"KDDL Limited Q1FY15 Earnings Conference Call"

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Moderator Ladies and gentlemen good day and welcome to the Q1 FY15 Earnings Conference call of KDDL Limited. As a reminder all participant lines will be in the listen-only mode. 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.

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 Thank you very much. Just a small correction; I am the Chief Executive Officer but I do have with me Mr. Sanjeev Masown who is the CFO of KDDL and Mr. Raja Sekhar who is the CFO of Ethos, our luxury retail arm.

Very good afternoon and warm welcome to all the participants. I hope you have received our results and the presentation. It can also be viewed on the Bombay Stock Exchange website. I will start by giving an overview of the financial performance of the company for the quarter ended 30th, June 2014. The number for Q1 are compared with numbers of Q1 last year post which we will respond to your queries.

On a consolidated basis our revenue has grown by 27% year-on-year to Rs. 85 crores in Q1 2014-15 from Rs. 67 crores in Q1 of the previous year. This growth was mainly on account of growth in both the manufacturing and the retail businesses. Both the businesses have grown by 20% and 34% year-on-year respectively. The manufacturing business has improved on account of healthy order position from both the domestic and export markets.

Our gross profit at a consolidated level is at Rs. 37.4 crores an increase of 27% year-on-year. EBITDA grew from Rs. 3.9 crores in Q1 of FY14 to Rs. 5.8 crores in Q1 of FY15, an increase of 48% year-on-year. EBITDA margin is now at 6.8% in Q1 FY15 expanded by 100 basis points year-on-year.

The net loss after minority interest for the quarter stands at Rs. 1 lakh compared to a loss of Rs. 96 lakhs in the Q1 of the previous year on a comparable basis.

Now coming to Ethos; Ethos registered revenue of Rs. 54.7 crores, an increase of 33.5% against the Rs. 40.99 crores in the same quarter last year. This is driven by couple of factors. Firstly, store additions Q1 FY15 has five additional stores compared to Q1 of last year. As on 30th June 2014 we have 43 stores of which 26 are matured stores. Secondly, our average sales per growth has increased by about 18% year-on-year from Rs. 1.08 crores to Rs. 1.27 crores in Quarter one.

Our gross profit for the quarter is at Rs. 14.4 crores a growth of 35% year-on-year. Gross margin have expanded by 30 basis points from 26% to 26.3% in Q1 FY15 compared to Q1 FY14. Currently our gross margins are in line with those of global watch retailers. The rental expenses at the front end have reduced from 12.5% of sales in Q1 last year to 11% in Q1 this year. Further employee cost at the front end have reduced from 4.2% in Q1 last year to 3.5% in Q1 this year. In keeping with our increased emphasis on reaching out to customers our marketing expenditures has been increased from 0.7% of sales in FY14 to 2% in FY15.

We are focusing intensively on improving our online presence and giving our customers the best experience. In accordance with this we have grown the in-house call center and also augmented the online team. This has led to an increase in backend cost from 4.8% last year to 5.5% this year which has resulted in a healthy growth in our online sales which has contributed to about 22% of our retail sales. Our website received 11.6 lakh visits in the June quarter and the average ticket size of the sales made on leads generated through the Internet stands at about Rs. 97,000.

I would just like to mention that this is a very significant figure because in no Internet business, the ticket size of sales is so high. It will represent the success of the Internet in the high premium and luxury based segment. it is like pointer for the potential of this segment in the future using the Internet.

Overall there has been a positive impact on our EBITDA margin it has increased from 0.8% in Q1 last year to 1.2% in Q1 this year. With an objective to optimize our presence across cities we have closed four stores across Pune, Bangalore, Bhopal, and Hyderabad. Due to the closure of these stores we have had to write off some assets relating to these stores to the extent of about Rs. 28 lakhs. We have made certain changes in our depreciation policy to align it with the Companies Act 2013. This has impacted us significantly as a majority of our assets are in a category wherein the useful life of assets has been reduced.

