"KDDL Limited Q2 FY 2015 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY 2015 Earnings Conference Call of KDDL Limited. 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.

Also please note this conference call may contain forward-looking statements about the company which are based on the belief, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risk and uncertainties that are difficult to predict. I now hand the conference over to Mr. Yashovardhan Saboo – Chief Financial Officer of KDDL Limited. Thank you and over to you, Mr. Saboo.

Yashovardhan Saboo: Good afternoon and a very warm welcome to all the participants. I am joined at this call by my colleagues Mr. Sanjeev Masown, who is the CFO of KDDL and Mr. Raja Sekhar, CFO of Ethos, our luxury retail arm.

I hope you have received our results and the presentation. It is uploaded on the BSE website as well as our own website. I will give you a brief on the financial results followed by an update on the business.

Let me begin with the consolidated results. For the quarter the company registered revenue of Rs. 98 Crores, year-on-year growth of 24% from Rs.80 Crores in Q2 of the previous financial year.

In the first half of the year that is in H1 the company registered a growth of 25% to Rs.183 Crores from Rs.146 Crores. For the quarter, the gross profits stand at Rs.45 Crores with a gross margin of 45% and in H1 at Rs.82 Crores with a gross margin of 44.7%.

In Q2 FY 2015 EBITDA is at Rs.11 Crores and a year-on-year growth of 52% from Rs.7 Crores in Q2 of the previous year. EBITDA margin of 11.2% represents an expansion of 207-basis points year-on-year.

For H1 FY 2015 EBITDA is at Rs.17 Crores, which represents a growth of 50% year-on-year. The EBITDA margin is expanded by 147-basis points to 9.1%. For the quarter profit after tax and after minority interest is at Rs.3 Crores, a growth of 103% year-on-year from Rs.1.5 Crores in the same quarter last year. Margin has expanded by 119-basis points year-on-year to 3% from 1.9%.

For H1 FY 2015 the profit after tax and minority interest is at Rs.3 Crores growing by more than five times year-on-year from Rs.50 lakhs in the same period last year. Margin expanded by 130 basis points year-on-year to 1.6% from 0.3% in H1 of the previous financial year.

Coming to standalone results for the quarter the Company registered a revenue of Rs.34 Crores year-on-year growth of 23% from Rs.28 Crores in the previous year. I just want to clarify now we are talking about KDDL standalone results.

In the first half of the year, the company registered revenue growth of 21% from Rs. 53 Crores to Rs.65 Crores. This growth in revenue was mainly driven by growth in volumes.

For the quarter the gross profit stands at Rs.27 Crores with a gross margin of 78% and Rs.50 Crores in H1 with a gross margin of 77%. In Q2 the EBITDA is at Rs. 7.6 Crores, a year-on-year growth of 51%.

The EBITDA margin is 22% with an expansion of more than 400-basis points year-on-year. For H1 the EBITDA is Rs. 13.2 Crores with a growth of 52% year-on-year with margin has also expanded by 400-basis points to 20.4%.

The EBITDA margins have expanded on account of increased contribution value and reduced costs, which is raw material cost, employee expenses and a few other expenses as a percentage of sales.

For the quarter profit after tax is at Rs.2.3 Crores, a growth of 89% year-on-year from Rs.1.2 Crores in the same quarter last year. Margins expanded by 232-basis points year-on-year to 6.6%. For the half year profit after tax is Rs.3.3 Crores, a growth of 131% year-on-year from Rs.1.4 Crores in the same quarter last year. This margin expansion is by 243-basis points year-on-year to now stands at 5.1%.

Now I come to the discussion on Ethos, which is our luxury retail arm.

Please look at the Ethos numbers, while keeping in mind that H1 is the non-seasonal period of the business. this period generally account for approximately 40% of the annual sale.

Our experience has been that the revenue and EBITDA margins are significantly better in H2 than in H1. Even in the non-seasonal first half our revenues have grown by 29% year-on-year to Rs.118 Crores and the EBITDA have grown by 64% year-on-year to Rs.4.2 Crores.

The EBITDA margin has expanded by 78 basis points to 3.6%. For the quarter the company registered a revenue of Rs.63 Crores year-on-year growth of 25% from Rs.51 Crores in Q2 of the previous financial year.

Most people might think that the growth is coming mainly from the increase in number of stores. Allow me to correct this perception. Our number of stores has not increased significantly. Last year at the end of September 2013, we had 41 stores, today it is 42.

The growth has resulted from a rise in same store sales and average sales per store. In H1 of the current financial year the same store growth stands at about 11%. Average sales per store are getting a boost from our online platform. It has increased by 14% year-on-year with one of the main driving factor being the online leads generated by our internet platform.

