"KDDL and Ethos Limited Q4 FY 2017 Earnings Conference Call"

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MANAGEMENT: **MR. YASHOVARDHAN SABOO -- CHIEF EXECUTIVE OFFICER, KDDL LIMITED AND ETHOS LIMITED**
MR. SANJEEV MASOWN – CFO, KDDL LIMITED
MR. C. RAJA SEKHAR -- CHIEF FINANCIAL OFFICER, ETHOS LIMITED

Moderator: Ladies and gentlemen, Good Day and Welcome to KDDL and Ethos Limited Q4 FY 2017 Earnings Conference Call. This Conference Call may contain forward-looking statements about the company which are based on the beliefs, opinions, and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

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I now hand the conference over to Mr. Yasho Saboo -- CEO. Thank you, and over to you, Sir!

Yashovardhan Saboo: Good afternoon, ladies and gentlemen. Welcome to our Q4 and Fiscal Year 2017 Earning Conference Call. I am joined by Sanjeev Masown -- CFO of KDDL Limited; and Mr. Raja Sekhar -- CFO of Ethos Limited, our Retail Arm; and also by our Investor Relations Partners Strategic Growth Advisors.

I hope all of you have had a chance to look over Results Presentation updated on the Exchanges and on our website.

Let me start with the key consolidated financial figures for the year ended 31st March 2017. Our total revenue remained flat at Rs. 455 crores as compared to the last financial year. This was mainly due to the slowdown we witnessed in our retail business at Ethos on a back of very significant changes in the regulatory environment from time to time during the previous year. We will discuss these in detail in a later part of our discussion.

Gross profit of the company was also flat at Rs. 172 crores for FY 2017. Consolidated EBITDA declined from Rs. 29.5 crores to Rs. 26.9 crores in the previous year. Company reported a gross margin of 38% and EBITDA of 5.9% which was a decline of 65 basis points from last year. The profit after tax for the year also declined from Rs. 5.3 crores to Rs. 0.6 crores.

Coming to our standalone results based on the manufacturing business. Despite of sluggish manufacturing environment especially in the watch segment, our standalone revenue of the company grew from Rs. 119 crores to Rs. 126 crores for FY 2017, an increase of 6% over previous year. This was primarily driven by the growth in the precision engineering business. Quarterly revenue of the manufacturing business also improved from Rs. 29.5 crores in previous quarter to Rs. 30.4 crores in quarter four. And witnessed a growth of around 3.4%.

EBITDA margin for FY 2017 stood at 17.2% while the quarter four the margin stood at 16.4%. Profit before tax of the company improved from 8.2% to 8.8%. Revenue in the precision engineering business for FY 2017 grew by 28% Y-o-Y basis along expected lines. The year-on-year growth in revenue from domestic market was 45% whereas from direct and indirect exports the sales grew by 15%. Our exposure to multiple segments in the precision engineering business has ensured consistent growth quarter-by-quarter, we are confident that our capabilities to manufacturing complex parts and components coupled with the preferred supplier status recorded by many large customers will help us in achieving strong growth in this segment given current year and in future.

During the year, the company has initiated various efforts for increasing its presence and reach with potential customers by regular participation in trade fairs and exhibition nationally and internationally. We are actively using the digital marketing platform for extend in our reach in market segments. The response to these initiatives is very encouraging and we are witnessing healthy growth in all leading indicators such as flow of leads, new enquiries and RFQs and opening order position from various manufacturing segments. We believe that this business is on a robust growth trajectory.

Our expansion with a new facility at the KIADB Aerospace Park near Bangaluru Airport is progressing satisfactorily. We planned to commence the production from Q2 in the current fiscal. Partial investments have been done in the existing facilities and we have already put this in operation. The benefits of this CAPEX shall accrue from the second-half of fiscal 2018 post addition of new capacities especially in the electro plating department in the new facility.

On the watch business segment, our revenue improved marginally by about 1% supported a domestic revenue growth of 15% but offset by an export revenue decline of 6% which was mainly due to a very sluggish environment in the Swiss watch industry. The watch component business was impacted by the weak off take abroad but despite this, our watch hands business especially has captured market share from competition by offering new features and designs and also gaining entry into several new customers in the high-end segment especially.

We have commenced the new financial year with an improved order position. We believe that the international watch industry will still need two to three quarters time for a full recovery. However, we are already seeing healthy green shoots even as we continue to consolidate and restructure watch component manufacturing business. We expect that with these initiatives we will be well positioned to capture and in-cash the opportunities as they emerge during the year.

The implementation of new Swiss made regulation is also likely to provide new opportunities for the company to enhance value by capturing new customers.

Coming to our retail arm Ethos. As you are aware FY 2017 has been a very challenging year for us as it has been for most premium retail. There were multiple regulatory changes including the Pan Card requirement for transactions above Rs. 2 lakhs followed in July 2016 by a new requirement for collecting TCS for all cash transactions above Rs. 3 lakhs. Thereafter, the demonetization event happened on November 8th, 2017 subsequently an announcement was made in the Union Budget that cash transactions above Rs. 2 lakhs would be banned, it is indeed they have been with effect from April 1, 2017.

