Vaibhav Global Limited
Earnings Conference Call Transcript
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Good evening everyone and thank you for joining us on Vaibhav Global's Q2FY14 results earnings call. We have with us Mr. Sunil Agrawal, Chairman of Vaibhav Global, Mr. Sri Burugapalli – Senior VP, Corporate Strategy and Mr. Anshuman Khandelwal from Finance. We will begin the call with brief opening remarks from the management. Following which, we will open the forum to answer any questions that you may have. Before we get started, I would like to point out that some of the statements made or discussed on the conference call today may be forward looking in nature and must be viewed in conjunction with the risks and uncertainties we face. A detailed statement and explanation of these risks is included in our earnings presentation. The Company does not undertake to update these forward looking statements publically. I would now like to invite Mr. Sunil Agarwal to make his opening remarks.

Sunil Agrawal

Thank you Dipti. Let me welcome you all to Vaibhav Global's Q2FY14 earnings call. To start with, I take this opportunity to briefly introduce Vaibhav Global to all of you especially those of you who do not know the company well. Our presentation provides further details both on the business and on recent financial performance. I trust the presentation will now be available with all of you.

Vaibhav Global is a global electronic retailer of fashion jewellery and lifestyle accessories in the US, UK and Canada. We have access to over 100 million households in these countries. Our US shopping channels reach customers directly on all major cable and satellite and DTH platforms that is Dish TV, DirecTV, Comcast, Verizon, Time Warner, Sky, Virgin, Freeview, Freesat, etc. Our e-commerce websites in US and UK complement our TV coverage while diversifying customer engagement. Our strategy is to deliver deep value proposition to the customer through lowest price guarantee. Our focus is on the discounts seeking buyer, a market that has historically delivered secular growth across various stages of the economic cycle. Our customer proposition is supported by vertical integration with a strong supply chain infrastructure that includes manufacturing operations in Jaipur and outsourcing from micro markets in China, Thailand and Indonesia. In Q2, we shipped over 2.2 million products growing volume by 25%. This amounts to over 24,000 items shipped daily highlighting the scale of our operations. Sales volumes from our customers on our TV platform grew 15% and web volumes grew 56%. Web contribution has been increasing steadily and reached 30% by volume in Q2 compared to 24% a year ago. We believe that the mix is thus getting more desirable in line with our objectives. All our customers on TV and web payback credit card. So the account receivable is negligible.

Now to briefly cover financial performance - in Q2, revenues increased by 46%. The key takeaway here is that in a traditionally weak quarter marked by pre-season discount sales, both revenues and sales volumes have far exceeded last year's high season performance which is Q3 or the October-December 2012 quarter. Like every year, we organized the discount sale in the month of July to liquidate old stock and make way for new collections. Strong volumes resulted in the discounting initiatives closing in just a few weeks this year which we believe augers very well for the second half of the year also. EBITDA margin expanded to 12.6% during Q2 as compared to just 6% in the same quarter of last year. Both revenues and margins comfortably exceeded our quarterly guidance for Q2. Profit after tax came in at Rs. 44 crore taking half yearly profits to Rs. 84 crore. Earning per share for the quarter was Rs. 13.5 and Rs. 25.9 in the first half. Return ratios remains strong. H1, ROCE was 48% and ROE was 77%. Free cash generation was Rs. 77 crore which has been partly used to bring down net debt by Rs. 26 crore. Net debt-to-equity is currently at 0.4 multiple and our objective is to become debt free apart from maintaining some working capital facilities. Yesterday we also used our internal accruals redeem preferential shares of Rs. 44 crore and a premium of approximately Rs. 3 crore.

Going forward, we see continuation of a strong performance delivered in the first half. We expect 30% revenue growth in H2 and EBITDA margin at 13-14% based on the visibility of strong seasonal demand from our customers in US, UK and Canada. Before I close, I would like to inform you that we have made an important addition to our Board of Directors by inducting Mr. Pulak Prasad. Pulak is the founder of Nalanda Capital, a key shareholder in Vaibhav Global and we look forward to his deep engagement as a key resource in our onward journey.

With that, I conclude my opening remarks and before we take your questions, I take this opportunity to wish all of you a very happy Diwali. I now request the operator to open for questions.