This has gone up by 71% in H1 of the current financial year. Online billing has increased by 92% year-on-year and the online platform has contributed to 22.8% of the revenue as against 15.2% in the previous financial year.

I clarify that what we are doing online is generating leads which is leading to billing at the stores, and this is what has contributing to the larger part of our overall business as mentioned 22.8% against 15.2% in the last year.

We are continuously working towards increasing the catchment area of every store, which will lead to increase in average sales per store, reduce frontend and rental expenses, reduced frontend employee expenses and resulting in an expansion of margins as we go forward.

This chain of event is evident in our average sales per store having been increased by 14%. The frontend and internal employee expenses have reduced by 180-basis points to 13.5% in H1 of the current financial year from 15.4% in the same period of the previous year.

To continue with our focus on online, we will need to keep investing in marketing initiatives and activities to expand our customer reach. We have doubled our marketing spends from 1.2% to 2.3% in H1 of this year. Overall impact of our strategy in bringing in economies of scale by limiting physical expansion by increasing sales through online lead generation has resulted in our EBITDA growing by 57% year-on-year to Rs.3.6 Crores for the quarter and to Rs.4.2 Crores for the half-year a growth of 64% year-on-year.

These EBITDA margins have expanded by 115 basis points in Q2 and 78 basis points in H1. Profit before tax is at Rs.0.8 Crores in Q2 a growth of 49% year-on-year and from Rs.0.5 Crores in the same quarter last year. The margin expanded by 20-basis points year-on-year to 1.2%.

For the half-year as a whole the net loss before tax is Rs.1.1 Crores. This is mainly on account of the increased depreciation expenses and finance cost. For the quarter profit after tax of Rs.0.5 Crores and cash PAT of Rs.1.5 Crores. For H1 the net loss after tax is Rs.0.7 Crores and cash PAT at Rs.1.1 Crores.

Our store count as on date is 42 with 8 Ethos Summit Stores and 34 Ethos Stores including Seven Store at airports. We have opened a store at Amritsar and at Vadodara; both of these are in collaboration with the Fossil Group.

The latest editions are exclusive RADO boutique, one at the Select CITYWALK Mall in New Delhi in October 2014 and one the latest in Mumbai at Linking Road in Bandra. With these two new boutiques we have expanded our ongoing collaboration with the Swatch group which as you know is the largest watch group in the world.

As mentioned earlier in this call, this year we have closed stores. In fact we have closed more stores than we have opened. We have closed stores at Bangalore, Bhopal, Pune and an airport store at Hyderabad. With respect to the store closure, we have taken a write off of Rs.27 lakhs in H1 and additional provision of depreciation to the tune of Rs.39 lakhs.

This quarter marked a milestone for Ethos. Ethos on an exclusive basis brought extremely prestigious and coveted Grand Prix d'Horlogerie de Genève (GPHG) to India. The GPHG is the world's premier event for recognizing innovations in international watch making at the high end. It is considered to be the Oscars of the watch business.

A grand event was hosted over two days. The first day at the Swiss Embassy with the Swiss Ambassador being the co-host and the second day at the Imperial Hotel. The Grand Prix d'Horlogerie de Genève saw 72 of the finest and most coveted watches being unveiled for the first time ever India. Luxury brands including Breguet, Blancpain, A. Lange & Söhne, Van Cleef & Arpels, OMEGA, Bulgari, Chanel, Louis Vuitton, and many others to part. TAG Heuer, Hublot, Hermes to unveil their special creations.

The watches ranged from cost of Rs.1 lakh up to the highest price point of Rs.10 Crores. I remind you that this show was brought for the first time ever to India and exclusively by Ethos. We also had Breguet exhibitions in Mumbai and Panerai exhibition in Bangalore.

In these exhibitions, we showed the latest range of watches under these prestigious respective brands. These events highlight our depth of knowledge and experience and relationship in the luxury brands in the watch segment.

The partnership gives us the confidence in our product and service offerings and reiterate our beliefs in the growth and future of our business.

With this I would like to thank you all for participating and would like to open the floor for question and answers. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Ayush Mittal from Mittal and Company. Please go ahead.

Ayush Mittal: Good afternoon Sir. First I would like to congratulate on a good performance and great retail setup you have done and Ethos is performing really well. In fact your online initiative is very interesting and good to see such numbers. I have several queries in regarding the business. First thing is I would like to understand the business on the standalone front, your traditional Hands and Dial business. I would like to hear more on this like what are the factors, which determine our growth or what are we looking ahead going forward in this side of business as this is our major business which is contributing on the profitability front?

Yashovardhan Saboo: Would you like me to answer this or why do not you put all the questions there so then I can sort of answer them altogether?

Ayush Mittal: This is on the standalone and then maybe I can take up on the Ethos.

