"Titan Company Limited Q3 FY20 Results Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Titan Company Limited Q3 FY20 Earnings Conference Call. As a reminder, all participants' 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 the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. I now hand the conference over to Mr. C K Venkataraman -- Managing Director of Titan Company Limited. Thank you and over to you, sir.

C K Venkataraman: Thank you. Good evening all of you. It is wonderful to see so many of you on the call. Before I share highlights of the quarter, I would like to quickly call out people who are with me this side; Ravi - CEO of the Watches and Wearables Division; Ajoy Chawla - CEO of Jewellery Division; Saumen Bhaumik - newly become CEO of the Eyewear Division; Suparna Mitra - Chief Sales and Marketing Officer of the Watches and Wearables Division; Rajeshwari Srinivasan - Chief Operating Officer, Taneira; Manish Gupta - Chief Operating Officer, Fragrances & Accessories; and of course, Subbu - CFO; Nandu his Deputy; and we have Ramachandran, Pulkit and Govind from the Finance Department; and Rajnarayan - our Chief Human Resources Officer. So welcome to the call.

Once again, it has been quite a satisfactory quarter. If we were to look at the retail sales slide, which is Page #42, you can see the performance in the quarter for the main formats of the company, World of Titan, Helios, CaratLane, Tanishq, all these formats grew in retail sales YoY better compared to Q2 and H1 of FY20 and in line and slightly in excess of the estimates that we had declared on the last call. So, from what we read about the competitive performance particularly in Jewellery and Watches, we are clear that we are continuing to gain ground and market share. Our assessment is that compared to our 16% growth of Tanishq. By and large the industry was in high single-digits or maybe worse, double-digit decline, which confirms our continuing trend in market share gain in this situation. And even in the Watch business, the performance has been very similar. We are sort of ruling the roost in the department stores with the Titan brand. The toughest environment with all the international brands that you can name fighting neck-to-neck with Titan, and Titan emerging well deservedly at the top. So, overall the retail sales growth performance was very good. The primary sales growth was little muted relatively speaking in the Jewellery business. We had a base effect in terms of a large institutional order of coins in FY19, and that was like-to-like situation for FY20. In the Watch business, we had some pressures on the trade side of the business which of course finally caught up back in the month of January.

So, the results take into account all these and overall we are reasonably satisfied with our performance. And I have nothing more at the moment to add to individual businesses. I think the CEOs are here, and we can start the Q&A and then I will come in appropriately as and when. Thank you very much.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: My first question is on Taneira. So, on a base of seven stores, you added three stores this quarter and you have expanded to new cities, Pune, Mumbai in the last two quarters. So my questions are, how is the sales per sq.ft. in this format, and what is the gross margin and EBITDA margin on a longer-term basis? And are you also looking at departmental stores in terms of the brand because you do operate in most of your businesses in the departmental stores, so will this brand also be taken into that in the medium, long-term?

C K Venkataraman: Abneesh, full marks to you on totally surprising us with the first question. But it is a great thing that you are asking a question about Taneira which is going to be a big, big bet for us in the future. Yes, the customer value proposition of Taneira has been very-very squarely built. We are very convinced about the differentiation that we have brought into this unorganized kind of market with the national brand and a national chain. And the metrics that you are talking about, gross margin, sales per sq.ft., stock turn and all that are currently in our focus. Our emphasis in the next one or two years is going to be actually building acceptable levels of gross margin, acceptable levels of sales per sq.ft. so that franchising becomes a viable, exclusive way of growth and thereby we can gallop towards FY25. So, at the moment, I am not in a position to share information on gross margin sales per sq.ft. or EBITDA in any case is academic at the moment, it is a start-up business.

Abneesh Roy: But sir one follow-up. In terms of expansion plan at least you now go aggressive because two quarters itself I think five stores have been added. At least that bit of confidence has come?

C K Venkataraman: Yes-yes, we are very confident. The reason why we set up those stores is we wanted a certain kind of coverage of the country in terms of cultures and catchments and all that so that we can build the business in a proper manner. So, we are going to take FY21 to do that, and thereafter actually take it into an explosive growth of expansion. So we have now high streets, some villas, some mall stores. So, we have a good mix of formats, regions and cultures for us to now sort of fix all the operating parameters for building the growth thereafter.