These changes have had a cumulative impact from the revenues of the company. The revenue remained flat at Rs. 326 crores from Rs. 328 crores. EBITDA stood at Rs. 4 crores with a margin of 1.2%. PAT saw a high loss of Rs. 7.5 crores. It has been our consistent position that such regulatory changes will have an immediate negative financial impact on the company as we have seen. But in the long run they will benefit the luxury watch industry and specifically our company. How will this happen? Besides creating a level playing field with the unorganized players in the business, we have historically benefited from grey market practices as a part of the business. These regulatory changes will help us in being able to serve our customers better. The regulatory changes will affect thus the consumer sentiment also in the short run. But in the long term they will find acceptance with the general customer. We found evidence of this when the Pan Card guidelines were introduced. The month in which the guidelines were introduced that is January 2016 showed an immediate drop in our sales. a very high drop compared to the same period previous year. However, the sales picked-up during the course of the quarter and the quarter as a whole showed a growth of 2% over the same period in the previous year. In the sequent quarter that is Q1 of FY 2017 the revenues showed a growth of 6% and in the very next quarter the sales of the company grew by 8%. This reflects the relative robustness of consumer demand for luxury watches.

The subsequent regulatory changes will gain wider acceptance and as they do that the company is confident and the sales growth will revert to levels witnessed earlier. We remain optimistic about the future outlook. The factors that make the market opportunity for premium and luxury watches look attractive, still as robust as they were before these regulatory changes. The penetration of luxury watches continues to remain very low. While the number of HNI households continues to rise and demographics continues to remain favorable.

What is required and what is the company's strategy to realign to the new environment. We are already taking proactive steps in this regard. The company has recalibrated its stock assortments to lower price points. We have moved away from price points, we have moved away from brands at price points of Rs. 10 lakhs and above and reduce the exposure to price points between Rs. 5 lakhs and Rs. 10 lakhs.

In addition to this, the company is changing its product portfolio with an increased thrust on exclusive brands which are brands that the company retails exclusively or with very limited distribution. And at the same time, we are reducing the emphasis on high luxury brands. This will help the company to improve the gross margin considerably since the company is able negotiate much higher margin from the house brands. They have already executed exclusive or limited distribution arrangements with 13 such brands. The share of sales of such brands has also gone up from around 3% in FY 2016 to more than 8% in FY 2017 and a further similar increase is projected this year too.

As you are aware, the company has closed operation as several of its stores over the last two years. We are now embarking on an ambitious expansion plan; having already signed up seven stores in prestigious malls across the country, to open this year, many of them actually within the current month itself. This includes several cities in which we are not present currently. Some of the malls that we are now entering are the DLF Chanakya Mall at New Delhi; the Seawoods Mall at Vashi, Mumbai; at Awadh Center in Lucknow; and The Pavilion Mall in Pune. Jaipur is another city where we will be starting very soon.

The company also believe that the market opportunity is large in tier-II and tier-III cities and actively planning a growth strategy in these location as way to accelerate its growth. The challenges in these locations are obviously the cost of the operating and managing the stores. These are the revenue potential. One of the strategies that the company is actively considering is the franchise.

The company is also investing in its omni-channel capabilities with a view to provide a seamless connect between the digital and physical store, in a sense also expanding the reach of the physical stores through the extensive reach of digital media.

In terms of GST and its impact the rate for luxury watches has been announced at 28%. Actually, this is the rate for all watches across all price points. This represents a much higher impact on our sales compared to the overall VAT incidence on watches in the current tax regime. However, the GST guidelines also allows for a set off of the CVD payable at the time of imports.

In addition to this, the GST rules also allow for set off of the GST payable on services availed by the company such as rent which is one of the largest expenses for the company. In the current tax regime, the company charges the Service Tax from these services to the P&L and almost the entire amount is treated as an expense. We believe that these two set offs under the GST regime will significantly compensate for the additional tax burden on the sales of the company.

The transition rules in the GST stock is expected to have a short-term impact on the company mainly in relation to the stock carried by the company on the GST implementation date. We are still awaiting a small print on the rules to be able to access the full potential impact. At the same time, we are making the strategies to ensure that this impact has minimized. We do believe that the GST regime on the whole have a continuing beneficial impact on the industry and the company in the long run besides adding a great new momentum to the economy as a whole. We are very hopeful to see an upswing in the business move on consumer sentiment for premium lifestyle goods in the coming season after September.

With this, I open the floor for Question-and-Answers. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the Question-and-Answer Session. We take the first question from the line of Chaitanya Adesara from Siddhesh Capital. Please go ahead.

Chaitanya Adesara: So, with regards to Ethos I have couple of questions. The first would be the employees' expenses as a percentage to sales is at 6.3% versus 6.1% last year and in this year you closed six stores vis-à-vis two stores last year. So, any one-offs in the same, why would the employee expense still be on a higher side despite closing six stores this year?

Yashovardhan Saboo: Okay, Chaitanya would you like to ask all your questions so we can answer them all together?

Chaitanya Adesara: Yes. So, the second one is, what is the discount level for the quarter where we see gross margins also falling from 23.8% last year to 22.2% this year? And my last question is, you mentioned 13 exclusive brand sales have gone up from 3% to 8%. So, does it have any impact on the margins either through discounts or may be these brands would have a better pricing?