Yashovardhan Saboo: Ok, first of all thanks for your kind words. On the standalone business in KDDL in manufacturing as you know the historic part of the business is manufacture of watch components, which is principally, watch dials and watch hands. 70% of this is for export, mainly to the very quality conscious and premium market of Switzerland and the balance is to the Indian client principally Titan and Timex of which we are principal vendors. Business, as you can see reflected in the standalone figures, have grown. There was a dip that happened about two years ago. I think that has been discussed in previous calls but going forward we see this business growing steadily. What I would like to mention is that there is another segment other than the watch component segment which is precision manufacturing and this is a business we are making fine stamping for various industries outside the watch business. So this is really going into instrumentation, which can be in defence, which can be in aerospace, which can be in medical any fine engineering products. This is a business, which we expect to grow much faster than the watch component business. These are in the nascent stages. So we are seeing a huge opportunity. Currently it is approximately a Rs.20 Crores business but we foresee a much faster growth in this business, which is under the name of EIGEN,going forward. So while to sum it up there is the watch component business that is the watch dial and watch hand business which we expect to be growing steadily. As you know the Indian market principally comprising of Titan and some other brands as well is now looking up. So we expect the Indian market to look up and the international markets there are some indications of a slight slowdown because of geopolitical issues but overall their sentiment is positive and we certainly have great potential to continue growing the way we are.

Ayush Mittal: On the margin front, how has been the volatility in some of the years before like out of last six years, if I see then half of the years have been margins have been below 15%-odd while in the other years you get 19% to 20% odd margins. What are the factors behind it and what should be our normal range that we should look at?

Yashovardhan Saboo: While the factors for the two dips actually are very clear. This was the double dip which hit some industries more than others. Since ours is 70% is based on export we were impacted by the double dip which happened in 2009 and then in 2010. So I think those are exception. If you go back 10 years you would actually find that the margins have been steady. in fact they have improved. We believe that the current margins where we stand are sustainable.

Ayush Mittal: So, coming on the Ethos part though I really appreciate the way the business has been put up and it has been scaled up over last 5 years, the online presence; however, I have several queries like first is on like the inventory part. I would like to understand that how has the inventory done. Is it purchased or is it part purchased. How is it structured?

Yashovardhan Saboo: Can you repeat that question Ayush?

Ayush Mittal: First part is the inventory part. Do you purchase all the inventory or is it something that you part pay for your inventory? How is it done?

Yashovardhan Saboo: There are different models with different brands, there are different arrangements. There is outright purchase, they are purchased as credit, they are purchased with a partial exchange and with some brands there is purchase with the kind of consignment understanding where there would be an exchange for unsold product. So there are different model following different brands and one can summarize a situation by saying that the more famous and the more coveted a brand the stricter would be the payment terms.

Ayush Mittal: Why this question came up is that in the case of foreign currency fluctuations, do you get to gain when the rupee falls? Because as you are importing all the watches and these are luxury items which stay with you for quite some time?

Yashovardhan Saboo: When the rupee falls there would be a gain when we import directly or in the brand that we import directly, There would be a gain, you are right over there. However, I would also say that the most significant part of our purchase actually happens from the subsidiaries of the main brands, which are established in India already. So the purchase is in rupees.

Ayush Mittal: So it is not dependent on the forex part as such.

Yashovardhan Saboo: To the extent that we are importing some brands directly, yes, but almost 75% of our purchases are in rupee terms from local subsidiaries in the international brand.

Ayush Mittal: Similarly on the competitive landscape when we see the other family run companies which are dealing in the luxury watches. In terms of discount and other offerings are we at par. The discounts are controlled by brand or is it up to you or the other companies to exchange the discount you can at your level?

Yashovardhan Saboo: The leverage that the brands have to control the discounts, is actually dividend. The way it depends on retail is what they want to do. So, discount is a competitive instrument, and the fact that we are groing significantly faster than our competitors only indicates that we must be doing something better than them. What I can tell you is that our discounts are not higher than the competitors. We cannot afford to give higher discounts than the competitors because we are growing and we need to make the margins, but I think what we are able to do to control the discount and still sell better because of the package of innovative services that we offer. First of all it is the availability of the right stock at the right time. Secondly, we offer things like insurance with watches. We offer a loyalty program which encourages customers to come back and the best customers are actually rewarded with special experiences or special recognition in some ways. So I think there are a lot of innovations that we are doing. It enables us to grow faster than the competitors.

while Not really at the cost of offering higher discounts. That said I believe that the prices in the end are very competitive, not only with competitors over here, but also competition everywhere in the world and that is the reason why we are among the fastest growing retail chain today in the world.

Ayush Mittal: That is great. Second thing is that as there was considerable amount of debt which has gone into the expansion of Ethos while at the same time the margins are very thin at 4% to 5%. Interest coverage ratio it is not very high. As a concept as a thought process at your end how do you think about this business if you have to scale up. Like if you have to scale up you will need lot more debt or money or maybe private equity funding, which you are looking at. If the private equity funding is not there, are you comfortable to grow it on debt?

