"Khadim India Limited
Q3 FY2019 Earnings Conference Call"

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Moderator: Good day ladies and gentlemen and a very warm welcome to the Khadim India Limited Q3 FY2019 Earnings Conference Call hosted by IDFC Securities Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Harit Kapoor from IDFC Securities. Thank you and over to you Sir!

Harit Kapoor: Thanks Ali. On behalf of IDFC Securities we would like to welcome the senior management of Khadim as well as everybody who is logged on, onto the call. I will now handover to Ishani, CEO to make opening comments. Ishani Over to you!

Ishani Ray: Thanks Harit. Good evening everyone. On behalf of the Board of Directors and the Management of the Company, we extend a very warm welcome to all of you to the conference call of Khadim India Limited to discuss the financial results for the Q3 of the financial year FY2018-2019.

In Q2, we faced multiple challenges due to the rise in crude prices, rupee depreciation and lower than targeted footfalls. While some of these issues persisted in Q3 as anticipated, it did not waver us from our expansion plan.

We have added 9 new retail stores and 19 distributors in this quarter. On year-to-date basis in nine months of FY2019 we have added 41 new retail stores and 73 distributors. As our brand outreach continues to grow, our total count currently stands at 794 retail outlets and 528 distributors.

On account of subdued response during festive and holiday season in Q3, the annual boost in sales was lower than expected and the pressure on margins continued. Picking up from a tough quarter last time and facing a challenging business scenario as has been an insightful and learning experience. Measures have been taken to correct the situation and get the growth backe on track.

Let me briefly discuss our financial performance during the Q3 of FY2018-2019 in the Y-o-Y term. Q3 FY2019 net revenues were seen at Rs.1764 million compared to Rs.2046 million.

Q3 FY2019 gross profit was Rs.730 million compared to Rs.772 million; however gross margin expanded by 357 basis points to 41.4%.

EBITDA went down from Rs.199 million to Rs.122 million. EBITDA margin declined from 9.8% to 7%.

With this, I would now like to open the call for question and answer session. Thank you.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Gaurav Jogani from Axis Capital. Please go ahead.

Gaurav Jogani: I had a question on bookkeeping. So while I was referring to your Q3 FY2018, I noticed EBITDA margins for retail were mentioned at 12.1%, and now in the current presentation, the base quarter's EBITDA margins are close to 13%. So is there any change, or a restatement in terms of margins?

Indrajit Chaudhuri: There has been a restatement of last year's numbers. The sales net off was not done in the presentation, which is sales minus selling expenses. So that has been done in this present quarter presentation.

Gaurav Jogani: So basically in the distribution, the sales Ind-AS adjustment has been done in this 13%?

Indrajit Chaudhuri: Yes.

Gaurav Jogani: But Sir how does the topline remains the same as what was mentioned in the last year's presentation . Is there a change in the other's business ?

Indrajit Chaudhuri: There is a change in the presentation for distribution segment numbers as well. Because in distribution segment also there are selling expenses which have been net off.

Gaurav Jogani: Sir, if you do not mind can you give me the breakup in terms of revenue for this particular quarter for the three segments?

Indrajit Chaudhuri: The retail is Rs.126.12 Crores, distribution is Rs.49.04 Crores and others are Rs.4.81 Crores. So overall total is around Rs.179 Crores.

Gaurav Jogani: And for the base quarter?

Indrajit Chaudhuri: Q3 FY2018?

Gaurav Jogani: Yes.

Indrajit Chaudhuri: For the base quarter, Q3 FY18 retail was Rs.124 Crores, distribution was Rs.47.75 Crores and others were around Rs.32 Crores.

Gaurav Jogani: we have seen pain in the retail business for the last two quarters. what measures have been taken to revise the growth in the segment?

