"KDDL Limited Q2 FY16 Earnings Conference Call"

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Moderator: Ladies and gentlemen, Good Day and welcome to the KDDL Limited Q2 FY16 Earnings Conference Call. 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 this 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 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. I now hand the conference over to Mr. Yashovardhan Saboo – CEO, KDDL and Ethos. Thank you and over to you Mr. Saboo.

Yashovardhan Saboo: Thank you and a Very Good Afternoon to all the Participants and A Warm Welcome at this Earnings Call. I am joined at this call by my colleagues Mr. Raja Sekhar -- CFO of Ethos our Retail arm and we also have with us SGA, our Investor Relations Advisors. Unfortunately, the CFO of KDDL who is customarily with us had to leave because of bereavement in his family. But we are in position to answer any queries or questions. I trust you have all seen our financial results and presentation it is uploaded on the BSE website as well as our company website.

Now, I will give you a brief update on the business followed by a brief commentary on the financial results. Let me begin with the consolidated results. In H1 of the current year the Company registered a revenue growth of 15%, growing to Rs.211 crores from Rs.183 crores with an EBITDA of Rs.17.4 crores which represents a growth of 4% year-on-year. EBITDA margin was at 8.3%.

Net profit after minority interest has more than doubled from Rs.3 crores in H1 FY16 to a profit of Rs. 6.64 crores. The net profit margin is at 3.2%, increasing from 1.6% in the same period last year. Cash PAT for the year is at Rs.12.4 crores a growth of 38% compared to the corresponding period.

Coming to the standalone results for KDDL. For the H1 of current year standalone revenues was at Rs.61 crores which was a marginal decline from H1 of FY15. EBITDA was at Rs.11 crores with an EBITDA margin of 18% and profit after tax at Rs.3 crores. The marginal decline in revenues is obviously a matter of focus for us. It is on account of softening of global demand for Watch components which we had anticipated with softer leading indicators already during the course of quarter one. This is something that has weakened but we believe that this decline is temporary and revenues are expected to improve in the quarter beginning Jan 2016. We are already seeing a strengthening of leading indicators in terms of new development for orders as well as a confirmation of orders which had earlier been postponed. And other detrimental factor has been the withdrawn of export in incentive from 5% to 0% particularly for some countries which included Switzerland which is really our major export destination for

Watch components. This had been restored to 2% two months after our representations to the government and it will start to have a positive impact after Q3.

I now come to discuss on Ethos - Our Luxury Retail Arm. In the half year ended 30th September, 2015 the company has 41 stores across the country with 8 Summit Stores, I remind you that Summit Stores are the High-End Luxury Stores, three Duty Free Airport Stores, three Duty Paid Airport Stores and 27 Ethos format stores.

We continue our focus on rationalizing and optimizing our physical presence in India and augmenting this very vigorously with the Online Presence to create and effective Omni-Channel Retail business. We have not added or close down any stores in the July to September quarter that we are currently reviewing. Our revenues have continued to grow robustly. They have grown 25% year-on-year to Rs.79 crores in the current year in this quarter. The revenue growth has been on the back of a very healthy same store sales growth which is at 18%. So as this compares quite favorably with the retail business in general in India during this period the revenue growth has been achieved again based on the continued emphasis on reaching out to our customers through our online platform and fulfilling the physical needs of luxury that feel and experience through the physical stores.

The revenues from the lead generated from our Online Platform increased by 56% and now constitute 28% of the overall sales up from 23% last year in the same period. The proportion of revenue from the Online Platform is enabling us to capture benefits of a better operating leverage. The combined front end expenses of rental and employees cost have reduced as a percentage of sales from 13.5% to 12.6% which is very much on track with our long-term plan and is actually a confirmation of the change of strategy which we implemented last year. This reduction has resulted in EBITDA margin expanding gradually over the quarter.

We are also investing in advertising and branding initiatives more heavily than in the past. In the past few months we have run several half page ads in leading Delhi Newspapers like Times of India and Mint in collaboration with leading global brands. Currently we are also running what is the called Trust Campaign through online channels and offline channels to educate customer and to create awareness about several risk and malpractices about buying Luxury Watches from dubious channels. These initiatives are garnering a very positive feedback and top of mind recall from the customers for Ethos and our position of trust and ethics.

The EBITDA margins have shown a marginal decline in Q2 compared to the same period last year. Part of the decline in the second quarter has been on account of a clearer accounting policy on purchase incentives, the lack of which had led to certain lumpiness in the accounting of incentives in the previous year. Another reason has been the higher level of competition in the market in an overall market, which have put gross margin under pressure. Notwithstanding this, for the entire half year period EBITDA margin has expanded 40 basis points to reach 4%

EBITDA in H1 of the current year, this has grown 41% year-on-year to Rs.6 crores from 4.2 crores in the previous year.

Significantly we have also been able to improve our capital efficiency by reducing our inventory carrying month to 8.6 months in H1 of FY16 from 9.3 months in the same period in the previous year and we expect this efficiency of capital to be further improved during the course of this year and lead to a significant improvement by the end of the year as was planned last year.

In the first-half of the year which is generally an offseason for retail business Ethos have continued its strong performance and has given us reason for that the new strategy which we have adopted is playing out well. We registered a net profit for the half year of Rs.12 lakhs against the net loss of 74 lakhs in the same period last year.

In the current quarter we have planned to open two new stores both at Mumbai of these we have launched one store just a few days ago at the new terminal the Mumbai International Airport Terminal 2 Domestic Departures Area. The other store will be opened at the Taj GVK Hotel attached to the Mumbai Airport we expect this to happen towards the end of the current quarter. We are also happy to inform you that the store at Ambiance Mall, Gurgaon which had to be temporary close down due to the incident of fire has now reopened. This store was one of our very good performing stores and the loss of business of two months in good season period has obviously also had an impact on our overall performance. Had this accident of fire not happened our results for the quarter would have been slightly better.