Yashovardhan Saboo: I think we are very clear. We do need funding and that has been articulated and we are also clear that we need funding in equity. So that is clearly articulated commission. We are expanding equity by a small amount this year. We would be looking at an equity expansion in the next one or two years as well. However, I also want to say that we are now at a point where we are profitable and therefore the profits will also go into funding the expansion.

Ayush Mittal: But if you have to really grow that business Ethos considerable amount of capital will be needed?

Yashovardhan Saboo: I do not know what you mean by considerable, but it is planned and we foresee a certain expansion of capital but I do not think this is something very, very large, so we are looking at an expansion of about Rs.22 to Rs.25 Crores of capital.

Ayush Mittal: Somehow I was under the impression I think in the last concall it was said that you are looking at a funding in the Ethos in the subsidiary only?

Yashovardhan Saboo: We were talking about the funding in the subsidiary.

Ayush Mittal: You are still looking in for the funding in Ethos now?

Yashovardhan Saboo: Yes correct.

Ayush Mittal: That would be sort of PE funding sort of you are looking at, I think.

Yashovardhan Saboo: As you know there are various options and we have to be conscious of the fact that foreign funds are not allowed in multibrand retail and we are multibrand retail.

Ayush Mittal: Sir, very far off question but, it may not be well suited for you as a luxury watch maker, but what about the smart watches thing, which have been coming up and which maybe a big craze in coming years.

Yashovardhan Saboo: Ayush, I think the smart watches are always an interesting question, but may I suggest that there are other persons, which are queued up. So let me take some of them and perhaps we can address and we can discuss this smart watch question, which is a very interesting question, perhaps towards the end of this call.

Ayush Mittal: Thank you Sir.

Moderator: Thank you much. The next question is from the line of Abhisekh Ranganathan from Philip Capital. Please go ahead.

Abhisekh R: Good afternoon Sir. Taking for taking my question. Just couple of things, just wanted to understand from a perspective of the loyalty program which you have mentioned which is growing pretty quickly; is it today how much does it contribute to the turnover of the business and we said whether globally is this a very normal practice to have a loyalty program for luxury watches. How does it play out abroad also?

Yashovardhan Saboo: Let me get you the figures of that Abhisekh. I am just going to try to recover the figures. I do know that the repeat buying is something of the order of it used to be somewhere around 25% to 26%, it went down a bit and now it is up to about 26% again during the season. Let me give you the figures as to how much of the sale it contributes, but before that while we wait for the figures I have already answered you what it is doing for us. I really cannot say whether the other luxury chains have royalty program. There is no other luxury chain in India for watches. What it does for us is simply it enables us to reconnect with customers who are buying from us. We see that repeat buying and referrals are extremely important in this business, and through the loyalty program we first get the permission of the customers to send them information whether it is about new products that we have, the new brands that we have or new offers that we have. It allows us to become part of some of their own celebrations, whether it is their birthday, whether they are celebrating a special occasions, we believe there are lot of watch purchase especially premium and luxury watch purchase is not a necessity. It is an expression of a customer feeling excited, feeling good about something, wanting to give or wanting to buy on a special occasion and that is why our loyalty program is actually called Club-Echo and Echo stands for Ethos Celebrates Happy Occasions. So what it does is it allows us to connect with customers, it allows us to know with them what are their happy occasions and gradually overtime inculcate a passion for watches which is leading to a lot of repeat buying. Qualitatively I can tell you, there are scores of cases where over the years a person transition from using a Titan Watch to his first premium watch, which could have been a Tissot to a first a entry to luxury watch which can be RADO with 70000 to 80000 of Lange, and eventually to an OMEGA and could be thinking about a Rolex or a Cartier or a Breguet. There are many such cases. I think this is something, which the royalty portion is doing very, very well for us. We are now in the process of refining the royalty program from a plain vanilla point base program to a multi –tier program and also connecting with perhaps other business entities where we can leverage our connect for similar line of businesses for getting a greater leverage from this.

Abhisekh R: Sir, when I was referring to the loyalty program, I was referring to the loyalty program and instances outside India in terms of watches for example let us say An Hourglass or it could be I was just referring if there is any database, which would give an idea of how this program would have played out somewhere in a place like China or Singapore?

Yashovardhan Saboo: Abhisekh, I must confess I do not have much information about loyalty program on Hourglass of China. I do know that in the European chains they are not running loyalty program. The loyalty program is not that much of culture of Europe.