Abneesh Roy: My second and last question is on the Jewellery business. When I see the like-to-like growth, Tanishq and CaratLane has seen very different kind of a movement. So Tanishq the like-to-like growth has actually accelerated this quarter versus the first six months. So, nine months is 7% and this quarter is 9% in terms of like-to-like growth. CaratLane, there is a significant slowdown from 23% for the nine months, it is only 14% in this quarter. So why this divergence is there? And in CaratLane why there is a bigger slowdown compared to Tanishq?

C K Venkataraman: Actually, CaratLane has got a two-pronged approach, Abneesh; one is the retail store and what you see here is a retail store. CaratLane also has a big online business and the online growth continues unabated. So, I would not go so much by one particular quarter here. I would like to see more a secular aspect here. If you look at a like-to-like growth of 23% for nine months, it is a very-very handsome growth in any business today. And I would look at it rather than wonder why 14% happened versus Tanishq being better and all that. That 9% is anywhere lower than the 14% of CaratLane. So, to that extent, it does not matter so much.

Abneesh Roy: One last follow-up. So Q4 marriage dates look good and base also turns quite favorable for the Jewellery business, just 21% Vs 36% in Q3. So, any comment on Q4 and how you are seeing FY21, I know guidance you may give a bit later, but any sense on FY21 based on qualitative?

Ajoy Chawla: This is Ajoy Chawla, CEO of the Jewellery business. So, yes, Q4, the marriage dates are good and the outlook continues to be good, but also volatile. We see opportunities for market share gains continuing in Q4 for us. In terms of outlook for the quarter, we are staying with the earlier guidance that we gave between 11% to 13% is the kind of growth that we are expecting to hit for this quarter. FY21 we would like to come back to you in May once we have kind of assessed the market even better. We are still in the process.

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

Avi Mehta: First question is on the watch segment. I wanted to just understand, has this weakness that you have seen in the watch segment kind of come off now because you said something about the trade channel now getting into the base in January. And if that is the case would you now reiterate that double-digit sales growth guidance that you had shared in the last quarter? The second is also the expectation of the Watch margins, if you could share that as well.

Ravi Kant: Overall growth in January has been good. See, the trade channel is still under pressure in terms of the liquidity crunch, in terms of stocks with the distributors. So it has not eased out completely and it will take I think the next two, three months for the trade channel to ease out and that is the largest channel for us. Retail, as you know, has done pretty well. So overall January has been a much better month than December. If you look at the last quarter, October, November was very good for us, it was only December which was not as good. So overall Q3 results, we are good on the retail front as we said earlier.

Avi Mehta: And the margin side, how should we see that given what the trade weakness that you are kind of alluding to?

Ravi Kant: This quarter is low on account of various reasons and it is down to 8%, but I think we hope to end the year where we want it to and where it has been so far. So Q4 will not be like Q3.

Avi Mehta: So you mean yearly it should be at least flattish, I mean, from an annual basis, that is quarterly only, but yearly?

Ravi Kant: We hope it will be comparable or slightly better than last year.

Avi Mehta: Sir, second bit was on the Jewellery margin, sir. If you could help clarify or kind of explain what is this channel mix impact that you alluded to and which you have highlighted and how should we look at margins as we trend forward given that the channel mix typically kind of improve in the next quarter?

Ajoy Chawla: With regard to channel mix, we have three different channels -- L1, L2, L3. L1 are company-made stores, company inventory, L2 are company inventory, but franchisee managed and L3 are inventory and management by franchisee. So, we have been seeing higher growth in the L2 as well as L3 which is the franchise stores. Many of these franchise stores are also in smaller towns and we have also expanded in many towns. So, we have been seeing higher growth there. And the management commission that you see is moving directly to the L2 stores which is showing a higher growth than our overall growth, and therefore, the channel mix is accounted for that difference. In terms of the operating margin, I think Q4, yes, traditionally has been a better operating margin. Thanks to the studded mix being higher, and we expect that to continue like previous years and therefore it should be a better operating margin hopefully in the Q4.

Avi Mehta: Given that L2 has seen stronger growth rate versus L3, does that in any way result in higher working capital as well for the company given that we are or no, it does not?

Ajoy Chawla: So L2 and L3 both have seen good growth compared to L1. I think working capital, yes, is a function of our inventory in L1 and L2 stores, and that is also a function of both the gold rate as well as the absolute tonnage of gold that we are seeing, because gold rate has been volatile and going up, that has also been taking up our working capital.

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

Manoj Menon: The first question is actually on the expansion in the Tanishq part of the portfolio. So, just trying to understand given that we have seen a good expansion, it was a relatively muted 1H and then suddenly we have seen an acceleration. Just sort of thought process not for the next quarter, little ahead of that, how do I think about expansion in general, just not trying to get a number for FY21, but whether it is number of cities or square feet or kind of, any directional comment would be very helpful?