We are further pleased to inform you of the new initiative which we are going to launch very soon and this is to partner with Shopper's Stop to establish a special section for Premium Watches under the Ethos banner at some select Shopper Stop stores. We will be initiating this on a trial basis with two locations of Shopper's Stop at Mumbai and Hyderabad which will be launched within this quarter. As hoped if these are successful we will roll this out at more Shopper's Stop stores this will be a new format of 'Shop in Shop' within Shopper's Stop and in line with global trends in establishing Premium Watch locations at leading department stores.

With this I would like to thank you all for the patience listening and would also like to open the floor for question-and-answers. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. We have the first question from the line of Alok Aggarwal from Striver Capital. Please go ahead.

Alok Aggarwal: My question is regarding the precision business. How do you see things shaping up out there over next year or let us say next 18 months?

Yashovardhan Saboo: Can just elaborate that a little bit Alok?

Raja Sekhar: What point of view?

Alok Aggarwal: I mean in terms of I mean the precision and Watch components like a combined right, where do you see the possibly more growth will be coming more focus will be there. How the investments will be moving in that business? And what kind of size potentially it can achieve?

Yashovardhan Saboo: I got it. So as we have been maintaining the Watch components part of the business we have maintained and I still maintain is that it will probably going to grow at about 10% to 12% per year however, if that was not be so this year because we have hit a bit of a speed break essentially it is because of soft global conditions some of it particular related to watches but I think overall in the globe there are softer conditions and that is reflected in a slowdown in manufacturing even in the precision components other than watches but not only I think if you look at manufacturing including globally whether it is China or other developing countries there is a softness in global demand. Coming specifically to watches, we had seen this weak leading indicators already in the first quarter in fact I had spoken about it and over second quarter it weakened further. However, now we are actually starting to see a reversal. We are starting to see strengthening of leading indicators which means some of the extra inventory in the system is playing itself out domestic demand seems to be turning up after a long gap. So I believe from Q4 onwards we should start to see a revival and we would be pretty much back on track for this 10% to 12% growth on the Watch components side. I am very confident that over the next fiscal year will be back on this 10% to 12% growth on the Watch components side. As far as the precision components goes, there actually the growth is much better and we have very ambitious plans for that. We are in the process of discussing how we can grow that business very-very aggressively by getting in by expanding in from the current role or current operation in precision stamp components, taking it further to include precision moldings and using these precision moldings to combine it with precision stampings to go into assemblies and sub-assemblies. So in the precision components business over the next three years to four years I definitely expected to get into a range of about 100 crore business by itself. For which will have to grow at an average rate of about 30% or more but there will be a lumpiness. We do foresee that perhaps 12 months from now we will be ready to make a bigger jump with some investments into a larger field with newer product groups and some new technology as I said moving from stampings and tooling along towards assembly and sub-assembly combing it with some precision molding. So that is roughly the dimension on the manufacturing business the way we see it.

Alok Aggarwal: Okay. And I mean you have recently raised about Rs.30 crores what is the usage plan for it as such going forward?

Yashovardhan Saboo: So 30 crores that have been raised in KDDL so they are going to help to provide some of the funds for this expansion which I have told you most of it actually the capital expenditure will be needed on the engineering side as I told you over the next 12 months is the longer period., actually it has already start so for example we have taken our land in the new Aerospace Development Park in Bangalore. So some of the CAPEX has already started and we expect that over a next 12 months period there will be CAPEX on this. There will be a CAPEX in KDDL and the regular needs in KDDL. What this does is of course allow KDDL to use its own internal cash generation to be then invested in Ethos which is also what we are doing..

Alok Aggarwal: Right. So how much of this will go into Ethos.

Yashovardhan Saboo: None of the raised funds are going into Ethos. The funds are being used for KDDL and KDDL's own generation is then being invested in Ethos.

Alok Aggarwal: And coming to Ethos, right I mean it is heartening to see in a soft environment you are doing about 25% growth and competition also is doing pretty well I mean there also have been growing. Where do you see like have these some kind of inflection point in this so called higher end or luxury segment? Where we can see a much more rapid growth and this operating leverage from the lead generation is it? how much it can play up to as such what is your estimate over next 18 months?

Yashovardhan Saboo: So Alok of course we are very happy with the 25% growth, I am sure you also got the comment about same store growth which is 18% which I think is very robust in today's market. We have not seen too many players in the luxury segment grow at 18% so I am not sure which competition you are talking about.

Alok Aggarwal: No, Helios also commented like all may not be straight competition they also said is a fantastic growth for them.

Yashovardhan Saboo: Yeah, Helios is always a good partner is a good benchmark. So 25% is a good growth it also reminds it is on every increasing base. So in terms of extra sales that we are generating every quarter is quite sizeable. We are at I think we when we talk about an inflection point 25% is a pretty robust growth the highest growth that China has recorded over a long-term period during the decade 2003 to 2013 for something like 27%-28% growth hence, Delhi recorded the highest growth over this period something like 30%-33% growth. So I think on a 25% we are pretty robust. What is going to cause this to expand further? I think we have to look for some signal that we have been waiting for. GST is one such signal. Main engine driving our growth is our offline-online combination. Our offline-online combination depends very much on effective logistics we need to be able to send goods fast and because high value products we do not have the luxury of sort sending them and not caring for them so we do not do cash on delivery and stuff like that so, we need to be very secure and we need to compete with local players who are making the watch available over there. So we rely very much on a much smoother logistic system. We lose in many of these transactions as some taxes because we do not get set-off. With a GST coming in, with a smoothening of proceeds I think that will be on very clear development that will lead to an inflection point. Second, the ability to offer a greater bids and depth of bands across the offline-online combination is again something that is playing itself out. As we increase our portfolio of brand and within the portfolio of brand is a portfolio of product, there are more and more reason for customer to come and research on website and buy from us. We see that happens. So I do not think there is going to be one inflection point in which it will start to accelerate but I think with the coming of GST and as our offering becomes more and more robust, as our dealings with customers become more and more robust, I think we will see the growth rate strengthening and perhaps accelerating. I do want to add over here again that the brand recall of Ethos was not very strong two years ago. Today we see a much better recall of Ethos. We have not done a formal survey yet but from some circumstances or some let us say informal survey that we have done online there is a much stronger recall of the brand Ethos. A lot of consumers are visiting the Ethos because of the content itself. They can research watches and they trust the information on Ethos. they trust the pricing information, they trust the service information, they trust to the information relating to what are new releases and so on I think these are all things which are causing a great qualitative improvement in the standing of Ethos and we can see it reflected in the growth which is I believe stronger than anybody in the competition.