Abhisekh R: The other question I have is on you mentioned something on exclusive tie-up with RADO and your going association with this Swatch group. A couple of things here is one is how do the economics of an exclusive store work versus a normal Ethos store and second is that what does it do to strengthen the relationship in terms of how do we get better terms of trade or are we likely to get better terms of trade as we go ahead?

Yashovardhan Saboo: Abhisekh, one thing we do not have an exclusive relationship with Swatcg group or RADO. We do have what I can say is the privilege relationship and I think for many of the Swatch group and we are the top retailers in the country and the association has been very long and based on a lot of trust and the brand has grown in India with us and we have grown with the brand. Swatch is the largest Group and the two Rado boutiques that we just opened is a fine example of that. Regarding the economics of the Mono Brand Boutiques, I think in general we have seen that the Mono Brand Boutiques are profitable. There are some exceptions which could be because of location or whatever, but in general we have seen that Mono Brand Boutiques are profitable and in some cases more profitable than multibrand stores and I think the average would be more or less the same. We do get better terms for Mono Brand Boutiques than for multibrand store just because the brands are also interested in showcasing their best piece in a Boutique and they encourage us by giving us better terms and of course it adds to the relationship. So for example what it does is, in many brands now we have limited Editions or you have exclusive launches. Then once it is of course done in the Mono Brand Boutiques. There are some watches available only in Boutiques. There are some watches which are available for the first three months only in Boutiques, which is this is something that enables us to reach to special customers. There is also something better training is organized for Boutiques or let us say more frequent trainings are organized for Boutiques. So it also helps in building a relationship and building an understanding our knowledge base about the brand and its product. So in many ways it helps the multibrand stores as well.

Abhisekh R: Sir, on the E-commerce, two things. One is obviously the fact that you mentioned something about you opened couple of stores with Fossil, if you could just explain what that is because this is in context of the market, which where we are seeing a lot or where we are like to see a lot of disruption and I guess you yourself also mentioned earlier in various platforms that would that be the categories which are maybe up to Rs.20000 to Rs.25000 a watch, they would actually migrate online very quickly so just wanted to get a sense of whether are we seeing that happening sooner or later it is a context of what happened in October continuing a lot of mega sales have gone by and more are likely to come.

Yashovardhan Saboo: Well, I do not know, what was your question regarding Fossil Group, but we do have an arrangement with Fossil Group, which is the WSI store by Ethos. WSI is a

Fossil Group concept for multibrand stores. We are running three WSI stores. I think it is one of the first three or among the first few WSI stores in India and this really focuses on five points below US $1000 with the Fossil Group many of them are very well known brands, Armani, Fossil, Micro Gold and so on, but we also have a representation of the non-Fossil Group brands in these stores. So that is the arrangement we are doing with them.

Abhisekh R: Is it similar to Helios in many ways you can say?

Yashovardhan Saboo: Not really. I mean Helios has lot of Titan Group brand and we do not have those.

Abhisekh R: Conceptually?

Yashovardhan Saboo: In terms of price positioning, I will say yes it is coming that way. As far as the online present, online sales and what are the disruptions going to happen over there, look in India obviously it is a traffic period and you know what happened in October was a dhamaka and so whether it is big in the context for the future, I cannot say, but I think what we can take a guidance from it what has happened elsewhere in the world. So elsewhere in the world, online sales has been happening and offline sales is happening as well in much more developed markets, then I think that is going to be the situation here as well, that there will be some brands, which will take an online and offline position and whereas some brands will continue to really focus on the offline whilst promoting them online but sales happen offline and there will be some which may go exclusively online although that it is rare. Having said that I do believe that some brands in India which today are not embracing the online platform, especially in price points below Rs.25000, in future over the next one or two years, I believe they will embrace the official online platforms, so as to reduce the conflict with their existing channels which is really a big question for them. they would like to do online business with their current authorized retailers and frankly we are ready and waiting for that.

Abhisekh R: What do you mean by you are ready and waiting for that?

Yashovardhan Saboo: Our model is ready, so if there are brands, which we are authorized retailers for, which currently we are not in the online space but over the next one or two years they decide that look we do want to get online and embrace the online platform with certainly live brands as far as processes and the engines are concerned, we can start at very short notice.

Abhisekh R: So basically, it means that your platform is ready to not just redirect, as of now it is redirecting sales of store, but it basically means that I can just complete the entire transaction on your website.

Yashovardhan Saboo: Yes. We are ready for that. Tests have been done and in fact a smattering, a small smattering of such direct sales with such brands that allow it is already happening, but it is too insignificant. It is really to test the models that it is working or not, but as I said if there was a call, which I am sure is inevitable it will happen. The only question is when. I think we are ready and we are far ahead of other retailers in this era.

Abhisekh R: That is very interesting, which means that this would basically mean that the brands which you are retailing and let say in totally which means that a lot of the Fossil Group brands which you maybe selling, just as an example I am citing, there would be the ones in totally they should be sold online through your website?

