ankit Agarwal: Okay. Can you give me the current capacity utilization for the KDDL business wise?

Yashovardhan Saboo: It depends, we have multiple factories, so depending on the demand I think it's very different. And again, what I am saying is, you cannot assume that this is going to be the capacity utilization which will continue. For example, my watch dial factories today is running at 80%. So if I don't get orders, if I don't get more orders in September, then they may come down to 60% or 40% or even 30% its not full business yet, right. Similarly from a precision engineering business, right now it is running at 75%, 80% because there are pent up orders from the lockdown which we are now rushing to complete for our customers. But if I don't get fresh orders, then I may not be able to continue this capacity utilization. What you have to keep in mind is that we don't have a standard product which we make, we only make products for which we get orders, every production that we do is based on a specific order. So we don't produce for stock.

Ankit Agarwal: Right. And sir, one last question. Sir, what is the status of Estima? Like, is it profitable as of now?

Yashovardhan Saboo: Perhaps you missed the part of my speech, no, it is not profitable. Last year was the first year and this year, of course, because of the COVID lockdown, we will not achieve the number that we had projected, so it will not be profitable. We are estimating a loss of little less than CHF 1 million during the year.

Moderator: Thank you. Sir, we have next question from the line of Nikhil from Sixth Sense Ventures. Please go ahead.

Nikhil: Yasho, Nikhil here. Yasho, one of the things that you alluded earlier was that because of COVID now a lot of global brands will look at shrinking the operations in India, and looking at distribution outlet like Ethos. How relevant is this? How large is this? And are we talking about large and relevant brands or these are these are Tier-2, Tier-3 brands?

Yashovardhan Saboo: Nikhil, I doubt if some of the top seven, eight brands are going to change their strategy for a potential country like India. So, I am not going to name the brands, but if you look at the list and you say, Okay, here are the top seven, eight brands, are they likely to close down their subsidiaries and go through Ethos, I doubt that. However, there are still several brands, very well known in the global market, which are still going through distributors in India or through some agents, some swiss agents. And that is where we expect the changes to happen.

Nikhil: And if you were to just take a shot at it, from where we were till last year, in the next couple of years what proportion of the business do you think will get generated from these distribution brands?

Yashovardhan Saboo: So, Nikhil, if you remember, our longer term goals, we had said that about 25% to 30% of our business should come from these exclusive brands. We are now expecting that by 2022, 40% of our business will come from exclusive brands or distribution brands. These are also the brands that have a higher margin. These are also the brands that give us a differentiation. And therefore, this higher share of business from these brands is really the cornerstone of our strategy, made possible with our digital presence and the ability to actually establish lesser known brands in the country.

Nikhil: Superb. Just lastly, Yasho, given that the uncertainty in the environment might continue for the next six months, do we need to recapitalize either of our businesses or both of our businesses?

Yashovardhan Saboo: I don't think that capitalization is necessary because of the uncertainties. Given the uncertainties today, we have done a contingency planning, and I think both of businesses are still good, still looking pretty solid for that. However, there is a discussion going on to capitalize on some of these opportunities which may come, specifically for a couple of big brands for which negotiations were initiated and they have been progressing, that might require an investment in the distribution or buying of their current arrangements. And to be prepared for that, there is a discussion ongoing that we might need some additional capital, particularly if debt funding is not forthcoming at the moment. That is still an ongoing discussion, Nikhil, it might happen. But a lot depends on whether we actually get these opportunities which we are pushing for.

Moderator: Thank you. Sir, we have next question from the line of Aimee Truesdale from Jupiter Asset Management. Please go ahead.

Aimee Truesdale: Just hoping that you can give us a bit more detail on the inventory. You mentioned that there's 7.9 months' worth, how have you been managing the inventory through this lockdown period?

Yashovardhan Saboo: So currently the inventory as on 31st March was about 7.9 months, that's pretty much the same as the previous year ending. Typically we are aiming for the months of inventory to go down. However, in the last year, because we opened several large flagship stores and the sales of these were not recorded for the full year. So in relation to sales, the inventory level was reflecting a little bit higher than what it would normally be. Our long-term goal actually is to get inventory down to about six months of sales, which we believe that for luxury watch business is actually very, very good. This year, of course, we are challenged with the fact that sales are going to be low and it's not going to be easy to reduce the inventory just like that. But we are looking at rationalizing inventory through a whole bunch of policies, including how we purchase, what we purchase, and also trying to, for example, stock deeper rather than wider. That's a very fundamental change that we are implementing this year in our purchasing strategy.

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

Lalaram Singh: My first question is, for Ethos I need specific numbers. So for example, for full year I think you mentioned 6.5% as the rent expense, was it for full year you mentioned?

Yashovardhan Saboo: 6.9% for the full year for mature stores.

Lalaram Singh: So that in terms of net revenues or gross billings percentage?

Yashovardhan Saboo: Net sales.

Lalaram Singh: Okay. And how much did we spend in advertisements and promotion in this financial year?

Raja Shekhar: So, we spent about 3% of our of our sales for advertisement and promotion.

Lalaram Singh: Okay, got it. Second question is sir, on the Swiss entity which you have acquired, Estima. Is there any benefit because of we changing the manufacturing strategy of players from China or Southeast Asia to back to their own country, is that happening? Because your commentary said that those also will be weak, so I believe that that is not the case.