Yashovardhan Saboo: Okay. Chaitanya, let me answer the questions on the margins first and start with the last which is on the exclusive brand. Yes, we are seeing the impact of the higher margin on these brands. Overall, as the share of the business of these brands is going up, that impact will become much more visible obviously at levels of 3% and 8% is not moving the needle too much. But not only is the margin higher but even after discounts are given, the gross margins that we earn from these brands is significantly higher than the overall average. So, it is pushing the overall average up. Of course, we have a very valid point, if that is happening then how come the gross margin overall for the quarter is down? I think we have to go into the details to analyze the different segments of different brands. So, one other thing which is happening is that consequent to our decision to get out of brands at very high price points, we are going on a pretty aggressive selling to liquidate brands over there and so as to free up working capital to invest in these exclusive brands. And typically, at the higher price points the discounts are higher while the margin that we earn, the vendor margin that we earn is lower. So, the combined effect of these is actually that the overall gross margin appears to be a little bit lower. This is the temporary phenomena happening while the liquidation of some of the high-end brand is happening. We expect that this trend will be reversed within the next quarter or so. Regarding the employee expenses, I am just let Sekhar, our CFO take you through that.

C. Raja Sekhar: Yes, Chaitanya, on your question regarding the employee expenses and the reason they have gone up as a percentage of sales, I think one of the thing that you need to note is that the sales itself has come down by about 1% over the last year while the manpower there has been increase in the man power cost at a per store level. Not only that, you would also note that we have actually closed down six of our stores which is not appearing at the store count at the end of the year. So, we closed about six stores for which we had to incur man power expenses during the course of the year for which the sales were significantly lower than what they were in the previous year. And third, also in terms of the backend there were certain gaps that we have to fill in terms of our backend cost especially in the marketing and internet team which also read to a certain rise of expenses which are supposed to be compensated by a higher sale that should have happened. But going forward in the next year we do believe that the man power cost as a percentage of sales would start showing a decrease.

Moderator: Thank you. We will take the next question from the line of Deepan Shankar from Trust Line PMS. Please go ahead.

Deepan Shankar: Sir, manufacturing business overall has not grown over the past three years and we have been seeing a continuous decline in margins also. So, what is the individual segments numbers for the FY 2017 and what is the outlook overall for this business? Is my first question and then in the retail trend when are we expecting the same store sales growth to improve to substantial levels? That is all.

Yashovardhan Saboo: So, on the manufacturing business Deepan as I mentioned during my speech actually the precision engineering segment which is again engineering if you go to our website you can see it over there, that is actually showing up pretty robust growth. It has grown by I think I had mentioned it has grown by 28% in the previous year which is very much along expected line, 45% growth in the domestic sales and 15% growth in the export business which you can imagine in a global setting, 15% growth with very large customers has been quite a good achievement. Of course, the larger segment is the watch component segment and the watch component segment has suffered because the international watch business is going through its cyclical kind of a downturn and it has been actually the longest cyclical downturn for a long time. In 30 years, it has been the longest and the most severe downturn. So, in the middle of that the watch component segment remains flat. Whereas actually overall the market has shrunk during this period. However, as I also mentioned the future we are seeing green shoots arising, we are comparing all leading indicators which are looking very positive. I had motioned that opening order position is very clear leading indicator. The other leading indicator is the new leads and the new request that we get, enquiries that we get if we monitor on a very regular basis. So, all the leading indicators even in the watch segment are much more robust at the beginning of this year than last year. So, we expect that the growth pattern in the watch component segment will also grow. And the precision engineering business will continue to show a robust growth. This year the new facility near Bengaluru Airport will also kick in and we will growth from that coming in the second-half of the year. So, overall in manufacturing I expect that the growth will be much better than last year.

Deepen Shankar: Sir**.** the absolute number for this manufacturing businesses precision and components?

Yashovardhan Saboo: Let me give it to Sanjeev, our CFO to give you the numbers.

Sanjeev Masown: I think, the numbers if you are saying, there may be marginal change in the numbers in the last couple of years but if that change is reflected because our precision engineering business revenue is increasing where the gross margins are lower compared to the manufacturing business. So, as the mix of that is going up that may be getting reflected in the gross margin change. But at a net level the company is continuously on growth part both our revenue is going up the profitability is improving. With the change in the mix there may be some change in the gross margin level.

Yashovardhan Saboo: So, on the retail side Deepan you had asked about the same store growth. In the FY 2017 the same store growth had fallen to 2% but it was still positive. Same store growth was positive. Of course, the previous year the same store growth was 12%. So, from 12% it felt to 2%. We expect the same store growth to be back in double-digit figures this year.

Deepan Shankar: Okay. So, post demon effect are we seeing increased traction on front of sales in the retail?

Yashovardhan Saboo: Post-demonetization for a couple of weeks there was a big fall and after that **it is on the way** to recovery, no doubt about that. So, for example, in Q3 the quarter when demonetization happened, our same store growth fell by 7%, it was (-7%) and in Q4 it has climbed back to 3% and as I said in Q1 and later on going on we expect it to recover to double-digit figures.

Deepan Shankar: Okay. So, the Q4 figures have been this only due to seasonal things if you are comparing Q-on-Q, so the drop is only seasonal impact otherwise not much impact?

Yashovardhan Saboo: Well, there is also lesser number of stores, some stores were closed down, so that is also there. For example, last year in Q4 we have 39 stores and this year in Q4 at the end of the year we have 35 stores. So, four stores were closed down net-net. Actually, more stores were closed down but some were opened as well.

Moderator: Thank you. We take the next question from the line of Ruhi Seth from Kanya Investments. Please go ahead.