Yashovardhan Saboo: Yes, I do not want to sort of.

Abhisekh R: Just as an example which I mentioned.

Yashovardhan Saboo: As an example, yes. I think all brands under the Rs.25000 price point which may go up overtime would be looking seriously at it.

Abhisekh R: Which would also mean that these brands were actually stopped selling on the other market places where they are getting heavily discounted, is that what you are mentioning, because you are getting alternative place to do this?

Yashovardhan Saboo: Absolutely. See most of the places where they are getting heavily discounted, they are either marketplace models or it is not authorized deals. And the brands are very keen to stop that because obviously the clashing with their existing channels and I do not think any premium or luxury brand today can go into a situation where it is exclusively available online. I think the online and offline platform have to sort of work seamlessly and both are important.

Abhisekh R: Thank you Sir.

Moderator: Thank you. The next question is from the line of Avinash Dolani from Aries Stock Trades. Please go ahead.

Avinash Dolani: First of congratulate for the good set of numbers. I have few questions. So do you want me to go ones all and you will answer it all or one by one.

Yashovardhan Saboo: I think best Avinash, if you can give all the questions then I think we can deal with them more efficiently.

Avinash Dolani: I have more questions about this Ethos; first of all the collaboration with Fossil Group. I just want to know how the revenue sharing works. How the capex model works? Do you have to invest in partnership with him or you have to open the store and you work on royalty model or stakes. Second is these RADO boutiques which you have opened is it also the same kind of Fossill format kind of thing and what or else what would be the defence vis-à-vis this Fossil WSI stores? Do not you feel these stores would lead to cannibalization leading to reducing your sales from Ethos and people would go to these WSI and RADO boutique and the last question would be going ahead what would be your focus majorly?

Yashovardhan Saboo: So Avinash, let me take up these questions. I think with Fossil Group, the basic arrangement is that the Ethos sets up and runs the WSI stores. The capex is shared. The space is shared between Fossil Group brands and non-Fossil Group brands. The billing all comes to Ethos. So it is an Ethos store. The billing all comes to Ethos. The products are purchased and they are sold. There are depending on the locations there is sharing of cost, there is a sharing of minimum guarantee. So there is a contract and an arrangement on this space base. So it is really sharing of cost but the revenue is all coming to Ethos. As far as the RADO boutiques are concerned, again broadly it is similar. The billing is Ethos. It is Ethos store. It is a RADO boutique but that is part of the Ethos group. So it is not that the billing is going to someone else. We are purchasing watches from RADO and we are selling it. The store is an exclusive boutique for RADO and as I mentioned in the previous question it is of certain benefit both in terms of relationship as well as in terms of financial with the brand and you must know that RADO is one of the best selling brands in India today. So it is a feather in our cap to have an association like this. I believe because as mentioned earlier also that these arrangements are not in conflict with Ethos, contrary to what you are thinking. So it is a part of Ethos and secondly what it does is it increases our collaboration and relationship with these key brands. These are also key brands in multibrand stores. So having these boutiques enables us to access some of their limited edition, some of their special products, some of their special trainings, so it gives us a greater access into some of, let us say, the more restricted areas of the brand, which is an advantage for our multibrand stores as well. So, I do not see a conflict. Going forward we will be expanding Ethos and we will be looking at opportunities to grow some in the Mono Brand Boutiques as well. So I do not think it is an either/or. it will be both, but I am again hasten to add that with our strategy is not going to be so much on expanding new stores. There will be some expansion, but the bigger stress is going to be to increase the reach of the present portfolio of stores.

Avinash Dolani: That is it. Thank you.

Moderator: Thank you. The next question is from the line of Manoj Dua from Geometric Securities. Please go ahead.

Manoj Dua: Good afternoon Sir. In your standalone business there are two businesses. One is the manufacturing facility for the dial and another is the Precision stamping division. Can we have the breakup of the same in this quarter?

Yashovardhan Saboo: You are expecting it for the quarter?

Manoj Dua: Yes in Q2.

Yashovardhan Saboo: So the watch component is about Rs.27 Crores and the others is the balance so that is about Rs. 7 Crores.

Manoj Dua: Basically, I want to understand this Q2 standalone quarter has been very good. As I go through past history, I think, 2 Crores profit has never been there in a standalone in one quarter. Is there any seasonality quarter wise in the standalone business or it is just yield deformity that is there in this?

Yashovardhan Saboo: I think in the KDDL manufacturing business, the seasonality is actually much less. I can say that there is really not much seasonality. Sometimes because it is based on the business which is seasonal there are some fluctuations but they are much less than what it is in retail segment where ultimately we are supplying components that go into watches which is highly seasonal segment. So sometimes a reflection of that happens which you know the customers postponing some deliveries or changing some delivery schedules and once they are done with delivery schedule, which we will have to follow. So that sometimes gives an element of seasonality, but generally, I would say that it is not really a seasonal business.