Alok Aggarwal: So means October looks also promising for you?

Yashovardhan Saboo: October is a funny month because last year October had Diwali and this year October does not have Diwali. You have to look at October, November, December as a quarter.

Alok Aggarwal: Okay, sure. Last question from side there was a one notice given to exchange about the put options what does exactly it means, it was not clear to me. Put options to three investors.

Yashovardhan Saboo: Okay. So sometime back, some investments had acquired preference compulsorily convertible cumulative preference shares in Ethos. These were maturing this year. After discussions, following the request of the investors. So, there has been an extension of the term and one of the terms of the agreement with the inventors would be that they would have an option to put the shares obliging KDDL to purchase the shares at a certain price when it comes for maturity two years from now. So that is the put option to which KDDL has agreed and that is what is detailed out.

Alok Aggarwal: I mean would you like to disclose the price point for because that will become the Ethos valuation essentially. Anything on that front you want to disclose publically or not?

Yashovardhan Saboo: Just one minute let me just check on this please. Alok, I will answer that let me just get picture on that it I will answer that to you.

Alok Aggarwal: Sure, I think we can take it offline also, no issues.

Moderator: Thank you. Our next question is from the line of Dhwanil Shah from I Wealth Management. Please go ahead.

Dhwanil Shah: Sir a couple of quick question on the Ethos side. Sir, as you said the market is under a bit of competition and you are seeing a bit of softening so, which has led to a bit of decrease in our EBITDA margin. So sir how do we see this going ahead for next two years I mean earlier we had planned around 7% to 8% kind of target on the EBITDA side. So what is our view on it if you could just throw some light on it?

Yashovardhan Saboo: Essentially our thesis is that we will continue to grow without physically expanding stores and that is what will allow us to reduce our rental and all our operating cost. We see that playing out. What has happened right now is because of general weakness in the market and frankly also in the watch market globally, there are pressures from the brands to sell more, not only on us but on all other retails which in the short run has laid to a little higher discounting then normal. So that is, this higher discounting in the market which is leading to this. However, we are concentrating that slow reduction in our cost that I had mentioned to you already and we expect the EBITDA margins to continue to improve over the year at the end of the year we already see the EBITDA margins being a significant improvement over the last year. We have planned overall, over the next three years to four years an EBITDA margin increase roughly of about 0.75% to 1% every year, we see that happening. We are already starting to get a feeling that the market conditions are going to improve the first signs of that are already there. We also believe that some of the competition is bleeding heavily, so the market is not growing that far the market is probably growing in similar degree that is our understanding. We are growing at 25% so we are taking away market share and competition is bleeding. We do believe that there is going to be a shakeout in the market over the next 6 months to 12 months and there will be a hardening of the margins as we go forward.

Dhwanil Shah: Okay, fair enough. So sir for this margin improvement, does our online presence should increase further I mean say from 28% to 30%-35% which will lead to this or even if this remains at similar level we will be able to achieve the 0.75% increase which we are talking about?

Yashovardhan Saboo: The share of the online business is said to improve so, I will just explain it. Today's what is happening is people are researching Luxury Watches on the net on our platform and then later on converting it to a purchase aided by our online information service they then go to the stores they buy there or sometimes they buy directly on the net as well. Now obviously a) the number of leads are increasing. We are not stressing or focusing too much on an increase of leads. We are focusing more on the improvement in conversions. The improvement in conversions is happening by two ways a) we get more relevant leads. We weed out what is relevant leads that are coming from let us say locations which we are not in a position to serve, very far away locations no client paying for those leads or leads which are completely relevant for example a lead which a person think that he can get a Rolex Watch for Rs.10,000 some leads are like that So we are finding ways to weed away these leads. So number of leads may not be increasing dramatically but we expect our conversion to increase. When the conversion increases of course it will be a greater part of our overall sales. We are able to achieve the 25% growth through this increased conversion and this increased conversion does not have extra cost of stocking, does not have extra cost of manpower, does not have extra cost of rent. So therefore, the two are connected because we are stressing more on the internet platform, the online conversions will increase. The share of online business will increase. And this will allow us to have better margins because cost as a percentage of sales would decrease.

Dhwanil Shah: Okay, fair enough, got your point. And sir one last question sir, if you could just throw some light on the CAPEX plan on the Ethos side for this year and probably next year. So this year we said that we are opening two stores this quarter and any other store planned?

Yashovardhan Saboo: So we are basically going ahead on a CAPEX plan of about Rs.25 crores between this year and the next year. It is what we have said that is on track.

Dhwanil Shah: Okay. And we would not be raising any money for it as of now?

Yashovardhan Saboo: As I mentioned in the earlier question as well, KDDL will be investing. We are anticipating that between this fiscal year or next year, KDDL and we will invest about 25 crores into Ethos.

Dhwanil Shah: Okay. So there will be a bit of more dilution on the KDDL side?

Yashovardhan Saboo: No, KDDL will be enhancing it. KDDL will be buying Ethos shares so, KDDL will be strengthening its equity holding in Ethos.

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

Jeetu Punjabi: Couple of quick questions. So long side, the data is showing that Ethos numbers are growing at 25% but when I hear the commentary, you are kind of saying the market is weak. Can you just help me to calibrate this and understand this in terms of has the mix been weak or how do you feel the pressure point of a weak market while still being doing 25%? And also just talk about a little about the inventory side, what are the inventory numbers like and are they rising or falling? And with the next connected question which I am going to put it off now only saying that if you and you also mentioned in passing that you were seeing size of the market improving, again can you just talk, give us some color on how do you see the market improving and what are our expectations going forward based on that?