Ajoy Chawla: So, expansion has been a good growth driver for us and we have seen very good results over the last couple of years. So, like this year we are continuing to put pressure on expansion. In fact, we are not letting the foot off the pedal because we see the opportunity continuing and delivering good result. So directionally like we have pushed hard this year, we will continue to push hard next year in terms of number of stores that we add or square footage or even towns. In fact, we are looking at adding many more towns next year, and that is the thrust of our expansion.

Manoj Menon: Second question is actually one on the mix and second on the margin levers. The first sub-question is on the mix part of it. Is it fair to say that they have actually seen somewhat deterioration in the gold mix?

Ajoy Chawla: I would not say that. Q3, we saw a better studded ratio, but I cannot say that because even if I look at January month, we are seeing a good resurgence in gold. It is difficult to predict because the two segments are kind of behaving independent of each other, they are not kind of linked. So, we are seeing a lot more people come into the market despite a studded activation on at this point in time. We are actually seeing a good traction on plain gold both the non-bridal or bridal as well as gold coin. So, it is difficult to predict. So, we are independently targeting the respective segments and the mix and the studded ratio that emerges is an outcome.

Manoj Menon: No, I am actually not referring to the studded part of it at all, I am only referring to the gold part of it because the grammage let us say for the quarter is (-5), revenue is 11 and as per the presentation Page #51, the price is (+19, 20). So when I add everything together, it does appear that there is a gold mix deterioration. I know it is Q1 FY'20. The reason I ask this because there is another trend, which you have seen in the past that when gold prices are essentially higher, consumer tend to move up from gold to studded itself. So, I am just trying to understand within gold, the mix part of it?

Ajoy Chawla: Sure, there is a grammage drop, but I think that is a lot to do with customers having a certain budget in mind when they are coming into buy. So, they do tend to downtrade on grammage when gold prices are up.

Manoj Menon: So basically, nothing material to call out in terms of any consumer behavior within gold which impacts the gold mix without taking the studded at all?

Ajoy Chawla: No, nothing, I would not...

Manoj Menon: Last one on the margins. Some statistics would be helpful in terms of let us say what is the percentages of exchanges or rather exchange gold which you have currently, and what are you aspiring that number to be in the medium-term? And secondly, one conceptual question which has got sort of a linkage to your margins is that if in a scenario of some stability in gold prices and let us say volumes for the competition comes back, is it fair to assume that because a lot of the jewelers actually do not hedge and they are actually sitting on a lot of inventory gain, would increase their ability to actually increase discounts versus you who is a 100% hedged operator?

Ajoy Chawla: So two questions. Let me answer the first one. You wanted to understand what is the contribution of exchange gold. We are seeing continued good response on exchange gold, we are seeing good growth. Gold exchange now is… I am excluding the Tanishq exchanges, old gold exchange is now sitting at 33% contribution for the year and you can add up another 9% which comes from the Tanishq exchange. So, we are seeing a growing trend of exchange gold. The second question that you asked was about whether competition because they are sitting on higher value of inventory. See, the offers are on continuously even now because the market is really down, single or even high single-digit or double-digit decline. So, the market and competitive situation is pretty aggressive. There are constant offers even now as we speak because of the wedding season, etc., there are significant offers in the market. So, one is unable to make out whether it is because of the gold that they are sitting on or because of the need to clock-in some growth. Having said that, our understanding on the ground is that several local players, regional and smaller unorganized players are facing a significant liquidity crunch and therefore freshness of merchandise in their stores is a concern. So, to that extent, it has its impact for them in terms of the capital that has gone up and liquidity crunch that they may be facing.

Manoj Menon: Just to confirm, on this comment about exchanges, so that is 33% plus 9%, 42%, so that's the share of exchange gold in the overall portfolio is largely the same, right, it has not really gone up or down?

Ajoy Chawla: Not significantly in this quarter, maybe one percentage point.

Moderator: Thank you. The next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.

Arnab Mitra: My first question was on the Jewellery margins. Is there any inventory gain or hedging related gains in the quarter given that the gold prices moved up very sharply towards the end of the quarter?

Ajoy Chawla: Hardly anything compared to last year, etc., Within the quarter, there have been some swings, but for the quarter as a whole it has not been anything material.