Manoj Dua: How are your customers doing financially and they have operations around China, India, etc.? How they are performing as in this world economy?

Yashovardhan Saboo: Our customers, you mean the customers that we are serving in the manufacturing business, standalone business?

Manoj Dua: Yes, standalone business.

Yashovardhan Saboo: Most of our customers are leaders in the field. When India has Titan and I think the financials of Titan are known to everybody. I think they are very strong. In internationally as well they are leaders in the business. We have confidentiality agreement so I cannot really tell you who are the customers are but they are among the best in the business. So, the financial stability of our customers is the least thing that we need to worry about.

Manoj Dua: It is nothing to worry, but how the demand from you in standalone business could be there in future I just wanted to see there, for that purpose? Secondly in Ethos part, have you added any luxury brand in this quarter?

Yashovardhan Saboo: It would be difficult for me to answer that, we added a luxury brand, no I do not think we have added any luxury brand in this quarter, Manoj. Let me also add it is not of classificatory to add too many more brands. They maybe some brand corrections, some brands may go out, and some brands may add maybe added but I think with our portfolio of more than 40 brands we have enough number of brands. As part of overall brand management of course there will be some changes, but I think we have a very, very strong brand portfolio.

Manoj Dua: Just for example, I was seeing a watch in UN; UN was not there. So maybe that way you have a business strategy which brands you want to keep or which brands you do not want to keep?

Yashovardhan Saboo: There are many, many luxury Swiss brands and non-Swiss brands. I do not think any retailers in the world can sort of cater to most of them. So we are pursued. I think we wanted to choose brands across the main large groups. So, we are one of the few retailers that have luxury brands across the major groups all of them. So whether it is Swatch Group, whether it is a Richemont Group, whether it is Rolex Group, whether it is Louis Vitton Group. We have representation from all of them and having said that by the way we do UN at duty free store. It is not yet a domestic store, but as a duty free store we do UN and it is part of our portfolio.

Manoj Dua: You said duty free shops are higher margin than normal stores you have or they are higher sales per store?

Yashovardhan Saboo: Yes and no. The duty free stores because of the traffic and high end traffic they do tend to have high sales and the margins are higher because the duties are lower. That said you should be aware that the airport cost, the airport franchise costs are extremely high, and that is not true only in India. all modern airports usually have revenue shares in the region of 25% to 30% of revenue. So frankly what is saved in duty is taken away by the airports.

Manoj Dua: Do you think you will increase the EBITDA margins in Ethos? What is your target for the EBITDA margins in the coming years? As of now I know it is sales are growing and I think the company can reach an infliction point where increase in sales will contribute to the profitability. What is the EBITDA margin you have a target in mind to reach something like that?

Yashovardhan Saboo: You know we benchmark, Manoj we benchmark ourselves against a very successful chain, Chinese chain it is called Hengdeli. It is a large chain. China is a large market and we believe in the years to come India will mirror China. So we benchmark ourselves against Hengdeli and Hengdeli works on EBITDA margin of around 11% to 12%, which we believe is achievable in India as well and we follow that as a benchmark to be achieved for the next four to five years.

Manoj Dua: How much funding you will like to see in Ethos subsidiary?

Yashovardhan Saboo: Ethos subsidiary we are targeting capital funding of about Rs25 Crores in capital.

Manoj Dua: Any factor what do you think is the threat to the company or sector which can affect the country? Any factors which can affect our company's profitability in the coming years? What threat should be that thing?

Yashovardhan Saboo: Manoj, list of risk factors you see our annual report this is a large list.

Manoj Dua: Have you seen currency fluctuation?

Yashovardhan Saboo: You know the mood of the country, Manoj, you know the mood of the country. If the country's GDP growth jumps up from 5% to 6% to 7% or 8% we all hope it would. I think we have to look at the opportunities not more than the risk factors. Theoretical risk factors are so many.

Manoj Dua: Ayush Mittal contributed a smart watch could be one thing and secondly technology could be one thing or similarly if you think most of the sale is in the cash, I think in Ethos stores so any guidelines from the income tax say the pan number is necessary. Are these things to look out for?

Yashovardhan Saboo: Smart watches is an important development in our business. Like I said, I will spend a couple of minutes at the end of this call to talk about that. As of now we have no requirement of any documentation for cash sales. All cash sales are deposited in the bank. I do not expect there to be a change in that rule. I think the government makes a lot of revenue from the tax that the watch industry is generating. I really do not expect a change in that much.

Manoj Dua: Any effect of GST in a positive way?

Yashovardhan Saboo: GST will be very positive for us Manoj.