Our depreciation has increased from 0.9% in FY14 to 1.6% in FY15 as a percentage of sales. In absolute terms we have to provide for additional depreciation of Rs. 22 lakhs in the current year due to this change. Interest cost has increased on account of addition of new stores however it has remained at the same level as a percentage of sales at about 3%. This quarter we have a net loss of Rs. 1.26 crores as compared to Rs. 1.16 crores in the same quarter previous year. However, I would just add that as mentioned this also bears the brunt of the impact of the additional depreciation and the write off assets due to closure of stores.

We have also to put in to perspective that our business has a very significant seasonality factor to it. The April to June quarter is considered the off season period of our business. In the previous three years the Q1 has accounted for 17.3%, 19.4%, and 18.9% of the full year sales. It is encouraging to see the healthier margins which we expect to sustain and improve throughout the year. We have also opened two new stores one in Amritsar in the month of May and one in Vadodara in the month of June. Both these stores are set up in collaboration with the

Fossil group and operated under the name WSI by Ethos.This is our third store with the Fossil Group. You may recall last time we had mentioned that the first store was opened at the Indira Gandhi International Airport at New Delhi. In addition to this we have also started working with the Nuance Group world leader in travel retail. With them we operate “Master of time” at the Chhatrapati Shivaji International Airport the new international terminal that has opened recently. This store has luxury brands in its offering. These partnerships give us confidence in our product and service offerings and reiterate our belief in the growth and future of our business. With this I would like to open the floor for Q&A. Thank you.

Moderator Thank you very much. We will now begin the question and answer session. The first question is from the line of Apurva Mehta from KSA Shares & Securities. Please go ahead.

Apurva Mehta Just wanted to ask what is the average sales for matured stores now?

Yashovardhan Saboo The average sales for matured stores you mean per store?

Apurva Mehta Yeah, per store.

Yashovardhan Saboo Our average sale of matured stores in the first quarter is Rs. 1.6 crores. Obviously the first quarter being off season you cannot just prorate it.

Apurva Mehta But by the year end how many we will have matured stores?

Yashovardhan Saboo We have now 26 matured stores. By the end of the year it will be about the same.

Apurva Mehta And the ad expenditures has gone up so that is the kind of 2% which we are targeting for a year ahead also?

Yashovardhan Saboo Yes, in fact if you remember from the last discussion that we had, there is a little bit of a shift in our strategy where we are saying that we will maintain our target growth rate over the next couple of years but we will shift the focus away from growth from new stores so we will shift investment away from new stores towards greater investment in marketing and reaching out. So this reflexes that. The change in the expenditure on marketing is a reflection of the change of the strategy to invest more in marketing.

Apurva Mehta So the online sales were for previous quarter that means Q1 of FY14. Online leads were how much it was around 17% so that has increased to 22%?

Yashovardhan Saboo It was around 17%. For the previous year quarter one was 13% and the year as a whole was about 18% and now in this quarter it has gone to 22%. We expect by this year end it should be closer to 25%. 25% of our sales will come through Internet lead generation.

Apurva Mehta So that will help us to really jack up your sales. So what will be our target for this year end that will be around Rs. 300 crores plus what we are expecting?

Yashovardhan Saboo It is difficult to project it but as I said that typically Q1 is about last couple of years it has been around 18% of the annual sales in Q1. If you were to extrapolate from that you come to a figure of around what you have mentioned.

Apurva Mehta And on the manufacturing side is there any seasonality in that also?

Yashovardhan Saboo Seasonality is there but it is less than in retail of course.

Apurva Mehta But it is there?

Yashovardhan Saboo It is there the reason is also that there is one part of our business is domestic purchase. Domestic purchase normally end of the financial year there is a certain sell out that happens and the off take in the year one is a little low also because the first six months of the financial year are little slow but tempo is starting to build up at this time now. So it happens nowadays most of the customers are also used to just in time delivery. So there is that seasonality both in the domestic and export sectors. But admittedly it is lower than in retail.

Apurva Mehta And what will be the CAPEX for manufacturing our CAPEX this year any targets?

Sanjeev Masown It is in the range of Rs. 10 crores to Rs. 12 crores during the year.