Ishani Ray: As I have told you all before, we were initiating a district wise study.The report of first analysis indicates that shortfall or the slide in the retail growth is due to the impact on the footfall. We have already seen there was slowdown in the footfall and measures are being taken to improve it.. the report also indicates that there was low-brand visibility.Over the years, our media spend was relatively muted. So we are taking steps to increase our media spend in the next financial year, but for the time being in this quarter, we have initiated on a localized store-based marketing activities. These are generating improvement in footfall. So the first month of Q4 has faredbetter than what we had seen in the last two quarters.

Gaurav Jogani: Okay and Ma'm with regards to your distribution business , how is the competitive intensity on that front and are there any price increases due to impact of crude oil prices. So have we taken the price increase that was required? Any color on the margins there?

Ishani Ray: No, distribution business as a segment is seeing some sort of a price war. We have seen in the last quarter that the two of our key competitors have reduced their prices irrespective of the pressure on the crude. Distribution being a pricesensitive segment, we need to be in sync with what our competitors are doing. They have decreased their price twice but lately towards the end of the quarter, we have seen they have again revised their prices and retraced to half of the earlier level. So we could not take a price increase and we do not foresee taking up a price increase in this quarter as well. So whatever margin improvement will happen through operational leverage and we will see some improvement because there is some softening in the dollar and the crude rate.

Gaurav Jogani: So my question was, we have not taken any price increase despite our competitors have taken two price cuts?

Ishani Ray: Competitors have taken two price cuts. They have reduced the price so there was no pressure of increasing the price.

Gaurav Jogani: We have not responded with the price cut of our own?

Ishani Ray: No, we did not, because we were in no position to take any further price cuts.

Indrajit Chaudhuri: In retail business we have taken one measure internally. Previously the retail head was looking after both COCO and franchise business. Now we have brought in a new person who would be looking after only the franchise business and the existing person who look after only the COCO business.

Ishani Ray: This was also done because we are expanding retail across the country with about 70 to 75 retail outlets on year-on-year basis, hence it requires more focus. New geographies are getting COCO stores, which require more focus. So we thought that if we can segregate the responsiblity to two separate business heads, then both the segments will received their due focus and attention.Any benefit out of this development will be seen in the next financial year.

Gaurav Jogani: And Ma'm any comment on new product introductions or any increase in the competitive intensity?

Ishani Ray: New product introduction by the competitors?

Gaurav Jogani: Yes, so new product introduction by the competitors post the GST rate cut near our price points has impacted our sales?

Ishani Ray: I would not say there have been many new product launch by competitors but they are positioning their product differently. It is not that the product range was absolutely missing. On the price front if you ask me, on the retail segment, we have seen one of our competitors bringing in a few SKU lines which are closer to the price range in which we operate, but personally I feel that did not have much impact on our sales . I can explain further, suppose a competitor has brought in products at entry level of maybe 799 or 699, but the number of SKUs designs available at their end would be much lower than the designs and the availability that you will get at our shop. So that does not really create a meaningful impact on the sales. Sales loss that we have seen is primarily due to lack of visibility on the media.Diversion of footfall took place because there was lot of visibility for the competitors in the media this year.

Gaurav Jogani: That is all from me Madam. Thank you.

Moderator: Thank you. The next question is from the line of Pratim Roy from Stewart & Mackertich. Please go ahead.

Pratim Roy: I just have a few questions, firstly, if you can give me the data number of pairs sold in the last six months from July to December FY2018 as compared to July to December FY2017? I am asking for the last six months data because of the dip in the festive season sales can be noticed in this range on a comparable basis.

Indrajit Chaudhuri: In retail?

Pratim Roy: Yes in retail and distribution both, if you can provide Sir?>

Indrajit Chaudhuri: In retail, we have sold 62,12,000 pairs up to Q2 FY19 and whereas we had sold around 61,62,000 payers till Q2 FY18 and up to Q3 FY19 we have sold 89,17,000 pairs whereas we had sold 91,31,000 pairs up to Q3 FY18. So there is a dip in the volumes.

Pratim Roy: if we add last six months that is around 152 lakhs last yearr and this year 150, right?