Manoj Dua: Thank you Sir.

Moderator: Thank you. The next question is from the line of Navneet Harikumar who is an individual investor. Please go ahead.

Navneet Harikumar: I just wanted to understand how you are willing to go with respect to diluting your stake in Ethos from a KDDL perspective?

Yashovardhan Saboo: Navneet, that is a question that I do not think, I alone can answer. That is a question for the board and eventually the shareholders of KDDL to consider. What I would like to answer is as follows: I think for KDDL and I believe as a shareholder of KDDL and a promoter of KDDL I think the overall wealth is being created is more important than what is the percentage that we control. I think Ethos is doing a fabulous job of generating that work and KDDL as a standalone is holdings its sway and maintaining a good position in the markets that it does. Obviously we are not keen to dilute at unrealistically low valuations, but you know valuation is a thing which has a lot of people will give you valuations because it is a factor of work. Someone will give you a valuation of one and someone will give you a valuation of 4 and promoters like to think although that the valuation is much more than the market thinks. Now having considered all these the fact also is that there is a huge opportunity. So we have to balance what is the opportunity with what is the terms of a dilution, some valuation is inevitable, because we believe the opportunity requires it. That said we believe that we can achieve the goals of Ethos without a very, very significant dilution.

Navneet Harikumar: The other 25% could you tell who holds the remaining portion. I believe KDDL owns 75%, is that right?

Yashovardhan Saboo: Yes, approximately right and the balance is held by various individuals, HNI or firms owned by them. These are mostly our customers who like what we have done overtime and in several stages they have invested in the company and this totals to about 25% currently. All of it in equity and some of it in interest and capital.

Navneet Harikumar: One last thing it is a question, where do you see yourself nearly in ten years from now?

Yashovardhan Saboo: Ten years is a long time, Navneet. What I can tell you is that we do see ourselves continuing to grow at 25% to 30% CAGR in Ethos and that about in five years time it should put us in a shooting range of Rs1000 Crores, and in the manufacturing business we are targeting a long-term growth of 15% year-on-year.

Manufacturing. I do not think can grow at the same rate as retail, but I believe 15% is a nice growth over there in both the segment we expect steady growth.

Navneet Harikumar: More specifically in luxury retail have you seen working capital coming down as a fraction of revenues, has it been into steady state?

Yashovardhan Saboo: No I do not think we are at steady state yet. Working capital as a percentage of the business that we are doing was high. It has been coming down every year. This year again it will be down a bit. However, I must say that we are not very far from the benchmark, which I mentioned in the previous question, the benchmark of 100 we are not very far from that. So if we were to do that we are sort of close to that. However, I believe that on this particular point, it is very important for India because our interest costs are far higher than China or anywhere else and there we need to be more efficient in working capital than perhaps China, definitely more than Singapore or Dubai or any of these places. So we need to be more efficient over there and I believe our internet and online initiatives will help us to do that.

Navneet Harikumar: You said your benchmark was Hengdeli is that correct?

Yashovardhan Saboo: Yes, Hengdeli. Look it up it is an interesting company.

Navneet Harikumar: If you reach Hengdeli level of profitability, capital efficiency, five to 10 years from now, would you be satisfied with that or do you think can achieve better?

Yashovardhan Saboo: Our goal is to reach Hengdeli benchmark in five years. I do not think we can do the signs which the Chinese size of the Chinese is about 15 times India size or 20 times. It is a big multiple. So I do not think we can reach absolute figures of sales and profit of Hengdeli but I think in terms of percentages and margins we should be reaching Hengdeli much before 10 years.

Navneet Harikumar: Thank you Sir.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to the management for their closing comments.

Yashovardhan Saboo: I had promised to everybody that I would add a few words about smart watches and let me do that now before I conclude. You know smart watches is a very interesting phenomenon that is happening. Many people and they have many, many views. I will express my views. I believe smart watches will have an impact on our business. It will have a positive impact overall. There might be some negative impact in the short run particularly in price segments below Rs.25000, but I also believe that many of the groups, operating in this price point, are very large groups with a lot of resources, so they would probably develop some version of smart watches themselves. So I believe there will be a certain churn that happens over the next two years; however, it will not impact price points above $2000 too much. In fact over the long run, it will have a very positive impact because a lot of younger generations which currently is not in the habit or is giving up the habit of wearing watches, will start with smart watches and gradually move on to other more valuable watches as they grow older or as they grow wealthier. So overall I do expect that the smart watches will be very interesting development and a positive development and this is the views that has been echoed by most of the people in the watch business whether it is in Switzerland, whether it is a global brand in Japan or in the U.S. With these comments, I would like to thank everyone for joining on the call. I hope I have been able to respond to your queries adequately. For any further information, I request you to get in touch with SGA our investor relation advisors. Thank you very much.

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