Yashovardhan Saboo Yeah Rs. 10 crores to Rs. 12 crores, that is Sanjeev who shared that information with you.

Sanjeev Masown In the last call also, we have shared that it will be somewhere in between the range of Rs. 10 crores to Rs. 12 crores the normal CAPEX.

Apurva Mehta So there will be no expansion in capacity?

Sanjeev Masown Nothing significant. just that high value and the high capability of the products which will be making, doing it ourselves to make that type of.

Yashovardhan Saboo Just let me clarify. I do not think we are looking at an increase in numbers, the growth is coming from an increase in value as we move towards higher value products both in the Indian market and in the Swiss market and to the extent that some equipments are needed to make some of the higher value dial or increase capacities of some departments I think that is envisaged but not an overall increase in quantities.

Apurva Mehta So any new customer added in this manufacturing business?

Yashovardhan Saboo You know again manufacturing is watch components and other businesses like our precision engineering business but I think we especially in the precision engineering business we are in discussion with several important new customers and we expect that to be an important area of growth. In the watch business in the domestic side basically there are no new players and who are the players here we are leading suppliers with them anyways. On the export front again I do not think we are adding any significant new customers. We have opened some very significant doors last year and we expect the business with these customers to go up steadily.

Apurva Mehta So from second quarter we will see retail giving more contribution to our EBITDA?

Yashovardhan Saboo definitely, yes that is what we expect.

Moderator Thank you very much. The next question is from the line of Chaitanya Adesara from Siddhesh Capital. Please go ahead.

Chaitanya Adesara Sir, I have couple of questions. One, the five stores addition you have done is it the net addition or the gross?

Yashovardhan Saboo So the five stores that we have mentioned this is five stores additional stores from the last quarter. Last quarter means Q1 of previous year. So compared to that we have added there is a net addition of five stores. In this quarter actually we have opened two stores but we have closed down four stores. So in this quarter there is actually diminution from 45 to 43 stores.

Chaitanya Adesara And sir, can you throw some light on the rental as a percentage to sales which has come down so do you expect it to remain at this level at 11% or you expect it to come down little bit more?

Yashovardhan Saboo We expect the rentals to come down. In fact that is one of the pillars of the model as we are projecting because as we are going to get our growth increasingly from enhanced marketing and enhanced Internet presence and less through new stores so that means rentals will not go up as fast as sales and it means that rental as a percentage of sales will certainly tend to come down from the current level as well.

Moderator Thank you. The next question is from the line of Mr. V. P. Rajesh from Banyan Capital. Please go ahead.

V P Rajesh My first question is you are talking about the Internet sale and I did not get the number you said for per sale value that you are realizing from the Internet channel?

Yashovardhan Saboo The per unit sale value that we are realizing is Rs. 97,000.

V P Rajesh And how does it compared to your average matured store?

Yashovardhan Saboo At an average matured store our sale value is about Rs. 50,000. So if I may add this is a very interesting.

V P Rajesh Saying that you see in this particular channel becoming 25% of the overall sales is there a longer term target that you are working towards because if obviously your realizations are much higher does it make sense to the more of Internet e-commerce play rather than brick and mortar?

Yashovardhan Saboo Well, the way we look at it is that for luxury and premium we believe the future is a seamless combination of the Internet space and brick and mortar space. I will give you the reason. I will just request two, three minutes of everybody's time for this. Luxury and premium retail a lot of it depends on the experience; the experience of the product; the experience of the brand and the whole shopping experience. So I do not think you can do away with the click and brick store. People will buy luxury watches after touching and feeling them and being explained the experience with the sales person or the sale manager.

At the same time the convenience of the Internet shops cannot be denied. The fact is that it is the future of the way the people will research products will browse products at their own convenient time and will ask their questions. So we believe that it cannot be either Internet or brick stores, especially for luxury retail it has to be a seamless combination.

Now given that this is to be so we are actually working on improving the experience seamlessly.

So when a customer goes on to our website he see the product there; he see certain information about the product we facilitate his call to our call center; our call center calls back or answers to his email, guide them through the whole research process whether it is for that watch or comparable watches and then we encourage the customer, "Sir or madam, please go to such and such store this is the closest to you. The sales manager is going to be waiting for you he will show you the products and any other questions you may have he will explain."