Arnab Mitra: Just one question on the margins again. Before last two years, your third quarter margins in jewellery were always below the second quarter because third quarter has low studded share. Now in the last two years, this year and the previous year, we are seeing that trend reverse in the third quarter being much higher than the second quarter. Anything specifically which has led to this despite the fact that the studded shares are much lower in the third quarter?

Ajoy Chawla: Overall, in this quarter, I can say that we have kind of held a tight control over the discount payout that has helped, and we have also actually held a tight leash on costs. So consequently, we are seeing a better kind of margin performance than Q2. Q2 also had a challenge in terms of growth. So that impacted the overall EBIT margin.

Arnab Mitra: My last question was on the demand environment. I think alluded that December had seen a bit of a softness. Was that largely to do with the increase in gold prices towards end of December? And unlike in let us say July period when that softness lasted for a while because gold had moved up, have you seen a better recovery in January after that gold price moved up?

Ajoy Chawla: So yes, December was a softer demand if I were to kind of disaggregate growth while we are seeing a 15% growth for the Q3, we saw 20% growth if you look at October, November, and there was a 4% growth in December. Unable to say whether it was due to the gold price surge towards the end. But, we did have an offer which kind of ended on 16th of December and thereafter we saw a drop in growth or in fact that is how the growth came down. In Jan per se the first week we saw a surge in gold prices, and that did impact walk-ins and overall demand. In Jan itself, demand has clocked back in the moment. We started our activation a week later this year. Therefore, in the month of Jan, the first week was soft, thereafter, it has been quite good.

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

Tejas Shah: Last quarter, we were saying that bulk of custom duty related inventory gains will show up in this quarter. So, anything you would like to call out in terms of margins?

S Subramaniam: We did have some custom duty gains, but that sort of featuring out at this point in time, but yes, between the second quarter and the third quarter, we have had reasonable gains. Let me also clarify one other thing. In a way, a year before, we did have a lot of contango gains which we are not getting now. The amounts that we got this time may be comparable to what we otherwise got last year in the contango part, because we were able to hedge outside India which is not happening now. So...

Tejas Shah: So, the gross margins are...?

S Subramaniam: Therefore, they are comparable from that perspective.

Tejas Shah: Contribution of GHS this quarter. How much was that?

C K Venkataraman: I do not have the quarter, but I know the GHS contribution for the year, sales through GHS stands at 21%. I do not have the figure on the quarter right now, but let me see if I can pull it out and share with you later.

Tejas Shah: Lastly, what you spoke about demand trend being relatively better in non-urban centers. Now if we compare with other consumer sector results so far this quarter, the trend is slightly reversed. Basically, urban centers are showing relatively better demand robustness versus the non-urban. So, is there any wedding-related uptick which you are seeing in the centers and the non-discretionary or the discretionary part of the demand is still subdued even in urban and in the centers?

Ajoy Chawla: Let me kind of correct that a bit. It is not about urban and non-urban. We are seeing differential performance across different cities and regions; we have seen a higher growth in the east and in the south whereas demand has been soft in the north and the west. I would not really call it urban or non-urban. The smaller towns because the base is low and it is the newer set of stores, we will tend to show higher growth, but they also contribute a lesser amount.

C K Venkataraman: Also, one other perspective on this is that more and more of the stores that are opening each year are L2s. So, when the stores of FY19 do a full 12-months in FY20, the L2 channel base gets that additional kick in and therefore it shows a 22% growth for example as opposed to the L1.

Moderator: Thank you. The next question is from the line of Jay Gandhi from HDFC Securities. Please go ahead.

Jay Gandhi: Just wanted to understand this so if you can help me navigate through the surge in construct. If gold exchange goes up, does the capital base also increase? And if it does, is my understanding correct that the upselling opportunity that it presents and its trickledown effect on EBITDA, helps you more or less manage your ROC on the exchange product. But if your upselling opportunity is significantly lower than you envisage, the capital base will keep on increasing, but you will not get the throughput value?

S Subramaniam: So, let me just explain this part. The way you have to look at exchange gold is second to buying gold on spot. It means that the capital employed would be higher if we were to buy gold on exchange. But as you know we have been using exchange as a customer acquisition tool for quite some time and there is an inherent upsell which happens which is very significant, in excess of 50% to 60%, every time we do an exchange. So exchange helps us actually getting customers and while it does increase the denominator which is the capital employed and possibly to some extent the cost of buying gold because the offers that we give are very attractive these days, it is a customer acquisition program, and therefore while the ROC might be slightly greater, EBIT could be much better if we do better on the margins and profitability. So in a way, we have not really seen much of an impact on ROCE because of this. Having said that, if we were to see what happened this last quarter where we have actually reduced gold purchases substantially, and most of the gold that we have acquired has been on exchange, then to some extent, you may see some impact on ROCE temporarily. But so long as we keep buying gold on lead to the extent of 50%-60% of the total gold that we buy, I think ROCE overall will be in the ballpark that we are now.