Yashovardhan Saboo: So I think the strategy for Estima actually doesn't depend on focusing away from China. In Switzerland, if you have the Swiss brand, there is a certain category of Swiss brands that essentially buys only Swiss made products. So that end of the market is close to us manufacturing from India and is also close to the Chinese manufacturing in China. And this has also become sharper because of new Swiss made regulations that came into effect from 2017, and from 2019 they came fully into effect. By which, brands to call themselves Swiss made watches, they need to buy more from Switzerland. So that is the second group of watchmakers which were buying from China or India, but now certain products they will need to buy more from Switzerland to retain the Swiss made label. So, to this extent, we may retain the market share or gain market share. Some of it may come from Chinese, some of it may even come from KDDL. So, for example, there is a customer who was buying from us, but now because of new Swiss made regulations, he cannot buy from KDDL India, he has to buy from a Swiss made component. Because we have Estima, we can still retain this customer or retain that business, otherwise it would have gone to another Swiss maker. So, the Estima strategy is really a longer term strategy to enter the clientele which will buy only Swiss.

Lalaram Singh: Got it. And based on the capacity which we have at Estima, what is the revenue potential at full run rate?

Yashovardhan Saboo: It depends a little bit on what segments we go into. But our goal is to get to the full capacity, it will require some balancing investments in the year. But two years from now, we do expect it to be able to hit about CHF 4 million to CHF 5 million.

Lalaram Singh: From CHF 1.8 million currently?

Yashovardhan Saboo: Correct.

Lalaram Singh: And in terms of margins, it can generate high double digit margins, that's what we had mentioned earlier?

Yashovardhan Saboo: That is right, at that rate once we achieve the breakeven, the margin structures are quite favorable in Swiss manufacturing.

Lalaram Singh: And what kind of investments which we have made this year in terms of CAPEX? And going forward this year, how much amount we plan to invest in Estima in terms of capacity?

Yashovardhan Saboo: This year we have actually postponed most of the CAPEX, some CAPEX was already committed in the beginning of the year so that we are going ahead. But other important large CAPEX we have postponed this year because of the situation this year. We are going to see how the situation is going to be, so really not much CAPEX this year. Last year, I think we had invested about CHF 700,000 to CHF 800,000.

Lalaram Singh: Okay. Sir, third question is that in Ethos in FY '20, we had some exceptional items linked to some litigation or we had set aside around a couple of crores of money. Not sure what exactly that was, but the footnote said that was 50% of the underlying amount. So is there any possibility of further 50% of the amount being set aside, or how do you look at that number?

Raja Shekhar: For FY '20, most of the extraordinary items were related to statutory development. The legal case that you are referring to, that was a smaller part of the provision that we made in the current year. And that is a last provision, we don't foresee any further provisions required to be made for that.

Lalaram Singh: Got it. And just for the existing stores which are still open at Ethos, as you said half of the stores are open. I understand they might also be open for a limited period of time in the day. But how are you seeing the things there in terms of traction?

Yashovardhan Saboo: Right now the traction is weak. I wish I could say something else. But frankly, the traction is weak, people are not confident or going into mall, it is not a pleasant experience going into malls. So, traction is weak at the moment.

Lalaram Singh: And just to understand, this doesn't change our long-term strategy of being present primarily in marquee mall locations? I think because you are few retailers who are primarily situated in malls, unlike other people who are at the high streets or standalone stores. So it doesn't change that long-term strategy, right, of Ethos, in how we position ourselves?

Yashovardhan Saboo: No, I think we continue to believe that malls will be the shopping centers. We believe even today that actually malls are more secure than standalone stores, especially good malls, they follow a very strong security protocol. And I believe, I think we all have to believe that this COVID pandemic is going to come to an end in a couple of months. So we are looking beyond that, this is a difficult period, but I think once it ends, life will be back to normal. In fact, it will be better. And the marquee locations will be the first to recover.

Lalaram Singh: Sir, finally for this financial year, at Ethos, are we going with these two big stores which we were planning to launch, one in Bombay and one I believe in Delhi, I am not sure?

Yashovardhan Saboo: Delhi was not planned, actually there was a flagship store planned in Mumbai at the BKC, the new mall in BKC. The mall itself is delayed, so we are not sure when it will come, it is now expected to come up in the last quarter of this year. We are still on for that project, we are very excited about that project, because I think it will be our flagship store in Mumbai. That is definitely on track.

Lalaram Singh: One small question, which is bookkeeping in nature is, for this quarter can I get the losses at Estima? I think you mentioned for the full year, which is their financial year, which is calendar year, if I am not wrong. I wanted for this specific quarter, which is January to March for Estima, , the revenue and the loss figure.

Yashovardhan Saboo: So the revenue was about 630,000 CHF and the loss was about CHF 380,000.

Moderator: Thank you, sir. As there are no further questions from the participants, I would now like to hand the conference over to Mr. Yosho Saboo for closing comments. Sir, over to you.

Yashovardhan Saboo: Thanks everybody to join this earnings call. And I wish everybody a good day. Please stay safe and healthy. Thank you very much once again.

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