Moderator Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Sunil Jain from Nirmal Bang. Please go ahead.

Sunil Jain Sir my questions relate to your guidance. What has changed in the last 3 months where you have become more optimistic about your business and increased guidance for the second half?

Sunil Agrawal We are seeing the trend in October, October just ended and we are seeing those kind of growth and last year we had in US the presidential elections and super storm 'Sandy'. So that had depressed our sales. So compared to last year, we expect to grow by these numbers.

Sunil Jain This growth what you are talking is definitely in dollar terms if I am not wrong.

Sunil Agrawal The guidance that I just gave is in rupee terms, but even in dollar terms, the growth will be quite substantial.

Sunil Jain This is more of a rupee guidance.

Sunil Agrawal Yes.

Sunil Jain And sir second thing is in this October month also, there was US shutdown and all. So was there any impact on sales of that or not?

Sunil Agrawal We did not experience any slowdown.

Sunil Jain Sir if I analyze your sales - if you see the TV sales that has grown by 15% whereas in the Q1, it was around 25%. So something to read in this or this is what the trend in second quarter?

Sunil Agrawal Only thing is that web sales has grown much faster than television, but the television sales continued to be strong as well.

Sunil Jain But are we facing any slowdown in TV sales?

Sunil Agrawal We are not really experiencing any slowdown. The sales continue to grow, but we have made certain investments in web. They are growing faster than TV.

Sunil Jain But you had said 30% growth that is…

Sri Burugapalli In Q1, our TV volumes were 1.37 million whereas in Q2, they were 1.57 million. So the TV volumes actually increased between Q1 and Q2, but it is just that the web volumes have grown much more dramatically. So the web that is the reasons why on a contribute percentage basis it is showing slightly low.

Sunil Jain You mean to say some shift has happened from TV to web?

Sri Burugapalli Not shift so to speak, but web volume contribution went up much more than TV volume, although there was growth in TV as well.

Sunil Jain If I put the same customer who are purchasing on TV has shifted to web, is that the trend or no?

Sri Burugapalli That is not necessarily the trend. There are definitely customers that shop on both channels and web customers have shopped more because we made some changes to our website to drive more of it, we do not differentiate so to speak between web and TV customers. Therefore it has the same value to us. If anything from our business metric standpoint, the customer that shop on both TV and web together cross channel shopping is worth a lot more to us than a customer that only shops on one of the two channels. So we would prefer for the customer to do cross shopping.

Sunil Jain Sir second question is more of data question. If you can share your subsidiaries sales in dollar terms of US, UK or may be consolidated.

Sri Burugapalli We are looking at our sales mainly from web, TV and B2B standpoint. The TV contribution for the first half of the year is about 73%, the web contribution is 16% and the B2B contribution is 11%.

Sunil Jain I just wanted to see whether dollar terms revenue, how much was the growth?

Sri Burugapalli Dollar terms revenue; total revenue growth was 26% growth year-to-year.

Sunil Jain Year-on-year 26% growth both in US and UK combined?

Sri Burugapalli Both in US and UK combined, yes.

Sunil Jain and both subsidiaries were profitable or what?

Sri Burugapalli Yes, both were profitable.

Moderator Thank you. The next question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta I have just started looking at the stock. What I wanted to understand from you is if you could help me get a sense on the history. How if you could just give a background of how did we got into CDR and how have we come out, if you could just start with that basic background please?

Sunil Agrawal Sure. Let me answer that. We went into TV retailing about 8 years ago setting up TV retail in UK and Germany and US and we raised funding from Warburg as well as Nalanda for our expansion into retail and we also had brick and mortar at that time. Then during the session, the critical time that needs to achieve the scale for profitability in retail, it took longer than we expected. By then we had raised we wanted to buy time and so we went into CDR. We did not ask for any principal reduction and there was only very small interest reduction, but we got 3-year time. So we took the time and we came out of CDR much before the maturity period. We have already paid all the recompense and a large part of the CDR debt.

Avi Mehta So you started over there with Indian debt which given that you got in this slowdown and hence you had to go through the CDR route. Is that understanding correct and Warburg bit, I am sorry I did not understand. Is that prior to this or was this after the CDR?

Sunil Agrawal Prior to this.