Yashovardhan Saboo: Right. So actually the pressure point which you mentioned is this extra percentage of discounts overall that we are having to give, to maintain this 25% growth in a soft market. So the pressure point we are feeling is on the margin. So there is always this trade off that do we try to get 25% to 26% growth and may be offer a little bit extra discounts across product categories to make that happens or do we hold back. Now, that is something which is a constant trade off that we have to do in our business. Typically, we are having to extend slightly higher discounts then budgeted to be able to achieve budget sales in the soft market. We did not expect the market to be soft. We expected it actually to be much healthier than this but given the current macroeconomic situation, the general sentiment I think it is not as optimistic as one has thought it would be six months ago. But the pressure point is really felt on the discount percentage which is reflected in the weaker margin. Of course, that is partly compensated by the reduction in cost as a percentage which obviously is also achieved because turnover goes up faster than cost go up. As far as the inventory is concerned, I think in terms of months of inventory, if you see at the end of quarter two, last year we were at 9.3 months and this year we are at 8.6 months. So there is a clear reduction of half of month. Now I just want to hasten to remind you that please do not be alarmed with these 9 months and 8 months figures. Please remember that September end is at the beginning of the peak sales season. So typically at this time, we would stock up. So therefore it is important to compare like-to-like. Last September, we were at 9.3 months and this September end we are at 8.6 month. So I think that is one of our very satisfying developments and we expect this to be reflected throughout the year at the end of the financial year as well.

Jeetu Punjabi: And can you have the mix of what you sold changed in this period when there was weakness as you pointed to?

Yashovardhan Saboo: So there is a greater percentage in our entire sales in term of value, there is a greater percentage at the higher price points. So the sale at the higher price points is slightly higher in terms of percentage of sale. Again I just want to add that this is not a surprise. As I had explained several times, in India the markets at the higher end will grow faster simply because the Indian market is turning, is now starting to move and reflect the global market where the market size at higher price point is much larger than the market size at lower price points.

Jeetu Punjabi: So if I have to read this like this, the Breguets are moving faster than the lower price Watches, is that correct?

Yashovardhan Saboo: You could take Breguets but you can also go one price point lower in India. You could say that price points that are 1 lakh which may be the larger, are the ones moving faster than or growing faster than let us say the Titan and the price points below 5,000.

Jeetu Punjabi: Okay. And then just the final for my question which I asked really was, you did point or saying you are sensing the market turning if I read it right and can you just talk about what you are seeing in very recent weeks or recent month? And how do you read the next three months or six months, you see growth accelerating from here?

Yashovardhan Saboo: In Ethos?

Jeetu Punjabi: Yeah, in Ethos, specifically in Ethos.

Yashovardhan Saboo: As I mentioned, I think we will probably see a continuation of the 25% growth, that is what we have calibrated, that is what we expect to be able to sustain over the next couple of years. Of course, if there is some good news, there is little good news on the microeconomic market; it would help to increase to accelerate this. As I mentioned, GST is something that we are certainly waiting for. I think some rationalization in taxes is again something I mean I do not want to sort of niggle on very small details. The fact of the matter is that every passing quarter we have seen some impediments and some difficulties in doing normal day to day business rather than ease of doing business becoming stronger. I am sure there are very good intentions of the government and I know that they have some plans of it. So when the ease of doing business expands, GST comes in mobility between goods between states goes and it makes things a lot easier. Currently, whether it is clearance from customs, having events, having exhibition events for expensive watches, booking orders and trying to getting good deliveries it is not that easy. There are impediments. As I said, I do not want to complain about small things, hoping that large improvements are just around corner. So let us wait for that. If that happens, I am hopeful we can go beyond 25%.

Moderator: Thank you. We have the next question from the line of Aditya Wagle from Aequitas. Please go ahead.

Aditya Wagle: My question is basically on Aerospace Development Park that you had mentioned, can you please elaborate on what kind of expansion we are doing there? And whether do we have any OEM tie-ups?

Yashovardhan Saboo: So this is for the precision stamping business, Aditya. We essentially at the momentum we are active in three fields in this business. We are active in the E&E that electronic and electrical that is largest part of our business. Second largest is the in some aerospace and defense and the third is really a mix between automobile and some medical instruments. The way we see this going forward, we certainly see aerospace and defense to improve. And yes, we do have some customers. But they are mainly global purchasing officials which buy in India, in the aerospace and defense field. We expect this to grow together and it becomes stronger than it is currently and for that reason we have applied for and got space in the aerospace park in Bengaluru, very close to the airport. This is a development that we see happening over the next two years. We will move to a larger factory which we will need to grow from the current level of Rs.25 crores to Rs.100 crores over the next three years to four years.

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

Vikram Suryavanshi: Most of the questions have answered but I just want to know, how is the progress on our service and repair on Watch side, that segment?

Yashovardhan Saboo: Yes. So Vikram the service vertical is one of our most important verticals. It is progressing as planned. There are some issues as we are now planning to take the entire service vertical online and integrated with both our programs which is our ERP network and with our marketing network which is the internet. So that integration is creating some issues. To be very frank, we are now in the process of enhancing our technical speed, our tech team in the IT space. But overall, we expect the service segment to be performing very well. For the year, it is pretty much as per budget. But frankly, we are looking at a very, let me say a very much expanded plan for service from next year onwards. We personally are now thinking that our budgets have been too conservative in the service space and we would look at a much more ambitious plan for service from the next fiscal year onwards. Just to complete that and it is for this purpose that we are looking at much more robust platform on which to develop this.

Vikram Suryavanshi: Okay. And do you have any internal target that x amount of revenue two year - three year or down the line in terms of absolute number or as a percentage?

Yashovardhan Saboo: Well we have done a very rough estimate and we believe that over a 4-5 year span, the size of the service business in the Premium and Luxury Watches alone would probably be something of the order about Rs.30 crores a year an obviously, service is a high margin business. And our goal would be to capture at least one-third of this.

Vikram Suryavanshi: Okay. And I was going through Annual Report there was some Packaging business, so what is the status of that and what are our plans?