That is when the cue passes on to the stores staff to awe the customer with the experience in the store to explain to put the watch on the wrist to compare with two watches to see how it looks the customer actually sees it. I think this is the combination which I think is vital for the success of luxury retail. I think we are catching something important here I believe this will be the template in future for luxury retail.

Now you mentioned that the difference in average price between store sale and Internet sale. True, this is very, very significant and the reason is that our Internet team is very surprised also to get very so many high value leads. As the quantum of sales through the Internet leads goes up it is possible that the average price may come down a bit.

But the quantum is likely to go up. And therefore obviously a lot of investment is going to go in Internet space to develop that space and frankly if we have 500,000 visitors coming to the website with a potential purchase value of Rs. 97,000 per piece it also lend itself to considering what other product lines he could consider in this price point. Because this price point compels very favorably with any other Internet sales. So I think this is a unique segment and it lend it serve to a lot of future potential possibilities which we are starting to look at now.

V P Rajesh So are you saying beyond watches you are looking at other products or something closely related to watches?

Yashovardhan Saboo You see so let us say in watches if we are successful in getting a purchase price of Rs. 97,000 and 500,000 unique visitors so what are the other needs of these visitors. That is a natural question which one asks and then looked at it. For example jewellery is a very, very obvious area of interest. The jewellery market is 20x the size of the watch market. Now the presence of the Internet sales on jewellery itself is in nascent stages like watches.

So these are issues which it is not only the benefit of 500,000 potential customers coming looking for watches what else could they be looking at and how can we leverage this traffic to expand our business may be beyond watches at a later stage. I think these are all the questions that are opening up from the success of our Internet experience.

V P Rajesh My next question is regarding the membership growth that you have outlined in your presentation. So could you comment on that what kind of engagement is there and if they are paid members or if they are the folks who have bought the watches in the past from you?

Yashovardhan Saboo So these are all members who are invited to join our loyalty program which is called Club Echo when they make their purchase and when they make their purchase they are invited to become members they get a certain number of loyalty points and every time they make a purchase these points are added. These points can be redeemed against future purchases and the number of members that have gone up now we have about 72,000 members.

What it enables us to do other than obviously engaging with these customers on a regular basis is to offer to them special deals or special offers that come from time-to-time. This is a very successful model of direct marketing which is far more cost efficient than let us say advertising in the newspaper. So from that point of view the loyalty program is important than the growth in the loyalty program membership is very important for us.

V P Rajesh And then just going back to the stores a little bit what is the CAPEX per store that you are typically spending?

Yashovardhan Saboo I am going to let Sekhar, our CFO answer that.

C Raja Sekhar So it depends really on the format of the store. As you know that we have got two different formats of the stores one of them being the luxury store which comes under the brand name of Ethos Summit Stores and then we have the multi brand stores which are the Ethos Stores. The CAPEX really vary from about Rs. 3,000 to Rs. 3,500 per square feet depending on the size of the store as well of the type of the store. But the more important investment that really goes in to a store is not really be CAPEX but really the inventory that is required to be stocked in the store. That is why the major investment really goes in.

V P Rajesh So when you are putting up a new store what is typical or the range of expenditure you do I am just trying to get a sense as you ramp up your store opening plans from 26 matured stores today what is the kind of CAPEX one would be seeing in the coming years?

C Raja Sekhar Just to give you an idea I mean there are very typical store although stores have their own differences but a typical Ethos store would need something like Rs. 40 lakhs to Rs. 50 lakhs in terms of the fixed asset investment along that we have about Rs. 2 crores to Rs. 3 crores in terms of stocks in terms of inventory. Our Summit Store would probably require somewhat similar in terms of fixed asset investment but requires far greater investment as far as the inventory is concerned which will range from Rs. 4 crores upwards to about Rs. 6 crores to Rs. 8 crores.

V P Rajesh And what is the total CAPEX plan for Fiscal Year 15 as well as if you can give some idea about the next year?