Avi Mehta Sir then just more fundamentally on the business model per se, what I understand is you fulfill orders through either the TV channel or the web channel. Now just wanted to understand a) how does the fulfillment cycle work, what is the timeline, what kind of inventories do we have to keep and how does the share that you currently have 75%, how is this expected trend going forward and what is the benefit in each of the channels if you could give this some brief on that?

Sunil Agrawal Sure. We fulfill out of our inventory and from our warehouse in Austin for US and London in UK. All our product lands there first before we present it on TV or on web and as soon as order is placed and most of the order is placed through IVR which is intelligent voice response system on telephone or through web. More than 75% of orders are now currently automatic without any human intervention and more than 85% of the orders get shipped within next day and balance within 72 hours and customers get the product within 4-5 business days.

Avi Mehta And you said it was discount focus, so these are lifestyle jewellery, is this like if I may say trinket etc. or the gold jewellery. What exactly is the…..

Sunil Agrawal We have very few gold or platinum jewellery. More for aspirational purposes and in order to create a perception of high end, but as you see from our average price point, most of the jewellery, is fashion jewellery, silver or brass or grass mostly fashion product, but quality for the value that feel is much higher than any of our competitors are able to do.

Avi Mehta Sorry, but I am not aware of the industry per se, but would the margin that you currently have about 11-12% would it be similar across other channels like QVC or even other fashion jewellery kind of players or does it defer and where, what kind of gives you the benefit?

Sunil Agrawal QVC sells pretty much everything including beauty products, health, or kitchenware and electronics, but average EBITDA margin is approximately 20%, but the main factor is the scale. QVC is at 6 billion in US and overall about 9 billion in HSN is approximately 3 billion.

Avi Mehta And sir the point about other fashion jewellery players. Would they have similar kind of margins or would you be able to give us any sense on that?

Sunil Agrawal We track QVC and Zara. Zara is one model that we think that we are very close to and they have same 20% kind of EBITDA with the factor of the scale and QVC also has 20% EBITDA.

Avi Mehta And sir how would the share of TV and web kind of change going forward and like you said web is likely to see growth - how do you popularize web. What kind of marketing do you do?

Sunil Agrawal As Sri explained earlier, we popularized or publicized our web through our television. We have real estate on our screen where we give URL address and also the host or the presenters speak about our websites and we have a special section in our web which has very prominent display, it is called one dollar auction or one pound auction. Everything starts with one dollar and then people bid like eBay, bid against each other and a kind of sense of winning when they get it and that mechanism is used for our clearance of the product or remaining product on television as well as we now have such good traction on that platform that we are having this specially merchandized for that area. So we publicize cross channel both ways mostly on TV for web and also on web for television.

Avi Mehta Sorry but I mean what would you say is the key differentiation that you would say and just as thought, why not India, you are an Indian company, why US, UK, if you could share any thought. Is it that the market is completely different? What is the advantage that kind of brings in?

Sunil Agrawal Two reasons. One is we are focused on executing in US and UK and both these markets combined, our target market for electronic retail of fashion jeweler and lifestyle, it is more than $15 billion. So our ratio, our market size is less than 2% right now. So we have long run way in front of us in those two markets and we do not want to divert our attention. Second thing for India, Indian electronic retail is still not profitable and our strategy has been to grow profitably. So we will not go into a market where we would not make money within 24 months and India is not there yet both for television as well as e-com.

Avi Mehta Sorry, but I did not get the chance. How do you see web and TV share changing?

Sunil Agrawal Web will continue to grow from our current ratio of 16%. We hope that it will continue to grow close to our competitors' numbers. QVC's current web ratio is about 40% and television is 60%.

Avi Mehta Sorry which one is 60%?

Sunil Agrawal QVC. QVC's web is 40 and television is 60. So it is more than 40 actually.

Moderator Thank you. The next question is from the line of Ruchita Maheshwari from Nirmal Bang Securities. Please go ahead.

Ruchita Maheshwari Just wanted to know in Q2 what was the contribution from fashion accessories and fashion jewellery in your revenue?

Sri Burugapalli Accessories jewellery contribution was a little bit higher than 7%, remaining was what we consider fashion little bit of fine jewellery, but mostly fashion.

Ruchita Maheshwari And what was the scenario in Q1FY14?