Jay Gandhi: So basically, you are banking on that cross-selling opportunity being significantly higher, that 50%, 60% upside that we have. But what is the 50%, 60%, a), either structuring comes off or b), just because of the trying external environment comes off, unfortunately, ROC shrink maybe for the time-being?

C K Venkataraman: One answer to that is, there is a certain level of attractiveness of the exchange that makes for customers to come to us and therefore the share to be at 40%. Hypothetically, supposing where it could go to 80%, your question is, the balance sheet will change, the capital employed will increase substantially and the ROC may fall for the same level of sale. Obviously, that 80 would not happen all of a sudden, we are at 40 today. And therefore, we will need to judge the difference between what to do saying that the EBIT expansion opportunities that is sitting and the extra sales that comes with exchange and the consequent bloating of the capital employed and therefore is it worth doing? So I guess, if it is not worth doing, we can always change the pricing of the exchange and sort of put a way impediment to the people who are more value-seeking to…. That is just a thought off the cuff I am just saying, but that is how I would look at it if it was happening.

Jay Gandhi: The other thing is you help us understand how much is the exchange Gold Plus? How much would be gold on lease for the year or 3Q?

S Subramaniam: For the quarter, gold on lease has tactically been single digit because we really clamped down an inventory purchase because of our shortfall in sales from our internal target, we were running at a much higher level by September, but we brought down the inventory levels very sharply by December. So from an overall quantity perspective, we are actually well within what it was in the year before or for that matter even what it was in March. So, we have done very well on that part. But what it has done is that we have therefore not bought any gold on lease. That is the impact. But going forward as we start buying more gold, you will find more of that coming out.

Jay Gandhi: How much would be the wedding contribution to our sales number?

Ajoy Chawla: Wedding contribution is 23% for the year currently. On the other question that you asked about gold on lease purchase, for the year we are at around 36% of our procurement.

Moderator: Thank you. The next question is from the line of Amit Sachdeva from HSBC. Please go ahead.

Amit Sachdeva: One question, obviously, like Venkat would always talk about how the January has been. So, how the studded promotion is tracking till date, I mean, if you can give us some guidance how the January shaped out?

Ajoy Chawla: Hi Amit! Ajoy here. January has begun a little slow for us as I was sharing in an earlier question; the first week, there were two things; one was the gold price shot up and thereafter it stabilized; second bit is we started our activation a week later, we started on the 8th. So, we had a good initial preview and the activation is tracking well. For the month of Jan, our overall growth is soft at 8%, but we are not too worried about it because we can see that the activation traction has picked up well, and we will cover up in the rest of the 1, 1.5-months or so that we would be running this activation. So, our overall guidance for Q4 continues to be similar to what we shared last time between 11% to 13%.

Amit Sachdeva: But if I am correct, 11% to 13%, Ajoy, was a guidance for the full half and you already done 11% on a very high base. So, I would assume that when you gave a guidance of 11% to 13% for the full second half which maybe the guidance implied Q4 to be 15% rather than 11% to 13. Are you sort of being less confident about that kind of number or that we misunderstood last time?

Ajoy Chawla: No, I am not being less confident of the number. Q3 certainly was a high base and we also had institution sale in Q3. So, while we are showing 15% growth in retail, we actually have 11%

growth on NSV. For Q4, as I said, one, Jan has been soft… the first week was soft, and last year, in March, we had a fabulous sell. So, the base was very-very high last year in March. Definitely, the base effect is playing a role and we think we should be in that ballpark even in Q4, we are at 8% right now.

Amit Sachdeva: Ajoy, the second bit on expansion. Basically, it is a great expansion of about 34, 35-stores till date and that is evident that push will continue. What comes to my mind is that as you sort of roll out and I assume that Tier-2, Tier-3 town are the focus area where marginal area is coming. So, do you see some sort of effect where Tier-2, Tier-3 towns as they open, it might weigh on the growth of nearby town which might be the feeder towns earlier for those towns, and do you see some effect of cannibalization happening, do you see some conflict in the channel which is weighing or is it something that its planning is so judicious that it is not impacting any of your channel partners, your marginal expansion?