C Raja Sekhar So as I said the CAPEX part of the investment is very little.

V P Rajesh What I mean CAPEX including the inventory sorry in your parlance obviously inventory becomes more important.

C Raja Sekhar So the total investment that we are looking at in the next couple of years would be in the range of about Rs. 25 crores that will be for the next two to three years and depending on the number of stores that we are able to put up and most of the investment as I mentioned earlier is for the purpose of investing in to the inventory of these stores.

Moderator Thank you. The next question is from the line of Dhvani Modi from ICICI Direct. Please go ahead.

Dhvani Modi Sir, you just mentioned in your commentary that Q1 is typically a weaker and off season quarter. If you could take us through the whole year and in terms of how the seasonality pans out?

Yashovardhan Saboo So typically the first quarter is about 18% as we mentioned you and the biggest quarter not surprisingly is Q3 which is October-November-December a combination of festival and wedding season. That typically is in the range of about 35% of the sale and Q2 and Q4 are approximately similar. Quarter 4 is a little bit better than Q2.typically. But you know it depends this could change from year-to-year as well.

Dhvani Modi And sir, in the similar period this year could indicate what is probably either our average ticket size or may be an average revenue per store?

Yashovardhan Saboo I think that the ticket size Dhvani does not change much. Because the sales increases when it increases across the board.

Dhvani Modi No, what I am trying to understand here is probably as to can you indicate how much percent of our sales comes through any discounts or promotions or that is none at all I mean this is what I want to get?

Yashovardhan Saboo No, in the premium and luxury space we do not have the concept of an end of season sale or all of that does not exists. That is why you will never really walk in to an Ethos or an Ethos Summit store and have a big end of season sale going on. On the accounts it is there, it is mostly on the fashion brands which is a small part of the sales and very discreetly done so. So the impact on overall ticket size is not very significant.

Dhvani Modi And if you could just outline the store additional plans over the next two years?

Yashovardhan Saboo Dhvani, we are looking at adding about 6 stores in the next two years.

Dhvani Modi I am saying if you could put some timeline to when do we look at the Ethos format breaking even on the EBITDA as well as the PAT level?

C Raja Sekhar So at both EBITDA and the PAT level the whole company has done a breakeven we did a breakeven three years ago.

Dhvani Modi I think Ethos this quarter has a loss?

C Raja Sekhar You mean to say each store or do you mean to say?

Yashovardhan Saboo So are you talking about the loss for the quarter?

Dhvani Modi Yes sir.

Yashovardhan Saboo So typically the loss for the quarter is Q1 as I said being weak it is the weakest quarter besides this particular quarter have been impacted by two extraordinary items one is the increased depreciation because of the new law and the write off of four stores that were closed down. Had that not been the case then the loss would have been lower by about Rs. 50 lakhs. But overall for the year, we were on PAT breakeven last year and the year before that we were profitable at

PAT levels and obviously this year we will also be profitable at PAT level. In fact the profitability will increase.

Moderator Thank you. The next question is from the line of Anil Kini from Envision Capital. Please go ahead.

Anil Kini Can you tell me what is the gross debt on your books at current levels?

Yashovardhan Saboo Gross debt on a console level?

Anil Kini Yes.

Yashovardhan Saboo It is about Rs. 122 crores.

Anil Kini And largely will be for the retail formats, right?

Yashovardhan Saboo No, it is about half-and-half.

Anil Kini Sir, you have also mentioned that you will be spending around Rs. 25 crores in the next two years as a CAPEX. Can you share how are you going to fund this CAPEX?

C Raja Sekhar So we are looking at an equity induction. We have tied up for debt to an extent and beyond the debt we are also looking at diluting to induct further equity.

Anil Kini Okay so you will be doing a QIP sort of thing or what?

C Raja Sekhar We are looking at private equity funding.

Anil Kini So it will be on the Ethos standalone basis or overall basis?

C Raja Sekhar Yeah, at the Ethos level.

Moderator Thank you. The next question is a follow up question from the line of Chaitanya Adesara from Siddhesh Capital. Please go ahead.