Sri Burugapalli The ratios were similar, slightly less than 7%. So accessory jewellery, we are increasing slowly in that segment.

Ruchita Maheshwari In the last concall, you had said that you have started to rationalize the discounts which you had extended in Q4FY13. So has the discounts been over for Q2FY14 which has driven your revenue growth?

Sri Burugapalli Yes. There are two aspects to the discount. Our offering itself is a discounted offering compared to our competition. So that part of it remains, but last year around the same time due to various macro factors in US primarily, we decided to offer additional discounts to retain market share. Now that decision has been undone since end of February-March, we have changed that back to our traditional model and as of May and June, we started seeing positive impact of that and second quarter results that you are seeing are fully inclusive of all these factors.

Ruchita Maheshwari And how much was the currency impact and revenue growth out of 46%?

Sunil Agrawal In rupees terms, it was 46% growth and in dollar terms it was 35% growth in Q2FY14 over Q2 last year.

Ruchita Maheshwari And how much was volume growth?

Sunil Agrawal 14%.

Ruchita Maheshwari And any additional customer in the current quarter - in this Q2FY14?

Sunil Agrawal Definitely, 25% growth.

Ruchita Maheshwari Customer repeat purchases in Q2FY14 versus Q2FY13 and Q1FY14?

Sunil Agrawal 13 purchases.

Sri Burugapalli We do not have that exact number right now, but we will get back to you if that is okay. I have the number, but there seems to be a slight error in the calculation. Q1 was 16 just for your information and Q1FY13 was 14. So 14 to 16 and the last calculation we had showed as 17 for Q2. There was some error in the number I have in front of me. So we will write back to you with that information.

Ruchita Maheshwari Perfectly fine and in fashion accessories, have we introduced any newer products in this current quarter or are we planning to introduce newer products going forward.

Sunil Agrawal We have a process of continuously evaluating our current lines and also the trends - what is it that we are seeing outside in the market and based on those trends, say just in handbags, handbags itself is a huge category; within category, we introduced different types of handbags. It could be totes, it could be shoulder cross-body, it could be clutch bags, it could be leather, or it could be color blocks. So we are expanding the lines that we have already introduced that is scarves or handbags or hair accessories or phone covers and we are experimenting and expanding them and as we are learning more about fashion trends and the runways, we are getting more traction for these products and we have also devised the policy within the group is to first add certain velocity and performance of certain items before going into new line.

Ruchita Maheshwari And what is the strategy of debt repayment and I believe in Q1 you have repaid some Rs. 30 crore. So have you repaid any debt in Q2?

Sunil Agrawal Yes, we have. Let me give you the number. We repaid about Rs. 15 crore and yesterday we repaid Rs. 44 crore of preferred shares that was due yesterday along with Rs. 3 crore of dividends which was due. So we repaid Rs. 48 crore of preferred and Rs. 15 crore of bank debt.

Ruchita Maheshwari And FY14 what will be the gross debt in your balance sheet?

Sunil Agrawal As of September, it was Rs. 145 crore gross debt and as of end of March 2014 we expect it to be between Rs. 100-125 crore.

Ruchita Maheshwari And by FY15, I believe it will be a zero debt company right?

Sunil Agrawal By the end of FY15, it will be zero debt company, but we will continue to maintain certain working capital. We will not have any term loan or any WCTL of any kind.

Ruchita Maheshwari And your view for H2FY14 - how do you see the market condition and your revenue growth?

Sunil Agrawal I will give you the guidance, we are looking at 30% revenue growth in H2 and EBITDA margins of 13-14%.

Ruchita Maheshwari It is on the stable rupee / dollar?

Sunil Agrawal This is on the current rupee term. I do not have data with me of what was last year's H2 rupee rate, but on rupee terms, we are looking at 30% revenue growth at current rupee rates.

Moderator Thank you. The next question is from the line of Elesh Gopani from Gopani Securities. Please go ahead.

Elesh Gopani I want to know what will be the tax rate for the year FY13-14 and FY14-15?

Sunil Agrawal We only have 18.5% MAT provision that we are making in our Indian subsidiary. In UK, we still have accumulated losses. In US, we will finish all our accumulated losses this year and from next year onwards, we will be under 35%, approximately 33-35% stable tax rate in US.