Indrajit Chaudhuri: No if you only take retail it is around 61 lakh last year whereas this year it is around 59 lakhs, so there is a 2 lakh reduction in pairs sold. This is because of the reduction in the footfall.

Pratim Roy: And up to Q3, 89 lakhs as compared to 91lakhs last year right?

Indrajit Chaudhuri: But in distribution we have sold around 1,91,00,000 pairs till Q3 whereas last year we had sold 1,56,00,000 so there is a growth of volume in distribution business.

Pratim Roy: And one more question Sir what is the SSG growth and what is the footfall growth year-on-year or any degrowth. So what is the footfall conversion rate right now?

Indrajit Chaudhuri: In Foot fall there has been no growth, there is a degrowth of around 7% and if you compare the SSG growth for the last quarter, it is around 8.29% growth in value for the last quarter, and on nine month basis, it is 0.73%. So conversion has increased from 40% to 42%.

Pratim Roy: And last year it was?

Indrajit Chaudhuri: Last year, it was 40%.

Pratim Roy: Okay, 200 bps improved right?

Indrajit Chaudhuri: Yes.

Pratim Roy: Okay Sir I will come back in the queue for further questions. Thank you.

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

Sangeeta Tripathi: On the SSG front again I would want to understand for this quarter, our revenue has declined by 13.8% right?

Indrajit Chaudhuri: Yes.

Sangeeta Tripathi: And we have added nine retail stores, so how can the SSG number be positive, I was perplexed with this.

Indrajit Chaudhuri: I told COCO SSG numbers. So if you see the retail sales, they have grown 1.61%. But if we breakaway COCO and franchise, we have grown by 14%. Whereas in EBO we have degrown by 18%. So the overall growth is around 1.61%. Out of the 14% growth in COCO for this quarter, 8.29% is attributable to SSG. That is mainly because last year the pooja was in Q2 and this year it was in Q3. If you see for Q2 in COCO, SSG was around 2.5% whereas in the franchises, the growth was around 12%. Last year, primary billing of franchises happened in Q2 whereas this year it was done in Q3.

Sangeeta Tripathi: If I just combine COCO as well as franchise put together, the SSG would have been the negative trajectory right?

Indrajit Chaudhuri: Yes because the SSG growth in COCO is flat at 0.73% so there is no SSG growth in the retail segment.

Sangeeta Tripathi: Is it no growth or negative growth?

Indrajit Chaudhuri: No growth.

Sangeeta Tripathi: And secondly, we talked about the measures or the steps which we have taken to increase our media spend because the visibility is low and impact has been on the footfalls. So is this the only reason or we are also seeing some question marks or or certain areas of concern in the product profile? We have launched new retail outlets, how is the response with respect to the product per se?

Indrajit Chaudhuri: We have not seen any negative response towards the product and from this study that we have done , three is no feedback on any non-acceptance of product line. We have not launched any new product line which is completely different from what we were doing. Every year we launch our new SKU for the seasons which are spring, summer and autumn.. The feedback that we have got both from our own analysis as well as from the study is that there was no negativity on the product or the price points. The major feedback that came was lack of visibility. Even the little advertisement that we did, it did not really register in the consumer’s mind.. So that is what we are working upon. We really intend to come next year with a big bang media spend as well as maybe bring in some celebrities toendorse our products. We are working on it and it will be finalize by end of this financial year.

Moderator: Thank you. The next question is from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: Thanks for the opportunity. Madam what was the proportion of institutional order in the base and current quarter?

Indrajit Chaudhuri: In the base quarter it was around Rs.33 Crores. This quarter there were no institutional sales.

Tejas Shah: So gross margin expansion was led by?

Indrajit Chaudhuri: Gross margin expansion was seen due to no institutional sales. But overall in retail we have seen a gross margin improvement also because the sub-brand contribution is higher.

Ishani Ray: That is also another reason for improvement in the margins.

Tejas Shah: And is there any big institutional order pending in coming quarter?

Ishani Ray: We have done one and also expecting another.