Ruhi Seth: Just wanted to have some clarity on how the GST will impact us may be in the shorter run, just ahead of the roll out a lot of brands have announced major discounts and sales going on. So, how do we see our Q1 margins looking like as of today**?**

Yashovardhan Saboo: Good afternoon**.** To be very frank, we are still trying to decipher the small print on the GST especially with in relation to how the transition stock is going to be treated. We expect more clarifications to be coming within the next few days which will decide our strategy. One thing is very sure, as you had mentioned across product categories there are sales, we ourselves have announced sales because stock which is more than one year old is likely to take a hit. So, there is a general effort across all businesses to liquidate the stock that is more than one year old. That said, you know the fact is that in our business, stock that is one year is not really necessarily old stock, it remains on the catalog, it remains valid, across premium brands it is a valid sort of stock. So, we are not going for very high levels of discounts, in some kind of distress sales. We are careful in what discounts we are offering, depending on what is the kind of volumes we can move, it will have some impact. I do not think the impact in Q1 is going to be that sever. But there will be some impact of the sales that happen. I think what will also happen is post July 1st, assuming that July 1st, will be the implementation date, we will have to get into a fresh round of negotiation with all vendors to understand who is getting what out of the new tax regime and that is going to be an very important exercise to be able to recalibrate our margins across the product categories.

Ruhi Seth: Okay. So, as of now the impact you are seeing, there would be an impact but not much?

Yashovardhan Saboo: There would be an impact but it would not be very high.

Ruhi Seth: Okay. And sir, with regards to Ethos for the coming year, what are our CAPEX plans?

Yashovardhan Saboo: So, we are in the process of revaluating the growth opportunities especially in the tier-III cities. There are two elements to this new thinking (a) we believe that the shift away from very high price points towards more accessible price points, we are seeing a very considerable traction in that and we are seeing the traction coming also from let us say some of our smaller stores which is leading us to believe that there are great opportunities in price segments around 50,000 at some of the tier-III cities. We have not really fully done this whole exercise but we believe that over the course of next two months - three months, we will finalize our plans for an expansion in these cities on which would then really depend the CAPEX requirements. The CAPEX for this year, that is already fully planned, we have that in hand, so there is no issues on this year. But for next year onwards we will have to plan once these opportunities become clearer.

Ruhi Seth: Sir, can you share what is the CAPEX for FY 2018?

Yashovardhan Saboo: It will be about Rs. 12 crores to Rs. 15 crores.

Ruhi Seth: Rs. 12 crores to Rs. 15 crores.

Yashovardhan Saboo: You know this includes this flagship stores that we are implementing at Chanakya Puri which is the new luxury mall which is coming up in Chanakya Puri, it is a DLF property. The implementation of the mall has got delayed. So, if that mall implementation gets delayed beyond this year, it is highly unlikely because they are saying it is likely to launch in November, but with that proviso, I think the CAPEX figure is what I told you.

Ruhi Seth: Okay. Sir, just one last question. You had I think earlier mentioned about some consolidation in the markets like Mumbai, the tier-I sector. So, are we still going ahead with that?

Yashovardhan Saboo: So, I mean I guess you are referring to something that I had mentioned one or two calls earlier.

Ruhi Seth: Calls back, right.

Yashovardhan Saboo: That we are moving towards creating larger stores may be fewer stores but larger stores and that is very much strategy going forward. In Delhi therefore, this flagship store at the Chanakya Puri luxury mall. In Mumbai, at least this year we do not see that happening, it will happen next year. See, we are in touch with the new Reliance Mall coming up in BKC and we foresee that our flagship store is going to be located there and once, that comes up there may be a consolidation, some stores may actually close down because we will have this large flagship store.

Ruhi Seth: Right. Okay. So, we will largely see this consolidation happening next year for FY 2019 onwards, okay.

Yashovardhan Saboo: Correct.

Ruhi Seth: And sir, just last question from my side, similarly a kind of follow-up with Ethos itself. Sir, can you just give us an idea about FY 2017, how much capital has been infused by the promoters and our key investment partners?

Yashovardhan Saboo: I am going to request our CFO Sekhar to answer that please.

C. Raja Sekhar: The parent company has invested around Rs. 12 crores of capital by way of straight equity in Ethos in the year FY 2017.

Ruhi Seth: Sure. And sir, by our partners have there been a separate investment?

C. Raja Sekhar: I am sorry.

Ruhi Seth: Our investment partners have they infused anymore?

C. Raja Sekhar: No, all the investment that has come in the previous year has been from the parent company.

Ruhi Seth: Parent company, okay.

Moderator: Thank you. We take the next question from the line of Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: Sir, can you just repeat, I just missed the number. What are the absolute amount of revenue we did in precision engineering?

Sanjeev Masown: So, this year the revenue was Rs. 25 crores in the precision engineering business.

Vikram Suryavanshi: Okay, sir. And sir, in Q2 we are expecting the new facility is to come up. So, are any pending CAPEX on that for FY 2018?

Sanjeev Masown: So, the expansion facility, expansion is already in progress. So, we will be doing the further investment in that, which is part of the overall plans for putting up this facility.

Vikram Suryavanshi: Okay. How much would be that in standalone for FY 2018?

Sanjeev Masown: Say around Rs. 15 crores.

Vikram Suryavanshi: So, Rs. 15 crores come in this FY 2018 basically?

Sanjeev Masown: Yes, Rs. 15 crores is the figure which we will be investing in the current year FY 2018 in precision engineering.

Vikram Suryavanshi: Okay, sir. And basically, I think you already mentioned about the outlook in terms of exports but in the domestic side are we seeing still recovery because of a lot of regulation change and all that. So, in domestic market particularly in precision engineering how we are seeing the outlook for next two years to three years?