Moderator Thank you. The next question is from the line of Percy Panthaki from IIFL. Please go ahead.

Percy Panthaki I want to know the total inventory to sales and the breakup in terms of the different processes? So one is your number of days it takes you to make the product then number of days it takes you to shift it to your main warehouse. Then after that, you will put up an ad on TV etc. then after that there will be an order processing time. So till the time it actually is going out of your books, there will be a certain number of inventory days total as a percentage of sales which you have experienced in the last year or so and also the breakup of that number of days?

Sunil Agrawal Totally we expect to end this year at Rs. 200 crore of inventories against the total sales of Rs. 1200 crore.

Percy Panthaki So about 2 months of inventory approximately?

Sunil Agrawal Yes, little less than 2 months of inventory on sales basis. So at cost of goods sold, it will be higher. As far as different section, different components are concerned, we are vertical like Zara. So we manufacture about half of our product. For that, we stock up the raw material for that and then there is work in progress and then shipping time and the half we source from third party manufacturers. So there is a different time cycles for product that we source from outside and longer for in-house product sourcing. After it reaches the channels, typically channels keep about 1.5 to 2 months' worth of inventory with them.

Percy Panthaki And also since I am a little new to your business model, would you be able to explain this TV business model to me. Is it something that you have to buy airtime on different TV channels and if so what is the cost of that airtime as a percentage of your sales. Also is the sales which happens to TV, is it sort of you selling it to the TV channel on a principal to principal and then the TV channel sells it to the customer or the TV channel is just sort of conduit for you to sell directly from you to the customer. So that entire business model if you can just explain to me?

Sunil Agrawal Sure. We are B2C company and we directly sell to consumers. Sometimes people buy from us like small shops or people who would want to have home parties like Tupperware. They buy and then they hold home parties within their home but that is relatively smaller portion of business, but we sell to consumer and take money from them on credit card. So we do not have any debt from those customers except the credit card collection period of 3 days.

Percy Panthaki I wanted to know like do you have a TV channel of your own or do you have to advertise on some other TV channel and you have to buy airtime and what is the cost of that airtime, etc.?

Sunil Agrawal We lease the channels on annual basis. Some contracts are longer, but mostly are annual basis and those channels are dedicated to us for the time that we buy.

Percy Panthaki So for a particular lease period, only your products will be advertised on that channel?

Sunil Agrawal That is correct. Mostly are for full time basis, but some channels we lease on part time basis for example in Canada it is only in nighttime, but during those times only our channel would show and then it will be live broadcast to those particular customers and next point about the cost, it differs from area to area and from popularity to popularity of the particular location on the platform.

Percy Panthaki But on overall company level, what would be that cost as a percentage of your sales?

Sunil Agrawal We do not break down TV alone. So TV and web marketing all put together is approximately 20% of our sales.

Percy Panthaki And since this website is probably hosted on your own, etc., there is hardly any cost to that website. Would I be correct in assuming that the margins on the sale which happen through the web are much higher because you do not have to pay that lease cost or etc. which you have to pay for the TV channel?

Sunil Agrawal That is correct. There is no lease rent you have to pay on the web, but since our cost per household is fixed, it is not as revenue share basis. For us, if more customers buy from the same broadcast base that we have, it does not increase our cost and in long run we believe that the web is the medium that will prevail and there will be merger of the television and web. So it is our interest to continue to increase the web penetration across all the geographies.

Percy Panthaki So basically you have two margin drivers. One is if your product mix shift towards web, that product mix itself will lead to a better margin and secondly if more number of customers shop through your TV channels since your lease cost is a fixed cost, that itself will give you an operating leverage. Am I right in understanding that?

Sunil Agrawal That is perfect. Just to give you an example. Our total sales per household that we broadcast is less than $2 per household and QVC per household revenue is $55.So to your point, as we scale up per household revenue, most of the margins close to the bottom line as the fixed costs are quite stable.

Percy Panthaki And last question you gave some guidance of 30% for increase in revenues in rupee terms. Would you be able to just tell me your constant currency expectations in terms of sales growth?

Sunil Agrawal So in rupee terms only, we expect to grow 30% in H2.

Percy Panthaki But that would also be because on a y-o-y basis the rupee has depreciated and that is why part of that 30% would attribute to that currency depreciation right?