Tejas Shah: Why there is such a divergence in footfalls in COCO versus FOFO because the problem statement that we are defining on brand visibility should have impacted both COCO and FOFO footfalls?

Ishani Ray: Both the SSGs are muted; for the COCO as well as the franchise are muted.

Tejas Shah: With the need to spend behind brand, how do you see margins coming along in next year or at least in coming quarters?

Ishani Ray: There would not be any negative impact on the margin primarily because the moment you spend more on your ATL activity, your marketing activities like schemes etc., comes down. So basically there would there would be some improvement in gross margin which would be offset by increase in advertisement spends. So on an overall basis, EBITDA level would be more or less similar or might see a slight improvement because of improving operational efficiency.

Tejas Shah: And lastly, one question on gross margin. We also saw one of the competitors who has published results had severe pressure on gross margin because of crude oil price-led inventory. So looking at that kind of scenario, do you think that the pricing interventions will be taken by industry at large or do you still see the kind of pressure which you saw last quarter continuing on pricing front?

Ishani Ray: I think in the distribution segment on the pricing front, the worst is over. Competitors had reduced their prices but even they realized after a point that, the price reduction is not sustainable. So they started going back to the previous price.. Their action clearly shows that maybe this continuing price war is not sustainable. So we feel that there would not be any further reduction or pressure on price. But taking a hike on the price is not immediately possible. We have to improve on our operational efficiency and improve the margins.

Moderator: Thank you. The next question is from the line of Ganesh A from ithought Financial. Please go ahead.

Ganesh A: I have a question related to the distribution and I remember in the last conference call you had said that you would increase the pricing for the distribution products because you saw the competitors increasing the prices by 2% or 3% from the first week of November. So has it happened, have we been able to increase the prices?

Ishani Ray: Yes, in the con call we had said that we would be in a position to increase the price. The feedback from the market was that the competitors would also increase the price because sustaining the crude and dollar pressure was increasingly difficult. but as I said there was a price war and in the process the competitor actually even though they could not sustain the margin pressure, there was a reduction in their price and that has clearly come out in the balance sheet numbers also.

Ganesh A: Yes, that when you said that during the first week of November they had taken a price hike.

Ishani Ray: Yes, but after that they slashed the price twice.

Ganesh A: Thank you, I will come back in queue.

Moderator: Thank you. The next question is from the line of Vishal Chopra from UTI Mutual Fund. Please go ahead.

Vishal Chopra: I think you have already clarified the institutional business, there is nothing this quarter and it was Rs.33-odd Crores last year same quarter. So based on the visibility you have what could be the quantum of institutional business in the ongoing quarter, Q4??

Indrajit Chaudhuri: We have already done Rs.15 Crores and we are expecting another Rs.15 Crores.

Vishal Chopra: And so you are saying approximately Rs.30 Crores. secondly, on the margins in the distribution business, this quarter we are at 4.5% EBITDA and nine month at 6% and as you said taking price hike in the near term is difficult. So in that case do we expect the 4.5% EBITDA margin seen in Q3 to improve going ahead?

Indrajit Chaudhuri: Yes, because the sales growth in distribution this quarter was 2.7%. So obviously going back to the 20% growth, the EBITDA margin will improve to 6%, 6.5%.

Ishani Ray: Because we will not have any additional cost whatever fixed cost that is same for both the quarters.

Vishal Chopra: So you are saying 6%, 6.5% for the current quarter correct?

Ishani Ray: Yes.

Vishal Chopra: So which will imply a similar number for the full year and next year do you think it could further improve from that level?

Indrajit Chaudhuri: Again if there is a growth in sales and if the margin remains the same since the fixed expenses are already covered there would be a growth in the EBITDA margin in distribution business.

Vishal Chopra: And last question on the margins again. So I am not sure that I was looking at the presentation and if I look at the gross margin in retail business it is up Y-o-Y 40 bps but when I look at the retail EBITDA margin it is down more than 700 bps so what has happened in the cost items.