Yashovardhan Saboo: So Packaging business is something that we have been in for several years now. At one time, we have thought that it could develop into a very significant business. However, we now believe that our precision component business has probably much more promise and a much more larger growth potential. We are evaluating the packaging business as to what relevance it has in the future. And for the moment we are continuing it but as I have also mentioned, we are evaluating as to whether we would be continuing this business or not.

Vikram Suryavanshi: Okay. And how much would be the total employee strength in Ethos?

Yashovardhan Saboo: It is currently about 320 persons, Vikram.

Moderator: Thank you. We have the next question from the line of Ashutosh Waja from Birla Mutual Fund. Please go ahead.

Ashutosh Waja: I am new to the company pardon me if I ask something not very relevant. So my first question is that you have described several segments. For example, Ethos is one, obviously the most important seemingly and there is the precision stamping and all. Would you highlight the expected ROE in all these businesses over let us say a two year or a three year period? I mean I can understand something starting just now, but what is your expectation couple of years?

Yashovardhan Saboo: I do not want to make a very precise kind of thing but we in Ethos over the next four years, we certainly expect the ROE to be in access of 20%. This is varying on the back of the improving EBITDA as I had explained to you and similarly in KDDL as well, it has been in access of 20%. And frankly, I do expect it to be in the range, I will have to look back and I will have to check this, I want to check on this.

Ashutosh Waja: But what about the remaining? Sir, apart from Ethos already you have an exports business, right so what is ROE there?

Yashovardhan Saboo: No, we do not break it up by export and domestic. So we have a KDDL Manufacturing Business and we have the Retail Business and in the Retail Business, we expect the ROE to go beyond 20% over the next 3-4 years. In KDDL, it has been in the region of 20% and we expect it to be in the region of 20% to 22%.

Ashutosh Waja: Now the reason, why I asked that sir is that I thought that if you yourselves believe that Ethos is probably a most important part of the business then should we back it up with more capital or should we start a few more of these businesses? I just wanted more clarity on that. Anyways, the second question which I had is that you have described this online-offline model which seemed very interesting to me. Do people really research before buying a Watch? Is it like an impulse that you come to a shop and buy or do they first research at home and then they, can you just describe the process according to what do you think works the best?

Yashovardhan Saboo: Yeah. I will describe it. So when people are buying a Rs.2,000 or Rs.5,000 Watch, they do not research much, there is not much to research. They like the watch, they buy it. When people are buying a Rs.3 lakh or a Rs.2 lakh or a Rs.5 lakh or a Rs.10 lakh watch, it is a little bit like buying a car. So you want to know about it, you want to know the price, you want to know features, and you want to know what are the things you should be looking out for? And Indians like to know what they are buying. Indians may be very rich, even the richest India, they do not want to throw their money away right we all are very value conscious. And if you are intelligent, you want to know what you are buying, right. Look, today it is a very good thing to compare it with car purchase. Whether someone is buying a second-hand car, we are not talking about second-hand watches but anyway, whether someone is buying a second-hand car or a new car, there is lot of research that happens. And that explains why among the most successful website in India are the car sales websites like CarDekho, CarWale and so on. So what they do? It is exactly what people do and they come to our site. They research, not only they research, there have a very active dialogue with out information center. We got a 48 men information center out of them about 25 to 27 are watch specialists that answer queries of the people who call in or write in, asking for information. There is a frequent dialogue that goes on for days, sometimes week because a person shortlist from watches again goes out to buy them. So it is a very-very popular and growing kind of a thing.

Ashutosh Waja: And do you keep all the watches at the stores or probably as you said that when somebody says that I want to look at this closer then you ship it to that store?

Yashovardhan Saboo: No. All the watches are kept at different stores. We have 41 stores as I mentioned, not every store has identical collection of brands or stock. So they are all distributed but all the stock is also reflected on our website. So that is one big advantage. Anybody goes to any competition to a store he will see, let us say, he will see a 100 pieces of Omega, 100 different SKUs of Omega. He goes on our website, it is 300 SKUs of Omega, practically the entire range. So that is one very big advantage of the offline-online combination, you have access to a much larger inventory, much larger range of products.

Ashutosh Waja: So what is the conversion rate for this people who get in touch with you online? How many of them actually get converted?

Yashovardhan Saboo: From what we consider as a lead and lead is a person who actually comes in and gives some contact details with whom we can respond. From a lead, we get a conversion of about 8%.

Ashutosh Waja: 8%?

Yashovardhan Saboo: Yes.

Ashutosh Waja: And I would presume that lead themselves will be very strongly correlate with the traffic on the website?

Yashovardhan Saboo: Yes, of course.

Ashutosh Waja: Strongly, so basically that we can anywhere see at the end. One last question sir, just I had this thing in mind that most of the so average price point would be what around, Rs.1 lakh?

Yashovardhan Saboo: It is about that. The average price point for sales generated from online lead is about Rs.97,000. The average price point overall global sales is about Rs.55,000.

Ashutosh Waja: Oh, slightly lesser. But these transition…

Yashovardhan Saboo: No, not slightly lesser, Ashutosh. It is significantly lesser, 97 versus 55. So this shows that the research is happening on high end. The online platform is being used by high-end buyer not by the Rs.10,000 buyer.

Ashutosh Waja: That is quite interesting, yeah. And the last question sir is that this transaction happens in cash or cheque?

Yashovardhan Saboo: Both.

Ashutosh Waja: Both like, what would it because the reason why I am asking is that so we have a lot of jewelry companies are hit by this new stipulation that crack down on black money or all the PAN supported transaction and so on, is that a risk for you, meaningful risk for you?

Yashovardhan Saboo: At the moment, there is no restriction in watch retail. This question has been asked several times that what happens with a similar restriction come on Watch sales. We are anticipating that, if a similar restriction would come, yes. It would impact the business for a short period. However, it would impact our business much less than our competition because the percentage of sales that we have in cash is much less than the competition. Besides, our customer segment is much more with cheque paying segment than the cash paying segment.