Sunil Agrawal I do not have the breakdown on the guidance, but I can give you the breakdown on what we have achieved so far. In H1FY14 to H1 last year, we increased 36% in rupee terms and 26% in dollar terms.

Moderator Thank you. The next question is from the line of Astha Jain from Hem Securities Limited. Please go ahead.

Astha Jain My question is about the interest rate. Basically as the company has exited from CDR, how much corresponding effect can be taken in the interest charges paid to the existing banks and how much it is going to impact margins going forward?

Sunil Agrawal As the debt has gone down steadily quite substantially, we do not see much impact on that anyway and if you remember in H1, the recompense that we paid to banks for all the interest forgone for the last 3 years was taken into account. So H1 already has the impact of high interest cost.

Astha Jain Again like as we have exited from CDR, so you are not expecting any hike in the interest charges going forward right?

Sunil Agrawal It will not impact margins for the guidance that we have given of 13-14% EBITDA, - the interest is after that but it is not material.

Astha Jain And other question is about your UK subsidiary as you are saying that it has accumulated losses, so you have taken that into account while calculating the tax charges I should say. Can we expect in FY15 also that UK subsidiary will continue to be in the loss making zone or we can expect a profit come back?

Sunil Agrawal UK has been profitable for last 3 years. It has not lost money in 3 years. The accumulated losses are from prior years that have not been utilized. These tax assets are still in the balance sheet.

Astha Jain So what will be the FY15 tax rate which we can expect?

Sunil Agrawal We have not calculated FY15 expected tax outgo yet. We will have to work on that because right now I am giving guidance only for the H2.

Astha Jain So 33-35% you are saying for complete FY14?

Sunil Agrawal I do not think so because UK, there would not be any taxation. US, it will be 35% and India there will be only MAT outgo. So net fixed outgo will be much lower than 33%. I do not have the data yet.

Moderator Thank you. The next question is from the line of Deepak Agarwal from Impetus Advisors. Please go ahead.

Deepak Agarwal Again on this guidance thing, this 30% revenue guidance is based on the current rupee dollar rate right?

Sunil Agrawal Yes, correct.

Deepak Agarwal And the EBITDA margin guidance; do you include FOREX gain in the EBITDA?

Sunil Agrawal 14% will exclude FOREX gain.

Moderator Thank you. The next question is from the line of Chinmaya Garg from Dron Capital. Please go ahead.

Chinmaya Garg You quantified the amount of dollar impact on sales. Can you also quantify the same amount on EBITDA margin because I am sure there will be some amount of EBITDA margin impact of the dollar appreciation or depreciation as well?

Sunil Agrawal The dollar appreciation is only on the component of Indian manufacturing where it is not as much in US and UK and also whatever the inventory benefit would have been, we do not take that into account as we had done last quarter, we have done same this quarter approximately Rs. 7.9 crore we created provision for the exchange gain that might have accrued because of inventory revaluation based on current exchange rate. So we have that reserve of Rs. 7.9 crore. So if we had taken that into account, the profit would have been more, from Rs. 44 crore, it might have been Rs. 52 crore.

Chinmaya Garg And we have created a similar round of provision in quarter 1 as such?

Sunil Agrawal We did and since we had sold that inventory in Q2, we wrote that back and created a new provision based on the average price of the product that is at the channels.

Chinmaya Garg We would have purchased something let us say in Q4 and that was sold in Q2. So that is not an inventory gain, that is an actual realized gain which you would have booked in your P&L and if you would have bought that in India or another currency which has now depreciated the EBITDA margin that you would have earned on this product would be higher right had the currency not depreciated.

Sunil Agrawal Most of the US and UK inventory is in dollar terms and we are not recognizing any end of the year inventory gain in rupee terms so there is no forex gain from those subsidiaries. But there is a forex gain from Indian subsidiary because of the labor cost and all the operational cost is still in rupees and they are getting the same dollar realization for the labor and markups. So only Indian subsidiary would have that forex gain. If there is any currency gain in terms of conversion of inward remittance into India from those foreign subsidiaries, we are not including them in our EBITDA guidance.

Chinmaya Garg That is fair, but just that our cost versus realization that difference would have simply expanded. Would that be correct to say?