Ajoy Chawla: Actually, we are expanding both in Tier-2, Tier-3 towns as well as in certain cities where we see opportunities and catchments. So, the expansion is going on. And yes, we do look at what is the potential cannibalization and what is the overall growth. So far what we have seen is that some of the new stores are even exceeding the number that were planned. And no, we have not seen any significant impact in terms of cannibalization even within the city or even nearby cities. So, the opportunity seems to be quite independently high.

C K Venkataraman: When we do the actual expansion decision, Amit, what we do is, for example, we are opening a store in Kondapur in Hyderabad and the opportunity in Kondapur is let us say Rs.50 crores and the contribution of people who live in Kondapur to the other stores of Hyderabad is 10%, and that is Rs.5 or Rs.7 crores let us say the stores which are of that part, in which case, the Rs.50 crores additional that we are going to get in Kondapur versus the Rs.6 or Rs.7 crores that we are going to lose as a result of cannibalization tells us that net-net it is worth setting up a store in Kondapur. And the same thing works for every new town as well because the new towns are typically contributing to an existing larger town nearby, and we look at the sale of that and therefore, the likely loss of that and effect net of the new store sale.

Amit Sachdeva: So, in that sense that your other franchisees who are existing, they are sort of still taken care of from ROI perspective I assume and there is no...?

C K Venkataraman: We are on a continuous distribution. They would come to know that we are setting up a store in a nearby town. It is likely to have an effect on them. They also know it is part of the business. We are setting up the store also in some cases.

Amit Sachdeva: One last slightly longer way of thinking. As you obviously think about India is obviously a large opportunity where expansion, penetration-led and market share gain opportunities are evident. What I also think is that now the eCommerce channel is evolving well for you through CaratLane and also, there are some large markets like, say US or China or nearby, now the barrier to entry in those markets I assume is broken in terms of there is an eCommerce channel which is very developed in this market. Have you been able to think through that there should be an operating model Tanishq being a brand now which is well-known, why should not Tanishq be in the US through an eCommerce channel especially in the SKUs that they would like to have and there is a price advantage you can have relative to some other renowned jewelers there. Is there any thought process of international expansion beyond the Middle East that you had envisaged so far?

C K Venkataraman: Yes, very much of that nature. We have formed an international business division about a few months back, bringing all the businesses under that. And in fact, even before that the Watches division had already started selling through amazon.com, Titan watches in the US and with reasonable success. And now the IBD is seriously evaluating what you mentioned which is taking Tanishq, CaratLane, Mia and even Zoya to international customers and in the US particularly. And these all are at exploratory stage.

Ajoy Chawla: If I may add, CaratLane has seen some good initial traction on international orders and shipments.

Amit Sachdeva: Is there any contribution number from CaratLane or it is too early to sort of quantify anything?

AjoyChawla: Too early.

Moderator: Thank you. The next question is from the line of Harit from Investec. Please go ahead.

Harit: This is Harit from Investec. So, the question was largely on the gold price increase. In the past, we have seen that the sharp increase in gold price also gives ammunition to some of the regional and smaller jewelers to kind of take advantage of in terms of higher promotions because they do take a call on gold versus us, here we are obviously hedged. Just wanted your sense on how you have seen the environment. I know you have gained lot of market share. But over the last few months, any sign that the promotional intensity would have increased from there end as they have got a little bit of a so-called ease of life because of some extra money because of the higher gold?

Ajoy Chawla: I shared this in response to another question along similar lines. Competitive intensity has been going up because overall the market has seen decline and therefore every player would like to gain as much share as possible. It is very difficult to figure out now whether it is because of them sitting on a gold price gain or generally because they would like to gain share. So overall even as we speak competitive intensity in terms of promotions and offers are pretty high. As I also mentioned earlier, because of this gold price increase, there is a pressure on capital employed even for jewelers and their ability to bring in freshness in merchandise, especially the unorganized players have got impacted. So, there is both sides of the effect sitting there.

Moderator: Thank you. The next question is from the line of Gaurav Jogani from Axis Capital. Please go ahead.

Gaurav Jogani: Question is with regards to what kind of margins can we build in the Jewellery segment for FY21 given the scenario that the higher gold prices and also the fact that the number of wedding days in the FY21 would be lesser?

C K Venkataraman: We will talk about this in May, Gaurav.

Moderator: Thank you. The next question is from the line of Kunal Vora from BNP Paribas. Please go ahead.