Sanjeev Masown: No, as far as the precision engineering business is concerned, we are not seeing any downward effect of the regulatory changes. So, the market is recovering, we are getting good leads, order position is good, our customer base is very strong. So, I think all the leading indicators are in the right direction and very positive.

Moderator: Thank you. We take the next question from the line of KG Iyer from Iyer Investments. Please go ahead.

KG Iyer: I have a couple of questions. The first being one of the manufacturing CAPEX was to get completed by the end of FY 2017 and now it has been pushed to Q2, so would there be any specific reasons for the delay?

Sanjeev Masown: No, actually there is not much change in the CAPEX investment. I think Mr. Saboo has already shared that partial investments have been done in our existing facilities which have already been put into use. It is only the electro plating part which is being deferred by one quarter and that we hope to start production from the next quarter onwards. So, in a way in this business it is possible to do the gradual investment phase, wise investments and we can start getting the benefits of those and we have been judiciously investing so that wherever the revenues are possible to expatiate that the way we are doing it. So, there is no much change in our investment plan.

KG Iyer: Okay. And sir, my second question would be that post this manufacturing CAPEX, what will be the revenue expectations assuming we are at peak capacity utilization?

Sanjeev Masown: As Mr. Saboo has already shared that we are planning and we are very hopeful that the growth which we have seen in the past year this type of growth we can easily sustain for the next couple of years.

Yashovardhan Saboo: But on the manufacturing side specially in the precision engineering business we are hoping a growth of around 3% year-on-year to continue for the next two years, at least and we should from the current level of about Rs. 25 crores, we should be able to push through to around Rs. 80 crores of top-line with this new investment that is being done. It will not happen in one year flat because you need a little bit more time to gain market acceptance especially with large customers but I think we are pretty confident of this 28% to 30% growth year-on-year.

Moderator: Thank you. We take the next question from the line of Rohit Balakrishnan Rare Enterprises from. Please go ahead.

Rohit Balakrishnan: Sir, I had two questions. One, on the retail side, few years back we use to give information which was around mature stores. So, I just wanted to know at this point of time how many stores are matured and if you can also give me the definition of what we call as mature store? That is one. And second, if possible can you also explain a bit about this precision engineering in terms of the kind of margin it earns, you have mentioned that it is growing at 28% - 30%. So, what kind of margins would you expect in those business?

Yashovardhan Saboo: Right. So, we have 32 stores, mature stores are 32 and the definition we use is a store which has completed two years of operation is termed as a mature store. And as far as margins in the precision engineering business are concerned, the EBITDA margins in this business are around 15 about 15%.

Rohit Balakrishnan: Okay, got it. Sir, I had a follow-up on your first answer. So, you mentioned 32 stores, obviously in the last one year there have been so many challenges that you have mentioned. Let us say a year before this what were the kind of margins would these matured stores be making? So, what I am trying to understand between the overall mix, I remember two years back there were around 44 stores and we had about 24 stores or 26 stores which were matured and those were making certain margins whereas at the overall level we were at a certain margin. So, I just wanted to understand how does that mix happen? How does that stand at this point of time, in the current scenario?

Yashovardhan Saboo: So, let me just understand this correctly. Rohit, what you are asking is what is the margin at matured stores compared to others, is that right?

Rohit Balakrishnan: Right. That is correct, sir.

Yashovardhan Saboo: So, let us say what you have to see is that there was a time when the mature stores were very different from the total number of stores. What has happened right now is that mature stores almost all the stores with the exception of three stores, are mature stores. 32 stores out of 35 stores are matured stores. Except for two new opening, we have not done new openings in the last year. On the other hand, we have closed down a lot of stores. So, the difference between total stores and mature stores is actually no longer very relevant. Now, this year as we are planning to open six or seven new stores then this metric actually starts to become more relevant. At the moment, there is very little difference between mature. It is actually the same.

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

Lalaram Singh: Sir, first question was on the online sales. So, currently we around doing around Rs. 116 crores in this year, correct?

Yashovardhan Saboo: Yes.

Lalaram Singh: May I know what is the average selling price in online, is it significantly lower than the physical sales or is it comparable?

Yashovardhan Saboo: Just one minute. So, just one little point of clarification, our online sales is really working through a lead generation model, just to clarify this. So, these are leads that are received online. There discussions are online, the transaction are done online but eventually in most cases it is choice of the customer which is then build through an existing store, sometimes with the visit of the customer and sometimes without the visit of the customer. So, it is not a pure e-commerce basket where you put your order in the basket kind of sale. On this now, the average price point MRP for online sales is now about Rs. 70,000. It used to be around Rs. 90,000 to Rs. 95,000, it has come down as we moved down on the overall price segment. It is still higher than the overall MRP which is currently around Rs. 65,000.

Lalaram Singh: So, the average MRP in the online is higher than your overall?

Yashovardhan Saboo: Correct, that is right.

Lalaram Singh: Okay. So, I want to understand being a high end, high price product, luxury watches in which we are present, we normally would assume that we would be skeptical of buying such products or looking to purchase or make a decision online. Instead I would prefer going in physical store on my own. So, can you help us understand the psychology if I am missing something for consumer?