Sunil Agrawal I am not sure, maybe there is some component of closing inventory in rupee. For example if we have certain rupee products sitting here, say brass inventory or silver inventory, at the end of Q2 that is converted into silver jewellery or costume jewellery and shipped to channels and then it got sold. So there would be some component of exchange gain from the end of the period inventory, but from the channel itself there is no exchange gain because everything is in dollars. We are not recognizing end of the period inventory exchange gain.

Chinmaya Garg So if I were to say that had the rupee level been same as was in March, our EBITDA would be largely be the same?

Sunil Agrawal Yes.

Moderator Thank you. The next question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta I am not clear on the CDR bit still. So you did explain the recession happened, did that mean that sales declined, you had a lot of inventory which were unsold which had to be written-off which is why you went to CDR is that what it was - the reason I am asking is just trying to gauge the risks if a recession or a similar intensity recession kind of comes through?

Sunil Agrawal Sure. Before recession happened, the TV channels that we had launched both in UK and US were kind of similar models like QVC or Home Shopping Network. Fine jewelry's average price points at $140 or so and in recession we decided that model is not going to work and then we changed our model, during that time starting December 2008, into deep discount model because we saw that the recession is going to last long term and that model has been very successful in Brick & Mortar for example Walmart has done well whether in recession or in growth. So we converted our model to deep discount, low priced product model and that has since done very well. Even the economy has continued to be slow or has recently started to take up. In both cases, that model has done well. This is our third year of growth with that model. There is third full year of proven model, profitable model that discount model has worked for us.

Avi Mehta So what happened at that time is the recession coincided with you shifting away from USD 180 to about USD 23-24 that you currently had and if that time the 180 USD could not be sold and you had to take hit on that inventory which is why the debt you had to take some interest cost that we had to extend. Is that understanding correct?

Sunil Agrawal Actually when we had raised the funding from private equity, we were confident that the funding would be sufficient to reach the critical mass for our channels, but the recession and the model was relatively higher price point and on the top of the recession, caused longer term to reach the critical mass and then I look back whether $140 price point, would we have finally made money or not. There is a hypothetical question because I do not know the answer. During that time we changed the model to a low price point model and low price point model seems to have worked for us and especially there is no other player in deep discount electronic retail in both US and UK and that also has helped us.

Avi Mehta So what triggered the CDR approach, I am still not clear. Was it inventory bit, you said that the critical mass was not able to reach with the PE funding, hence your approach it which is fair, I understand that point. But what was the thing that triggered the CDR bit. Was it the inventory which was not sold off and hence you were not able to meet interest payments.

Sunil Agrawal Debt was raised prior to recession. So it is not that we raised the debt after recession came about. So the debt was raised with the expectation that the funding that we have equity as well as debt would be sufficient for reaching the critical mass, but since it did not and we had the debt repayment schedule that we though we could not meet we went to CDR so that we do not have to pay the debt as we agreed.

Avi Mehta So you were actually not making profits then and then there was an interest cost which you obviously were not able to service. Is that this?

Sunil Agrawal Yes, that is correct.

Avi Mehta And you said that you do not do a mark-to-market on the inventory which is on the US or UK shore. So how does it work? For example if I were to just take a very basic, if something is retailing at $10, you are obviously going to put the price, or you going to bring it to the warehouse before you show it so you have not setup the price right. So will you pass that benefit from any currency depreciation to the customer?

Sunil Agrawal Usually not. The point of mark-to-market was more about revaluing that inventory into rupees. Usually Indian listed of company, we have to revalue all the assets of group subsidiaries into rupees at current rupee price. So my answer to earlier question was we do not want to value the inventory in US and UK that was purchased at 55 on 61 because it is not sold yet. We created a reserve of about Rs. 7.9 crore. That would be the difference between the actual purchased price at that time or the rupee price at the time of purchase versus now. So that data we did not add into profits and we created a reserve.

Avi Mehta So that is the way it will swing, it is like any export business in a way that would kind of swing your profitability either upward or downwards and you are showing that in the reserve also in the P&L.

Sunil Agrawal And if it goes downward we will show it, we will book it, but if is creating the profits, we will not. So this is just a conservative practice we want to practice. It is not about just India to India. It is usually India to US subsidiary that the rupee has depreciated.