Kunal Vora: As hallmarking becomes mandatory starting next year, how would it impact the industry -- will it have different impact in metros versus Tier-2, Tier-3 towns and will you need to make any investments for that?

Ajoy Chawla: So, it is still early days to gauge a full assessment on that. While we welcome this move, actually it is very good because it tries to make a level playing field for everyone. Currently, the quality of hallmarking center, there is a question around that and therefore there is significant effort by the government to try and both increase the number as well as enhance the quality of these hallmark. They are certainly much lesser than what would be required. So certainly, in smaller towns, there is going to be more pressure. In terms of investments, no, we do not have to invest anything. In fact, technically, we cannot invest in any hallmarking. It has to be completely arm's length and independent. But we are looking at enabling certain good quality players to ensure that they set up some kind of dedicated facilities for us so that logistically we are well covered. And we are pretty much aware on the ball in terms of preparing ourselves for ensuring that there is a smooth transition. There will be a certain cost which is involved in hallmarking, but that is true for everybody, and in a way it would impact very marginal level in terms of pricing.

C K Venkataraman: Just one statistic on this. When Tanishq was launched in 1996, around that time, other people's gold that we used to exchange was around 19 carats. Now 24-years later, it is still only 20-carats, around 20.1 or something like that. And this varies across the country but not significantly. In the south, it is better which means that the caratage that jewelers are typically used to making and selling is of that order as an aggregate. Obviously, there are many jewelers who are selling 22 carat also. What this would mean is for them to conform to the new administration of purity. They will have to raise their purity, they will have to incur that cost, they will have raise their prices and that would have a beneficial advantage to the organized sector, all those players who are currently offering 22 carat.

Kunal Vora: Would there be a bigger opportunity for you in smaller towns compared to metros or you think the quality issues could be consistent across unorganized?

C K Venkataraman: You are right. It becomes worse in many of the small towns maybe 19, 19.5 carat for the exchange.

Kunal Vora: What will be the mix of L1, L2, L3 now? I think you mentioned L2 is what is driving the expansion, right…number of stores as well as like sales.

Ajoy Chawla: By sale it is still about a third each. The numbers have gone up in L2 and L3. We will get back to you with an exact split. Do not have it right away.

Moderator: Thank you. The next question is from the line of Sabyasachi Mukerji from Centrum Portfolio. Please go ahead.

Sabyasachi Mukerji: You mentioned that going ahead L2 store expansion will be at a faster pace and Q3 EBIT margin drop was kind of attributed to a higher commission paid for the L2 agent commission. So going ahead, do you expect margin pressure because L2 addition would be at a faster pace?

C K Venkataraman: I will just follow-up a sequence of thinking here. One is that our expansion will come more and more from small towns and small towns means franchisees, not companies, that is point #1. And we are realizing that at the cost of borrowing that we have and the control that we want to have on inventory and L2 makes more sense than L3 from a financial as well as an operating advantage point of view, and therefore, maybe 80% of our expansion of franchises is L2 and 20 only is L3 because of these reasons. The point in the Q3 is among many things, one thing is the L2 commission growing faster than sales. But that was in a quarter where the sales did not grow much, whereas in a quarter where sales grow and even if L2 grows at 22% it may not matter. So, it is not having a bearing on the EBIT margin profile of the business.

Sabyasachi Mukerji: So, this commission paid to these franchisees is based on sales or it is on something?

C K Venkataraman: Earlier, it used to come above reported income. As a franchisee, an L3 and L2 are actually performing the same service for the company to the customer and earlier we used to report the commission on sales to L2 as well as commission on sales to L3 above the net sales value. Under IND AS, it has come down. Otherwise, you would not even have seen it, it would have just gone.

Sabyasachi Mukerji: And now this is reflected in other expenses?

C K Venkataraman: Sales overheads I think. That channel has grown 22%, so the commission has also grown 22%. The L3 and L1 have grown at a lower rate and L2 has grown at 22%, the net being roughly half of that. So, in this quarter, it shows up like that because of that difference.

Sabyasachi Mukerji: So L2 grew at 22% and the blended is around 11% and the other two is less than?

C K Venkataraman: Also, like I explained, in this year the annualizing of the new L2s also has this impact. It is not as if like-to-like L2s have grown at 22%. It is the like-to-like situation here and that may not repeat every year because the base is maybe much bigger and smaller and so on.

Sabyasachi Mukerji: One more thing on the EBIT margins. Actually, I was going through the presentation. If I look at the segments, be it Jewellery, be it Watch and Eyewear, if compare YoY the EBIT margin on each segment we see drop 20, 30 basis points here and there. But when I look at standalone or consol, the EBIT margins are higher. What am I missing here?