Indrajit Chaudhuri: No, it means the margin increase is 40 bps. But there is no growth in the sales, only 1.6% , so the extra contribution that it generates not come to the EBITDA.

Vishal Chopra: So basically there is such a big negative operating leverage?

Indrajit Chaudhuri: Yes, because if the retail goes back to the SSG of 5% to 6%, that 5% sales contribution will directly add to the EBITDA.

Vishal Chopra: So if you have a 5%, 6% SSG in retail your margins will again go back to the 12%, 13% range?

Indrajit Chaudhuri: Yes.

Ishani Ray: We have seen there is a degrowth of about 6% to 7% in the footfall. So if we convert that 6% to 7% footfall to numbers and with the conversion rate of 40% our sales projection would have been achieved. The primary problem is in the footfall.

Vishal Chopra: And one question on the distribution business, this quarter your growth again has been muted in distribution but on nine month basis you have still done very healthy 19% growth. So what level of growth do you expect for the distribution business say for this year and next year full year?

Ishani Ray: See this year full year because distribution business this growth of 2% there has been some shift of sales from the Q3 to the Q4. Usually during this time of the year, we offer distributor scheme. Last year the entire scheme had ended by Q3 but this year this scheme was floated a little late, so this scheme has overflown till the month of February. So in Q4, we expect a healthy growth and by year end, we will clock a growth of around 19% to20%.

Vishal Chopra: So this quarter you are saying the distribution could see a 20% plus growth?

Ishani Ray: Yes.

Moderator: Thank you. The next question is from the line of Vismaya Agarwal from ICICI Securities. Please go ahead.

Vismaya Agarwal: Madam just had one question regarding the steps that we are taking to improve the footfalls in our stores. So you again mentioned that we will be increasing our ad spend and compensating it with lowering the consumer promotion for the schemes that we have at the stores. If I remember correctly, you always maintained that the kind of business that we are in, certain proportion of discounted sales is necessary to get footfalls in our store. So would it not be counterproductive of moving that incentive from one place to the other? Effectively this is creating another area where there will be pressure on footfalls. Can you give me a proportion of discounted sales in the nine months? It used to be in the high teens for FY2018 so a similar number for the nine month period this year?

Indrajit Chaudhuri: The nine months discounted sale is 14% at present.

Ishani Ray: And now to address your question on shifting the entire scheme cost to advertisement. We will not be shifting the entire schemes cost to advertisement, we will shift part of the scheme cost to advertisement so that we do have a bucket for offering discount during the discount seasons. If you spent on media, providing discount and marketing activities were necessary to attract footfall. Lately we have seen that competitors have shifted their stance. from giving discounts we have to make afashion statement in the media. So we need to change our tactics,have more visibility and talk of our product so that we can attract the footfalls. Particularly to attract the younger crowd so there would be a kitty for usual discount but part of the kitty will also be shifted towards advertisement. So I do not think there would be any pressure on the margin per se.

Indrajit Chaudhuri: See if the kitty of the advertisement is raised by Rs.100 then Rs.50 will come from the scheme and Rs. 50 would be compensated from the control of fixed expense in the other administrative type of expenses.

Vismaya Agarwal: I understood. Got it. Thank you so much.

Moderator: Thank you. The next question is from the line of Pratim Roy from Stewart & Mackertich. Please go ahead.

Pratim Roy: Madam this quarter if you compare that other income and employee expense is much more higher side and in the opening remarks you have mentioned that there is a low visibility of your brand. Can you please give a breaup of the increased other expenses which have shrunk our EBITDA margin?

Indrajit Chaudhuri: Other expense detail can be share to you offline.

Pratim Roy: Okay and ideally it is mainly driven by the advertisement expense right?

Indrajit Chaudhuri: we can take that question offline.

Pratim Roy: Okay and one more question, is there any price hike that you have taken in your retail segment?

Indrajit Chaudhuri: when we launch new product there is a new MPR. we have seen there is a growth of ASPL of around 5% this year.