Moderator: Thank you. We have the next question from the line of Chintan Shah from Kitara Capital. Please go ahead.

McEnroe: Hi, Mr. Saboo Mcenroe here from Kitara. Sir my question is more towards Ethos, especially you mentioned earlier that the growth will come from increasing the brand portfolio and brands you take in the portfolio and then your category. So if I just want to have some brief idea on how many brands you have added in this year vis-à-vis last year?

Yashovardhan Saboo: We will have to prepare that a bit to tell you. I do not think there has been a net addition of brands. What we are doing is actually rationalizing brands that we see are not pulling their weight or not doing too well and we do not see that happening in future. We are actually getting out of, getting out is obviously, you cannot just get out one day to the other. You have to plan it, you have to plan in stores. And on the other hand, there are some brands which we think are missing in our portfolio, we are adding them I do not think there is a net addition. How do we add a brand? I think that would be, why do we drop a brand? Very clear, if the brand is not performing, you drop it, right. How do we add? We add one of the big indicators for adding them is we check which of the brands for which there are leads people are enquiring online. So which are the brand people are interested in globally as well as in India. In India, we got a clear demand, globally, because what is happening globally is going to come to India and the second thing which we look at it is the brand interested in India. Are they willing to make marketing investments? Are they serious? Do they want to work with a player like Ethos? Or do they have a more opportunistic stand? Do they have a long-term stand? So looking at both these two things we decided to add a brand that is pretty much a portfolio. There are a few brands which we would like to have, which we do not have in our portfolio and specially in the high-end segment and we will be working on these brands over the next one year or two years. And with these brands, our portfolio will pretty much be complete.

McEnroe: Yes. Just a more light on that, how long it takes for you to add a brand in your portfolio?

Yashovardhan Saboo: If it is a mid-end or a low end brand, today we have the power and every brand is attracted to come to us. At the very high end, some very high end Luxury Brands very exclusive brands it is difficult because worldwide what has happened is brands are reducing their points of sales I do not want to name any particular brand, but many-many brands, Luxury Brands today are saying that our luxury content or our luxury selling is going to increase by making the brand more rare. So in the past, 10 years or 15 years ago many of the brands had overextended themselves by opening too many points of sale which lead to discounting. Now they are reversing it by saying we want to reduce points of sale. So even though India is an important future market, many brands are saying let us go slow in increasing the number of points of sale and there is a reason why it takes time to convince a brand. A very good example is one of the most famous watch brand in the world, Patek Philippe I am sure you have heard about that. Patek Philippe has not established a presence in India yet. They are saying, well, the taxes in India are too high anyway we have two little production any Indian wants a Patek Philippe you can buy it somewhere else in the world. But there are another few, couple of other brands like this. We are in touch with them and given the fact that today we have the strongest presence in any retail partner in India we are confident that over the next one year or two years continuing to engage these brands we will have them in our portfolio. But it is a long courtship; you have the long period of understanding, dialogue, matching of values, matching of strategies which happens before you can add a Luxury Brand in the portfolio.

McEnroe: Yeah, but when you add a brand in your portfolio is there a discussion on whether they should be available to be projected online or you can have full right to put any brand on online?

Yashovardhan Saboo: When you do an arrangement with a Luxury brand everything has to be agreed and discussed.

McEnroe: Okay. So you have to be very clear that this is a sales channel. Okay, and on one side just wanted to check in your online lease model the sales which is generated through that channel, how many you can say top two brands to three brands which contribute to these sales or this is very fragmented.

Yashovardhan Saboo: I think what is the online and the offline actually pretty much reflecting each other except for the fact that the online lead generation model does not do much business in price points below Rs.20,000 because it does not work below Rs.20,000. At a price point below Rs.20,000, you cannot afford to engage a watch specialist to speak for one hour or two hours or three hours with an interested buyer how is basically looking for Rs.15,000 watch. So, on the lead generation model, the price points tend to be higher except for that the brand mix pretty much matches.

McEnroe: So how many brands must be contributing to top 50% of the sales?

Yashovardhan Saboo: Top 50%?

McEnroe: Online sales.

Yashovardhan Saboo: I would say about 10 brands to 12 brands.

McEnroe: Okay. So just want to check if in future any brand wants to opt out of your online model so you do not pursue any risk on that?

Yashovardhan Saboo: Sorry.

McEnroe: The brand is currently ready to provide their inventory on online it is allowing you to sell their watch on online but in future they are not ready?

Yashovardhan Saboo: Sorry, we are not selling the brand online.

McEnroe: No, you are not selling but you are projecting it online right, I a mean at least you are showing the watches online

Yashovardhan Saboo: We are showing the watches online. Today every brand is actually embracing online so long as it is done qualitatively, so long as we are not pushing it on the basis of discounts, so long as we are not violating there guidelines in the way some of the large format retailers are doing. And if you visit our website you will see that the greatest emphasizes actually is on content if you see our watch blog, if you see our watch articles archive. this will really project the watches, launch of new watches, the currently one which is the launch of Omega New James Bond Watch Spectre and that is exactly what the brands want in future. We are not really pushing transaction, we are pushing brand knowledge, brand quality, and we are pushing the brand experience.

McEnroe: You do not think any rest of brand opting out of this particular sales channel that is what is what I wanted to know?

Yashovardhan Saboo: No, I do not see ,in fact I think when embracing it and I see them embracing it more closely not indiscriminately but with retailers, authorized retailers who respects there brands on their websites.

Moderator: Thank you. Our next question is from the line of Sanjiv Patkar from SBI Mutual Fund. Please go ahead.

Sanjiv Patkar: I just have couple of very small questions. One is with the emerging times what sort of percentage of sales are moving on EMI if any because that might be a trend which is visible right?

Yashovardhan Saboo: We expected EMI to be doing better than it is Sanjiv and at the moment I do not have the exactly the figures but I can tell you it is not very significant. At the moment EMI in Watches and Luxury watches does not seem to be getting the traction we were hoping it would get. What seems to be more popular and more successful with us is the Insurance facility that we are offering on Watches.