Yashovardhan Saboo: Yes. Mr. Singh, what happens is that the consumers are researching online. You know our online model is for customers who research their purchases online. And then, you are right, most customers would still prefer to go to a store and look at the watches before they buy it, which is the essence of the whole omni-channel platform, that it is a seamless connect between the digital online space and the physical offline space and that is what is really working for us. So, you are right, absolutely right that I do not think there are too many customers who will select the Rs. 2 lakhs watch and just straight away buy it online. That is not yet happening and it is not yet happening in many places in the world. However, researching, discussing, talking about, finding about watches, seeing what is good about the watch, comparing it to others all of that is happening online, and the very last act of buying, still happens in majority of the cases at the store.

Lalaram Singh: Okay. And this researching part, comparing, and all that, this is happening on our website?

Yashovardhan Saboo: It is happening on our website. So, the time that our potential customers are spending on our website is extremely important and it has been steady that is why our website is very content rich and you know it is also aided by our team of luxury watch consultants. We have a team of about 24 luxury watch consultants who are taking calls and messages and mails from customers and they are in a constant dialog. So, this is something that has become a very sophisticated model. So, for example, if you go to the website and you call the website and a person answers you and you express your interest in a particular brand. You will be directed to a consultant who is a specialist in that brand. Three days later you call again, our system will automatically direct you to the same guy, so you are not talking again to a completely new person. So, relationship builds up between the consultant and the prospective customer which helps to research the watch and eventually to buy the watch. In the beginning that always happens at a store, as the persons get more use to it, for repeat sales sometimes they just buy online.

Lalaram Singh: Got it. And our repeat billings were at around Rs. 71 crores in this year which is, around 20% of the sales is it correct?

Yashovardhan Saboo: Yes, it is a bit more than 20%. I think repeat buying is about 21% of our sales.

Lalaram Singh: Okay. That is significantly high number, I mean it is very positive. So, do our customers keep on buying high-end watches, but is it a normal trend across the world where the customers the repeat customer is so high?

Yashovardhan Saboo: Absolutely. Here you have figures but anecdotally that happens a lot because you take some time to make your first investment in an expensive watch. Once you do that then you want to buy for the whole family. You buy for others as well, maybe you want to gift one to your water; maybe you want to gift one to your wife and so on. The other thing that happens is people start to collect watches. Because once you get to know the watch, you get to know the brand then one watch is usually not sufficient, you need one watch when you are on holiday and another watch when you are going for work and a third watch when you are going for party. So, multiple ownership is much higher at high price points than at lower price points.

Lalaram Singh: Okay. So, in this case, is it fair to say that after the acquisition of customer the incremental cost is not there, because he is purchasing again and again? So, do we sort of internally see or spent time on how can we acquire customers or obviously I mean some kind of target strategy?

Yashovardhan Saboo: Our entire communication strategy is built around that, encouraging customers to understand by again we monitor repeat sales very-very closely. We have a lot of programs to encourage repeat buying and we believe a figure in the region of 25% to 30% is a very good sort of target to go after. We also don’t want repeat buying too much because India is still a country where there is a lot of people who have not yet bought their first premium watch, even though they have the wealth and income to buy it.

Lalaram Singh: Yes. So, exactly my point was that we have target those customers because in the end they would again buy a repeat, in a sense it is like a multiplier effect. Once you become a customer as you said then there is always a probability of buying a new watch again by the same customer.

Yashovardhan Saboo: Absolutely, correct.

Lalaram Singh: Yes, got it. If you can make us understand about the Club ECHO. What is the privilege that the customer can get or some thoughts around that?

Yashovardhan Saboo: So, Club ECHO is our loyalty program through which we are encouraging and monitoring repeat sales and so on. So, there are benefits like membership points, tier upgrades, invitation to special events, gifts for watch collectors. So, it is multifaceted program.

Lalaram Singh: Okay. One last question, you said that you are focusing now on sub-Rs. 10 lakhs or Rs. 5 lakhs watches. Is this on the back of regulatory change in the system?

Yashovardhan Saboo: Yes, absolutely.

Lalaram Singh: So, does it mean that before this, all the high-end purchases were made by cash? What would be reason for that?

Yashovardhan Saboo: Yes, higher percentage of the high-end watch purchases was done in cash. And people who are buying very high-end watches they have options, so we do believe that some of the buying of very high-end watches will shift to be bought outside India.

Lalaram Singh: Okay, like in Dubai and all, okay.

Yashovardhan Saboo: Yes, exactly.

Moderator: Thank you. We take the next question from the line of Shreekanth PVS from Spark Fund. Please go ahead.

Shreekanth PVS: My first question was on precision engineering business, on which you said you have done revenues of Rs. 25 crores this year, right?

Yashovardhan Saboo: Yes.

Shreekanth PVS: How does that break-up between your domestic business and your exports business and your exports business?

Yashovardhan Saboo: Just one minute, we will just get those figures. Would you like to ask all the remaining questions at one go, so we can answer that?

Shreekanth PVS: My question was I also wanted to understand if there is a significant difference in the margin profile between your export and domestic business on the precision engineering piece because you have guided for fairly strong growth on that business to Rs. 80 crores over the next two - three years. The idea was to try and understand whether it is going to be a lower margin business that is going to drive that revenue going forward?

Sanjeev Masown: Regarding your question about the margins in the exports and domestic, exports is always lucrative and that is the preferred segment for us and over the years as the export is growing but it takes more time to get the RFQs and conversion into the orders, it takes time but the margins are healthier there. As far as our present revenue is concerned, one-third is from the export and two-third is from the domestic.

Shreekanth PVS: And you believe that the mix will largely remain unchanged even when you get to Rs. 80 crores of revenue?