S Subramaniam: I think we had the IL&FS thing last year if you remember. We made a provision of Rs.70 crores for the quarter. Not actually like-to-like. They are not in the division. they would be in corporate.

C K Venkataraman: It sort of a negative, is the positive.

S Subramaniam: Yes, yes, that is the difference. We have one-off this time as well, but the IL&FS one was much...

Sabyasachi Mukerji: One last thing on the comparable IND AS numbers. What is the rental impact? I saw it Rs.55 crores in the standalone. What would be the consol impact?

S Subramaniam: I think there is a chart on Page #43 if you see the IND AS impact is there.

Sabyasachi Mukerji: I think that is a standalone.

S Subramaniam: Consol, not much of a difference there. Only CaratLane is there and nothing much.

Moderator: Thank you. The next question is from the line of Chanchal Khandelwal from Birla Mutual Fund. Please go ahead.

Chanchal Khandelwal: Just one question on your expansion plan. When you are saying you all go deep in L2 and L3 and go deep in number of cities, but if I look at your presence in the top-20 cities, still you can go much deeper. Why are you focusing on the L2 and L3 and not L1 now? The reason I am asking you are already in 200 cities and you have 300 stores. So if we do just math, your top 20-cities still can be far, far superior than what you are today.

C K Venkataraman: Is your question about that we should be expanding more in the large cities or is the question about why not L1 or both?

Chanchal Khandelwal: Both sir.

C K Venkataraman: Actually, about two years back, we had created a pipeline of about 250-stores over three, four years including in the large cities. So, the push for middle there is not necessarily coming at the cost of a lack of focus on the larger cities. In times like this, when the consumer sentiment is a little down and we are little more watchful and we do not open the seventh city in Ahmedabad or the 18th city in Mumbai or the 27th city and NCR Delhi kind of thing and hold for a little while, whereas open the Alwars, open the Ganganagars and so on priority. So that is the background. Otherwise no important catchment in existing cities is left unoccupied. So, it is very much part of that. In fact, even in the 50 that we will end up opening this year, I do not know, maybe 15 or 17 or something like that is in existing cities and the balance 30 are the new towns, whereas L1 question is different because only in the big cities, metros, do we want to open L1 for reasons of cost as well because when things do not go as well, for example, this year has been a little muted overall that we are holding only some of the stores is a big advantage for us. Old stores who are L1, last year would have been a blockbuster, but this year would have been a big problem.

Chanchal Khandelwal: Secondly, on the size of the store, when you go to L2 and L3, do you normally have a smaller size of the store or you tend to maintain the 3,000, 4,000 sq.ft.?

Ajoy Chawla: No, in smaller towns and actually even in catchments which are relatively smaller potentially in existing cities, we would go for smaller store sizes. So, we are typically operating in many of these Tier-2, Tier-3 towns at 2,000 sq.ft., and with an option, sometimes to expand as sales grow up. So even in a big city like just to give you an example, Secunderabad, we did open at a 2,000 sq.ft., but we have retained an opportunity to probably expand it once we see good traction.

Chanchal Khandelwal: Lastly, on the CaratLane, you just spoke about your international expansion plan that CaratLane would be the preferred choice to do. Do I read it right? And also, because CaratLane is more studded and lower ticket sales. Is that the reason?

C K Venkataraman: No, no, just to clarify, CaratLane has already begun its export plans with a certain effort level, and even in Tanishq, actually the tanishq.co.in, we have been exporting in very small numbers over the last couple of years. I mentioned that we have recently formed an international business division which is going to give a thrust to this entire activity. They are part of TCL, and they are working closely with the CaratLane team to deliver an integrated approach to developing the jewellery opportunity in the US and other parts.

Chanchal Khandelwal: Maybe if I were to just reframe it, so you are first exploring the opportunity to do eCommerce format and then probably do a store format? Is that the…?

C K Venkataraman: No, we are not looking at stores at all. eCommerce with all the brands of the company including CaratLane.

Moderator: Thank you. We will take that as the last question. I would now like to hand the conference back to the management team for closing comments.

S Subramaniam: Thank you for being on the call. Hope we have answered most of the questions that you had. We look forward to interacting with you in future again. Thank you.

C K Venkataraman: Thank you. Bye-bye.

Moderator: Thank you. Ladies and gentlemen, that concludes the conference call. Thank you for joining us and you may now disconnect your lines.