Pratim Roy: By when can we regain EBITDA margins which we enjoyed at the time of our listing?

Indrajit Chaudhuri: If the SSG growth comes back to 5% to 6% will definitely reach the figure that we have attained in FY2018 and FY2017.

Pratim Roy: Thank you Sir. Best of luck.

Moderator: Thank you. The next question is from the line of Keyur Shah from Emkay Global. Please go ahead.

Keyur Shah: You mentioned that you will be incurring higher media expense. So do you have any number in mind for next year?

Ishani Ray: We are working on it. We will come back to you once we freeze it.

Keyur Shah: And any guidance on new stores to be opened in the next quarter and next year?

Indrajit Chaudhuri: This year we have already opened around 40 to 45 stores. So we will be closing at 60 stores and next year we will work with the same target .

Keyur Shah: And what would be the geographical mix?

Ishani Ray: See most of the new stores that we open till date we are focusing on geographies outside east. So that focus will continue. We will be opening more in the southern market and the western market.

Keyur Shah: Okay so can you distribute how much percentage or how many stores.

Ishani Ray: See after 60 stores that we have said around 20, 22 would be COCOs. So out of the COCOs maybe 3, 4 COCO's can be in the east, but the rest about 15, 16 would be in south and west and to some extent north. about 60% to 70% of the Franchise outlets would be in other geographies and balance 20% in the eastern part of the country.

Keyur Shah: Okay thank you. That is it.

Moderator: Thank you. The next question is from the line of Jignesh Makwana from Asian Market Securities. Please go ahead.

Jignesh Makwana: I just missed the number of SSG growth. If you can repeat for COCO and franchise for this particular quarter?

Indrajit Chaudhuri: The COCO SSG growth for this quarter is 8.29% and the overall year is 0.73%, the SSG growth for franchise is around 6% this quarter and the overall SSG growth of franchise is 0%.

Jignesh Makwana: But our retail sales growth is somewhere around 1.6%. Am I missing somewhere around that part?

Indrajit Chaudhuri: Primary SSG for FOFO is degrown in this quarter ,the COCO has grown 14% whereas EBO has degrown by 18%. So the overall growth is 1.61% because in the second quarter the EBO has grown by 13% whereas the COCO has grown by 2.5%. last year the pooja was in the Q2 and EBO billing was done in the Q2. So the Q2 the sale was high and this quarter since the festive sale to SSG was down so their lifting has reduced.

Jignesh Makwana: And how is the retail performance in the non-east like South India and west zone where we are relatively new.

Indrajit Chaudhuri: See the SSG growth for across the country is muted.

Jignesh Makwana: have we seen better growth in the western market?

Indrajit Chaudhuri: New stores were added in the western region. So total growth in COs for the nine months is 7.5% and that in the western region is around 12% to 13%. But SSG growth for all the stores, for all regions is muted because everywhere the footfall has come down.

Jignesh Makwana: Okay. Thank you.

Moderator: Thank you. We will take the last question from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor: Just wanted to get a sense about how you are seeing FY2020 in terms of distribution growth. If you are going to continue to grow at over 20% what will be the kind of key drivers of this, will it be new product, will it be dealer expansion? How do you see that for FY2020?

Ishani Ray: We do expect to grow at a 20% plus sort of a rate in 2020 also and the key drivers would be dealer expansion .consolidating in home ground of Eastern market., We are still working on the few aspects, but we expect to come out with newer product in the few lines.

Harit Kapoor: Super, okay. That is it from me. Ali any more question on the queue.

Moderator: No Sir, there are no further questions in queue.

Harit Kapoor: So I will close it from here, on behalf of IDFC again I would like to thank the management and all the participants on the call for taking out time. Ishani any closing remarks, I will hand it over to you please.

Ishani Ray: Thank you to everyone for giving us a patient hearing and we hope to come back with a bang next year. So just expecting that to happen and thank you for being with us.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of IDFC Securities Limited that concludes this conference call for today. Thank you for joining us. You may now disconnect your lines.