Chaitanya Adesara Sir, just a follow up. In the rental agreements is it the kind of a fixed agreement or on a revenue sharing basis for almost all your stores?

Yashovardhan Saboo It is a mix bag Chaitanya. At some places it is fixed trend and some places it is revenue share and some places it is differential revenue share that means there are certain revenue share up to certain level and then it will different ; some places there is a fixed rental and above a certain level our revenue share starts. So it is pretty much mixed bag. More agreements tend to become revenue share now in good malls and Airports are typically heavy revenue share airport models though airports also tend to be the most profitable.

Chaitanya Adesara And the high street ones would be on a rental basis?

Yashovardhan Saboo High street and malls both some are fixed rentals; some are fixed plus revenue share typically the revenue share starts above a certain sale and some are revenue shares subject to a minimum guarantee.

Chaitanya Adesara And sir, you mentioned that you would be adding six stores in the next two years. Have you identified any cities or any metros or Tier-I cities?

Yashovardhan Saboo We have, you know, but I do not think they are a very specific cities identified. However, as a general policy we tend to favor new large airport that is something which is of interest to us and we are not that strong on Tier-II cities. We still believe that it is probably better to expand in Metros and Tier-I cities.

Chaitanya Adesara And most of these would be in which format? Would be the Ethos Summit or the multi-brand this thing?

Yashovardhan Saboo I think it will be a mix of the two but obviously there will be more Ethos stores than Summit stores.

Chaitanya Adesara And just one last question. In the online sales would you be selling all the luxury brands or there are some big luxury names generally do not prefer to be sold online so any insight on that?

Yashovardhan Saboo Yeah so Chaitanya, just to make this clear again we do not sell the luxury brands online not even one. We are not selling online. We are interacting online through our call centre through chat and various means. So the leads are generated online; the interaction is done online but the fulfillment is done at the store. We encourage the person who is interested to visit the store where the watches are stocked and displayed and the interaction is done there and the sale is closed over there. This is in line with the policy, all luxury brands for the moment do not allow online sales, and that is why we are not doing any online sales. In future we believe this will change because as the Internet becomes more important I think the luxury brands will also have to relook at their strategy.

Moderator Thank you. The next question is a follow up question from the line of Mr. V. P. Rajesh from Banyan Capital. Please go ahead.

V P Rajesh Just wanted to understand the experience in closing down Bangalore because I noticed in your presentation that you closed that location. So just curious what did not work there?

Yashovardhan Saboo So this was in Orbit White Field so basically we have had a very positive experience Inorbit malls in Mumbai I mean the Malad Mall in Mumbai as well as the mall in Vashi they are among our best performing stores and they have been that way but unfortunately our Bangalore

White Field the mall did not take off at all as it was intended to and we were there for about more than 2.5 years and we tried to make the location work but I think the mall just did not get the traction that we would expect Inorbit Mall to get.

V P Rajesh So I assume you will open in Bangalore again right?

Yashovardhan Saboo We have a pretty strong presence in Bangalore, for example, we are at the Orion Mall in Bangalore and this is the store that now in the second year it is doing well and we expect a huge amount of growth coming from this store. So if you visit Bangalore you will see the Orion Mall in as such that actually a very good decision. We moved to a larger store on the ground floor in the Forum Mall. We have stores in the UB City luxury mall and we have got standalone stores.

So Bangalore has a strong presence. I am not sure if there is room for greater expansion in Bangalore immediately but Bangalore is the large city and as it grows we will continue to look at it. By the way our duty free store at Bangalore Airport that is the airport terminal has just been renovated and we are moving to a larger more central swankier location that was supposed to happen in March last year but it has got delayed the renovation of the airport and triggering off the new terminal has got delayed but we expect that in September, October we will moving to a larger store at Bangalore Airport as well. So Bangalore is very important for us.

Moderator Thank you. As there are no further questions, I would now like to hand the floor over to Mr. Saboo for closing comments. Over to you, sir.

Yashovardhan Saboo So I want to thank all the participants. It has been great interacting with you and we look forward to more interactions. Thank you very much.

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