Sanjiv Patkar: Okay. And my second question was how is your strategy aligned if at all tomorrow currency appreciates? One is it will benefit you in terms of prices point but there will be an inventory which will be what and as you said it will be as high as five months to six months on an average, right? So if Rupee come down to say Rs.60 or Rs.50 we do not know but how are they looked at those sort of risk if at all they come. When they come we are not prepared to be honest.

Yashovardhan Saboo: The MRP of the watches pretty much remains fixed and almost 75% of our purchases are actually made locally so is there going to be exchange risk over there, is it more with the subsidiaries of the brands that number one. Number two I do not think it change like what you are mentioning from 65 to 50 is something is gone happen very…

Sanjiv Patkar: Even I do not think but it is better from a risk management perspective to understand how you are looking at that event…

Yashovardhan Saboo: Then I have to say that fortunately as I said 70% to 75% of our business really happens, we are purchasing locally so we are not exposed to that risk actually.

Moderator: Thank you. We have the next question from the line of Surabhi Dogar from Param Capital. Please go ahead.

Pratik Singha: It's Pratik Singhania, her colleague**.** So, Sir you were talking about giving higher discount to Y-o-Y so is it possible for you if you can just quantify if the amount of discount Y-o-Y would have been similar what incremental EBITDA margin could we have gain?

Yashovardhan Saboo: Just let me try to understand your question Pratik, you are saying that if we had not given the higher discount….

Pratik Singha: So Y-o-Y the average discounting have remained same in that scenario what kind of an incremental EBITDA margin we could have gained?

Yashovardhan Saboo: So we believe that is 1% increase discount that you are talking about would translate to 1.2% or 1.3% point improvement in EBITDA. This could be the additional EBITDA that could come had this discounting not happened.

Pratik Singha: How many basis points?

Yashovardhan Saboo: This will be 1.2% additional EBITDA margin that could have come if we may not had to discount additional because of the market conditions.

Pratik Singha: You are talking about 1.2% EBITDA margin or is the absolute increment in the EBITDA?

Yashovardhan Saboo: So, 4% EBITDA would have been about 5.2%.

Pratik Singha: What kind of Rs.100 crores target for precision engineering and stamping division. So what kind of operating margin you are looking at full potential that?

Yashovardhan Saboo: That something which we have not fully worked out Pratik, as I mentioned that to go from the current level to Rs100 crore business would require us to enhance the production capability currently our strength is high precision tooling and stampings coming from that. Now we plan to move into sub-assemblies and assemblies and one part of this is including precision plastic molding because these combine with precision stamping and some machine parts perform these assemblies and sub-assemblies in the kind of product segments we are operating and we want to expand into. Exactly what would be the operating leverage, what would be the margins on this we expect them to improve from what they are at the moment because we are going to higher value addition segment but exactly what they are going to be currently we have not really worked out in that much detail yet. We are moving towards establishing a more detailed plan together with an investment plan but I do not think this is probably going to take another 8 months to 12 months to start implementation.

Moderator: Thank you. We have the next question from the line of Sadanand Shetty from Taurus Asset Management. Please go ahead.

Sadanand Shetty: I have few small questions; I will ask all of them together. Number of Watch specialist that you have for September end? And visitors on the website and also if you can provide lead generated number?

Yashovardhan Saboo: Currently we have 25 watch specialists. We are also implementing a program of deputing some of the watch specialist to physical stores so that they experience the physical environment and are better able to interact in the stores and interact to customers. So currently there are 25 watch specialties in the Watch Information Center. In terms of visits to the websites in quarter two there were 17 lakhs visits to the website compare to 14 lakh in same period last year and the leads are about 33,000 leads which is a little bit lower than the leads last year. But as I mentioned we are not really emphasizing too much of increase in the quantity of leads rather in the quality of leads and this will reflected in the conversion percentage in this quarter being 8.1% compared to 4.5% in the previous year.

Sadanand Shetty: Right. I will also come to each point, number or watch specialist I would assume one of the key drivers for your online sales?

Yashovardhan Saboo: Yes.

Sadanand Shetty: Given that backdrop is it not growing fast you had 27 watch specialists if I have not mistaken in quarter one.

Yashovardhan Saboo: Yes.

Sadanand Shetty: So the phase growth looks in a lesser than what it was in last quarter it should have grown faster?

Yashovardhan Saboo: Yes, we are but as I also mentioned to you Sadanand, we are in fact last year we were talking about to grow this to about 45 watch specialists. What we realize is that just increasing watch specialists to answer irrelevant leads is a waste of money and waste of time. So we are saying it is better to have more dedicated, better trained watch specialists, and answering fewer leads to be able to take the conversion from 4% to 8% to 10% to 12%. So while you are right we want to increase the number of watch specialist and there is we are looking at increasing that, there has been one or two recent attrition I know that. I know that. But we are also, as I told deputing watch specialist to our stores to get an on-store experience which improves the quality of the interaction finally at the Watch Center level. While you are right we should be increasing the watch specialist, we will be doing that but it is not that we need to increase it proportionately with the sales because increased sales is going to come from increase conversion, increase effectiveness of the watch specialist rather than increasing the number of specialist.

Sadanand Shetty: All right. Visitors on website although has grown substantially on year-on-year basis but on quarter-on-quarter basis it is lower than the last quarter preceding quarter it is nothing abnormal right? You would say is it perfectly okay or you are not worried about it, in spite of the Ad Campaign and the Trust Campaign that you had carried?

Yashovardhan Saboo: So the businesses are increasing.

Sadanand Shetty: Yeah, but if I compare to April-May-June where you add 18 million visitors to the last quarter which is 17 million. So is it a seasonal factor or you are saying it is declining…

Yashovardhan Saboo: Sir, for an example in quarter three we are seeing a big peak and I think it will also related to timing of when we spend the money. So this time for an example, I know that over the last two weeks we had consistently highest ever number of visits, so I would not read too much into this decline in the numbers of visit. I think you are gone see peak in quarter three.