Sanjeev Masown: It is very difficult to say at this point of time. But in a way the opportunities are very large both in the domestic and in the expert segment and as consciously these segments in which we are moving, more growth is possible to get from the exports also.

Shreekanth PVS: From exports, okay. So, you think it can tilt in favor of exports when you get Rs. 80 crores?

Sanjeev Masown: Yes.

Shreekanth PVS: The mix, the mix I mean.

Sanjeev Masown: Yes, so mix at that point time we feel that it will be more tilted towards the exports.

Shreekanth PVS: Okay, understood. My second question was on watches business. Here if I understood you correctly in your initial remarks, you said the incidence of both import duty as well as CVD will be set-offable against GST, right?

Yashovardhan Saboo: CVD as well as Service Tax. Import Duty will not be set off against GST, basic import duty will not be set off GST.

Shreekanth PVS: Now, if I would just some of the component of Service Tax on CVD, and set it off again you fall under the 28% GST bracket I assume.

Yashovardhan Saboo: Correct.

Shreekanth PVS: So, will the sum of CVD please plus Service Tax be lower than that 28%?

Yashovardhan Saboo: The two are actually not directly related. So, it depends on assumptions of what is the rent and other services on which we pay Service Tax as compared to the volume of watches that we buy. But overall, as we go forward, I think the set-off will be more than that cost that we pay. Currently, it will be less. What I am saying is that the current burden of 28% will be slightly higher than the set-off that we get but from next year onwards the set-off that we get would be net-net a bit higher than that tax that we pay.

Shreekanth PVS: Sure. And is that something that you will pass through or something that you can retain?

Yashovardhan Saboo: We do not know what means passing through because currently, we are selling at a loss, right. So, I think one of the small prints that we do not know yet are exactly what are the implications about this. What are the implications of the rules concerning anti-profiteering and various others. So, I think, a lot of the small print is not clear. I really do not know how you are going to able to monitor what you can pass through and what you cannot because on the whole, compared to let you say six years ago when the Service Tax was very low or seven years ago when the Service Tax was not there at all, the service tax got added on all this and that was an extra burden in the anticipation that will be set-off against GST and now when it is going to be a set off against GST, I think it would be unreasonable to expect that the benefit from that necessarily should be pass through, especially when currently the burden has been much higher and growing over the last two years. This is something that we have to work through with the experts and what is going to be the legal position on this. I think I would like to point one thing out over here which is very important that currently the financial retail selling price of most of the watch brands that we see in India is slightly to significant lower than the price you would get in 95% of the countries around the world. So, India is one of the most competitive countries in the world buy watches despite having amongst the highest taxes.

Shreekanth PVS: Understood. And my final question is I just wanted to understand what is your gross debt on the balance sheet as of March 2017 consol.

Yashovardhan Saboo: On consolidated?

Shreekanth PVS: Yes, gross.

Yashovardhan Saboo: Rs. 113 crores.

Shreekanth PVS: And is that likely to trend down as we go towards the end of FY 2018 or you expect that to remain where it is?

Yashovardhan Saboo: At a consol level I think, it will not go down because we are borrowing more for the CAPEX in the manufacturing business. But we expect the debt level to growth down.

Shreekanth PVS: Okay. Because I noticed that you had some Rs. 30 odd crores of CAPEX and your CAPEX that you have outlined is not as high your number is that. So, I was wondering whether the incremental cash that you generate will go down to repay debt.

Yashovardhan Saboo: Well, the CAPEX spent if you take it on a consol level, I think it will be about the same as the cash that we have. So, I do not think there will be a big change in the borrowing.

Moderator: Thank you. We take the next question from the line of Vinay Nair from Emkay Global. Please go ahead.

Vinay Nair: Just wanted your outlook on gross margins, it seems to be under pressure for last one year and in fourth quarter it came down to around 20.8% around. So, do you see going forward the discounts waving and better terms with vendor and better mix of brands with higher margins one is that. And secondly, since now because of the PAN regulation your RPSF would be slightly under pressure because you are cutting down your price points. So, does that change your EBITDA margin outlook based on your rentals and man power cost and last is the targeted stores, the stores six stores that you are targeting what are the areas which you are targeting for these six stores? That is it from me.

Yashovardhan Saboo: I would answer the last question first about the 6 stores cities. There is Jaipur, there is Pune, there is Lucknow, there is Navi Mumbai, the new Seawoods Mall coming up over there and there Chanakya Puri in Delhi. And in Pune there are actually two stores so, that is why they are six. We are actually looking at one or two additions. But I do not think it is going to happen at least not before December what we slipped into next year. For example, we have signed on a new location in Nagpur but that is probably going to happen next year. Now, I am just coming to the point regarding gross margin. So, you know what is happening, overall, it shows up as a reduction in gross margin and obviously that is something that we focus a lot on it. But it is a combination of what is happening in the different segments. So, one thing which we can say that in the past years while discount was going up, in many segments actually our discount is going down and whereas vendor margin is actually sort of going up and down in different segments. So, in the luxury segment, vendor margin is down and the discount is up because we are trying to liquidate something over there and we believe that the faster we liquidate the better it is, so we have been aggressive in that liquidation. As the result of that we are seeing that we are able to now channelize some of the investments from that segment into the exclusive brand segment where the margins are much higher. We are not yet seeing the impact of this but from next quarter onwards you will start to see the impact of this. As far as vendor margins are concerned, I think I can safely say that we have negotiated better vendor margins for this year with almost all vendors and therefore, as more of the stock with this year's vendor margins comes in, that will start reflecting in our sales as well and I am talking about significantly better margins which are negotiated. Having said that you must understand that with the new GST rules there are going to be pretty significant impacts both on the vendors and the retailers and that is still we are trying to figure out that what is going to be impact on each, right? And there will be a fresh set of negotiations on margins for this. Specifically, I think new rules favor the importers more than the retailers. So, in the case of brands that are exclusive to us which we are directly importing the two effects net out each other. So, we are neither better off no worst off, but in cases where we are buying from local purchases, let us say from subsidiaries here, I think the importer is standing to benefit more or at the cost of the retailer. So, we have to get into a fresh round of negotiations to extract better terms from them which will happen post July because right now the small print is not very clear yet. As far as your third question was regarding average sales price, yes, average sales price is coming down but you know the margins are better at the price points that we are getting into now. So, I do not think it is going to have any impact as far as the gross margin or share of expenses is concerned. We do expect the sales overall top-line to be affected because of this.