Sri Burugapalli And the reason for that, just to clarify, is because of the unexpected swing on a steady state basis or a gradual depreciation basis, we probably would not resort to such conservative practices because the normal practices would be good enough, but the swing in rupee has been dramatical this last few months and we did not want that to impact our performance one way or the other.

Avi Mehta So you will keep on increasing that reserve because you will not show that in the margins, but the decline will be there in the margins that's how it is. Is my understanding correct?

Sri Burugapalli That understanding is correct and just one more thing. I know you are focused on the inventory side quite a bit which is good. Just to clarify we do not have an inventory risk so to speak. Our aged stock is extremely low almost minimal overall. The reason being we do have slightly higher inventory than we would like to have, but the reason for that is because we are vertically integrated and bigger portion of our inventory is in the raw material that is needed on the gemstone price which we choose to keep due to competitive reasons and due to market availability reasons and so on and so forth. So it is a positive thing actually that we have some of the inventory at the stone level, but at the finished good level, our inventory is quite appropriate for us and all that and when we went into CDR as well, the inventory was not the reason for anything at all. It was mainly the cash front and the profitability issue that they had.

Moderator Thank you. The next question is from the line of Deepak Agarwal from Impetus Advisors. Please go ahead.

Deepak Agarwal The employee cost has risen by Rs. 10 crore on a sequential basis this quarter and the other operating expenses also substantially jumped. So are we still continuing to invest into infrastructure like warehouses etc. and into the recruitment of management team and how long will that continue?

Sri Burugapalli The employee costs have increased. A good portion of that is proportionate to the volume increase that we have seen. Along with volume comes higher handling cost in terms of the call center, customer service and in terms of order fulfillments, labor that is needed in the warehouse and all of that. A big chunk of that is due to that. A smaller portion of that is also due to continuing investments into e-commerce teams, marketing teams mainly that is where we are focused on, merchandizing teams where we want to invest and grow our merchandizing capability significantly. Especially down the road, we would like to expand our product offerings - where someone ask the question earlier - accessory markets, there is huge potential to increase our offering. So we are preparing to improve our capabilities in those areas. Those are the two main reasons for the HR cost increase. As far as investment into infrastructure is concerned, we have invested into a new studio and warehouse facility in UK and we have already made that investment in this quarter and we have plans in the upcoming quarters to improve on our warehousing capabilities in US also. So those plans will be implemented over the next 3 to 4 quarters.

Deepak Agarwal So this volume linked cost increase into employee cost etc, so if volume dips, will this cost also go down as in you have terms or how does it happen, are these variable costs?

Sri Burugapalli These are variable costs mostly, other than the say merchandizing, marketing and e-commerce team cost. Those are the fixed costs. These would be sort of salaried employees, some of them, but on the call center, customer service and warehouse site, those costs would be variable costs which would vary with volume. Some portion of that would be fixed cost there as we do have a mixed model. We use temporary people also and we gradually roll temporary people into full time after evaluating them over a certain period after joining them and so on and so forth. After validating for all sorts, once we have seen this trend continuing for a quarter or two then we gradually roll people over.

Deepak Agarwal We mentioned that most of our contracts with channels, etc., are about a year or so, but if you look at the last annual report, it mentions about Rs. 54 crore payable beyond 5 years and Rs. 25 crore is between 1 year and 5 years, how is that?

Sri Burugapalli We have contracts anywhere from 1 year to 6 years that is the range of our contracts. So the payable that was shown based on the longer term contract that we have in couple of instances, but in last 6 quarters, general contracts that we make are one year contracts with option to renew. That is most likely contract that we try to make.

Deepak Agarwal So the longer term contract when they come for renewal, will you be renewing them for one year or will you continue to renew in for a longer period of time?

Sri Burugapalli It all depends on the opportunity that is available and also on the performance of the channel itself, how lucrative or how beneficial is it for us to extend the contract. Based on that, we try to influence the length of time. Sometimes we are successful, sometimes we are not.

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

Sunil Agrawal Thank you for taking the time out to join us on this call. I hope we have been able to answer your questions satisfactorily. If you have any further questions or would like to know more about the company, please be in touch with any of us.

Moderator Thank you. On behalf of Vaibhav Global that concludes this conference. Thank you for joining us.

- ENDS -

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