Sadanand Shetty: Sir, your conversion ratio is also lower comparing to April-May-June of this year that is also nothing to worry. You would say it is perfect fine, it is kind of seasonal in nature how you do, if I am not miss taken it was 8.60.

Yashovardhan Saboo: 8.50.

Sadanand Shetty : Preceding last quarter and the last quarter is 8.01?

Yashovardhan Saboo: Yeah, so I would not read too much into this but look at the trends. So for example in 2013-2014 I am just looking at the chart here in 203-2014 as well quarter two was lower than quarter one and then quarter three went up quarter four went down. Last year quarter one and quarter two were similar but if you look at the overall trend it is 4.3% in 2013-2014, 6% in 2014-2015 8.2% YTD in 2015-2016. Our goal is to last year we actually said that if you want to take it up to 7% now it is actually up to 8.2%.

Sadanand Shetty: Okay, can you share me your Club Eco Membership base as of September ending?

Yashovardhan Saboo: It is 99,800.

Sadanand Shetty: Mr. Saboo, what is stopping you too carry your ad campaign on the television media because you are in a such a sweet spot, you could really scale up your demand?

Yashovardhan Saboo: Wonderful question we are debating this in every meeting and so the big question they are asking is should it be television and the investment as required on the television or should it be digital media, a lot of people at the cutting edge of where marketing and where media is going are telling me that the television viewership especially among younger generation is falling rapidly. Younger people are no longer watching television especially in the educated, upper middle classes and upper classes more and more they are looking even for all the news, all there entertainment online. And therefore should we be investing Rs.5 crore of marketing money that a good television campaign would we? Or should we rather invest much lower on a very effective digital video campaign. Two schools of thought very interesting ideas I tend to believe that I am not listen to younger generation a little bit more on this because I think the trend is more toward digital then old world media. And the investment required in old world media seems to be still over the top and less attractive than what it seems to be on digital media. But again I mean this is a discussion that is still going on and we will take a decision this year as what we have to do? We would take at least one of the two either and a very strong presence on video or digital media or on television next year.

Sadanand Shetty: If you can give us absolute amount that is spent on advertising or advertising or marketing whichever it is convenient for you to share in our last quarter and quarter prior to that?

Yashovardhan Saboo: I think over all we would said that 2.2% of our sales is currently spend on marketing.

Sadanand Shetty: 2.2% of Ethos sales right?

Yashovardhan Saboo: Correct.

Sadanand Shetty: And you are more or less would be in line with that budget?

Yashovardhan Saboo: Yeah.

Moderator: Thank you. Our next question is from the line of Sangeeta Tripathi from Sharekhan. Please go ahead.

Sangeeta Tripathi: I may apologies if it may be a repetitive one because I had joined the call very late. Just wanted to understand from you the same stores sales growth for Q2, I understand that you have given in the presentation first half your same store sales growth is 18%, for specifically second quarter what is the sales growth?

Yashovardhan Saboo: Second quarter is 18%

Sangeeta Tripathi: Okay. Second quarter is also 18% and for the first half is also of 18%?

Yashovardhan Saboo: Correct, I mean yeah.

Sangeeta Tripathi: Now if I look at this 18% same store sales growth and…

Yashovardhan Saboo: The first half the first quarter was lower than 18%, it is about 16% and second quarter is 18%

Sangeeta Tripathi: Okay. And the overall first-half also is 18% right?

Yashovardhan Saboo: First quarter is 16%, second quarter is 19%, and first-half H1 is 18%.

Sangeeta Tripathi: Okay. So this same store sales growth at 19%, which is quite a decent and healthy number now on this growth plus there has been a reduction in the other fixed expenses which we see as part of Ethos. Now despite that there has been a margin contraction probably you might have answered it. But for the benefit of my understanding if you could just let me know what is the reasons why we have not seen margin expansion for this entire first-half as well in the second quarter?

Yashovardhan Saboo: You are right Sangeeta, this point was discussed in quite a lot of detail and in some previous question and also taken up during my presentation. But not a problem, I will explain it briefly again. So I have mentioned that the overall market conditions have been soft not only in the Watch business but across most of sentiment as you know. Despite that we manage a 25% growth and this was and we feel pressure points on this and this robust growth 25% and 19% so one of the things that impacted this was the higher than budgeted consumer discount and consumer offer deals and which we have offered and that is what is laid to his margin contraction. I would like to say again that overall for the half-year we are better off than the previous year.

Sangeeta Tripathi: And what would be typically the discount that we had given for this first half I mean on an aggregate basis blended?

Yashovardhan Saboo: So it is been about 1 percentage point higher than what was budget. So let me answer that. If we did not have to do this the EBITDA would have been better by about 1.2% which means instead of 4% it would have been about 5.2%.

Sangeeta Tripathi: Okay. And going forward like in the next two years' timeframe the kind of margin guidance that we had talked about for Ethos, reaching about 8% to 10% mark that continues to be there or there has been any change in the guidance?

Yashovardhan Saboo: No, I do not expect that the long term direction is going to change; I think what we see currently is temporary weak market situation we already starting to signs of this improvement from Q4 onwards and we will be on track to do the improvement of about 0.7% to 1% EBITDA improvement every year. I think this year, we also spoke about what are some of the points, what are the some of the turning point or inflection point that will help to improve the situation GST, rationalization of taxes, we spoke about that we expect those to be come in next year. We were certainly confident that we are going to be back on track to achieve this EBITDA improvement that was projected.

Sangeeta Tripathi: So, in next two years' timeframe we should be setting that 8% mark?

Yashovardhan Saboo: We have actually we have foreseen that from the level of 5% last year we would increase about 8% to10% overall a three years to four years period, that is what our position was and we maintain that.

Moderator: Thank you. Ladies and gentlemen that was the last question, and we will now close the question queue. I would like to hand the floor back to Mr. Saboo for closing comments, please go ahead.

Yashovardhan Saboo: I would like to thank everyone for joining on the call. Thank you very much and I hope we have been able to respond to all your quires adequately. For any information please get in touch to SGA our Investor Relations Advisors. Thank you once again.

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