Vinay Nair: Okay. So, EBITDA margin outlook does not change because of the change in the price at least because you have cut down the non-performing stores also.

Yashovardhan Saboo: Non-performing stores and non-performing brands.

Vinay Nair: Non-performing brands, right. And these local purchases what you were talking about, I think that constitutes a significant portion of your revenues when I total it. So if you could bifurcate between import and local purchase?

Yashovardhan Saboo: Vinay, about 70% is from domestic purchase.

Vinay Nair: Domestic purchase, so that is that crucial area wherein you need to negotiate and get the margins, right?

Yashovardhan Saboo: Absolutely.

Moderator: Thank you. We will take the follow-up question from the line of Rohit Balakrishnan from Rare Enterprises. Please go ahead.

Rohit Balakrishnan: Sir, what would be the fixed cost that you will at the store level before your central expenses?

Raja Sekhar: Rohit, if you are referring to the front-end cost at a store it varies quite significantly from store-to-store and from location-to-location. But if you look at it an average, it is about 16% to 16.5% of the revenues of the front-end expense which include essentially, the rent, man power, marketing expenses, and the running expenses for the store.

Rohit Balakrishnan: You are saying that is around 16% to 16.5% at an overall level, obviously?

Raja Sekhar: At an overall level for the front end, yes, for the front end.

Rohit Balakrishnan: Okay. And our gross margins anywhere between at this point of time 22%, right?

Raja Sekhar: 22.5% is what we did last year.

Rohit Balakrishnan: Okay. So, in terms of our margins improving, so these costs are broadly at an absolute level, will grow at an inflation level or slightly more than that?

Raja Sekhar: Yes, at an inflation level will be better, because most of the expenses are negotiated in the case, of rent for example there are rent agreements in place which have increases already built in but which are much lesser than that inflation rate and there is the man power cost where there is certain amount of increments that need to be given. So, on an average the rate of increase will be less than that inflation rate and definitely less than the growth rate of the sales.

Rohit Balakrishnan: Got it. And our effort on exclusive brands will at some point of improve our gross margin business, right?

Raja Sekhar: Yes, absolutely.

Rohit Balakrishnan: Got it. And sir, just one question I do not know if this is the right way to ask this question. But do we have in our business anything as obsolete inventory or inventory which is not going to get sold or anything of that sort?

Yashovardhan Saboo: So, Rohit in our inventory we aged the inventory of course, in the watch business what happens you have to consider it over the different price points. Typically a price points below 25,000 - 30,000 which are the so called fashion brands most of the time we have the arrangements with the brands that any inventory that is beyond a period of one year to one and a half years is liquidated either through end of season sales which are done in conjecture with the brand or it is exchanged by the brand. So, there is very little chance of that happening at the lower price points. What happens that at higher price points is that, old stock does not really go off the catalogues. So, whether in brands like Longlines, TAG Heuer, Omega, Rolex, all these brands the watch stays on the catalogue, it is a relevant product for sometimes for as long as 15 years - 20 years but 7 years to 8 years is very-very common over there. But yes, we do monitor stock that goes older than let us say about two years and typically we have the program either through Club ECHO or offered through what we call the friends and family sale through our network of consumers where through special deals these are sold off. And you know even in these sales which are done at special discounts, these are not something which is sold below cost. The margin may be very low or in some cases zero but it is typically we do recover the full cost.

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

Lalaram Singh: I want to know that do we have any franchise as of now?

Yashovardhan Saboo: No, at the moment we do not have any franchise, Mr. Lalaram.

Lalaram Singh: And all the stores currently are on rent, lease?

Yashovardhan Saboo: Yes, that is right.

Lalaram Singh: Okay. Secondly, on advertisements, what would be our A&P expense?

Yashovardhan Saboo: Our marketing expenses is about 2.5%.

Lalaram Singh: 2.5%, okay. And the advertisements which we put for the specific brands, so is it like do we spent it on an overall or is it combined with the brand, I mean how does it work?

Yashovardhan Saboo: There are different arrangements for different brands but most of the time it is what is called the co-op, so it is brand and our sharing the cost.

Moderator: Thank you.

Yashovardhan Saboo: I think there are no further questions. And with this, I want to thank everybody for joining on the call. And I hope we have been able to respond to your queries adequately. For further information please get in touch with SGA, our Investor Relation Advisors. Thank you very much and have a good day.

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