"KDDL Limited Q1 FY18 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the KDDL Limited Q1 FY18 Earnings Conference Call. This conference call may contain certain forward-looking statements about the company, which are based on the beliefs, opinions, and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Saboo – Vice Chairman and Managing Director, KDDL Limited. Thank you and over to you, Mr. Saboo.

Yashovardhan Saboo: Thank you. Good afternoon, Ladies and Gentlemen. And a very warm welcome to our Q1 FY18 Earnings Conference Call. I am joined by Mr. Sanjeev Masown – CFO of KDDL and Mr. Raja Sekhar – CFO of Ethos, our retail arm and our Investor Relations Partner, Strategic Group Advisors. I hope all of you have had a chance to have a glance over our presentation updated on exchanges and our website.

We will start the discussion with the key consolidated financial highlights for the quarter ended 30th June, 2017. For this quarter our total revenue increased by 14% YoY to Rs. 121 crores versus Rs. 106 crores. The growth was driven by a 39% growth in Ethos on the back of strong pre-GST sales during the quarter. The total revenue of the company has grown by 17% over the previous quarter. Gross profit of the company increased by 2% YoY to Rs. 44.4 crores. This would have been better had it not been for the adverse impact on profitability on account of higher raw material expenses which increased by 23% YoY. Consolidated EBITDA dropped to Rs. 5.2 crores from Rs. 5.6 crores in the previous same quarter. The loss in Q1 was Rs. 31 lakhs, declining sharply from the loss of Rs. 90 lakhs in the second quarter in the previous year. Cash profit however was healthy Rs. 2.6 crores versus Rs. 2 crores, witnessing a growth of 32% YoY.

We turn to the developments in our manufacturing business. The global cyclical downturn in the watch industry seems to have bottomed out and sales are showing signs of recovery, notably in China. The major growth is in the premium end of the watches which is the market segment catered by us. Consequently, we see an improvement in the export figures in the watch component segment. On the other hand, the domestic revenue of all the manufacturing business segments of the company were negatively impacted by the GST implementation as many customers deferred their off-take to minimize transition period losses and procedural complications. As a result of this our standalone revenue stood at Rs. 32.4 crores which is about 5% lower than the previous year corresponding quarter wherein the revenue of the company was Rs. 34 crores. However, the revenue of the company has improved by 6.4% compared to the previous quarter on account of overall recovery in market segments.

EBITDA margin for standalone business stood at 18.6% with an EBITDA of Rs. 6 crores. EBITDA of the company improved by 215 basis points compared to previous quarter. Profit before tax and profit after tax at Rs. 3.9 crores and Rs. 2.5 crores respectively compared to corresponding quarter of previous year, but it has improved by 50% compared to previous quarter results.

Revenue from the Precision Engineering business for Q1 grew by 10% on YoY basis. The growth in revenue is both from domestic and export market segments, with our concentrated marketing efforts the flow of RFQ enquiries and leads are very encouraging which has resulted in a healthy order pipeline. We have well proven capabilities in engineering coupled with a very strong base of clients. Our preferred supplier status with many of the key clients will give us increased business going forward, resulting in improved profitability. We are confident that the Precision Engineering business of our company will continue to witness a very healthy revenue growth and the increased business going forward will result in a much better profitability.

The first phase of our expansion facility at KIADB, Aerospace Park near Bangalore airport has been a bit delayed. But now it is nearly complete and we plan to commence trials within the next week. The benefits of this CAPEX shall accrue from H2 of this fiscal year.

On the Watch Component business, our revenue is 6% lower compared to corresponding quarter of previous year, but 14% higher compared to previous quarter. As you are aware, during the last financial year the watch market had declined continuously but it has not bottomed out and is on the recovery path. This is evident from the revenue growth during the quarter and the order position in hand.

We now shift to discussing Ethos Limited, our retail arm. Revenue for Ethos increased 39% to Rs. 98.8 crores. Gross profit increased 16% YoY to Rs. 18.6 crores, EBITDA witnessed a turnaround from a loss of Rs. 1.1 crores in FY17 to a profit of Rs. 0.2 crores in the current year's quarter. Both these figures are comparable as per new IndAS requirement.

We have been able to reduce our interest cost on the back of better working capital management. Interest cost has reduced by 17% on year-over-year basis. Inventory carrying months have improved from eight months in the previous year to about 5.5 months at the end o first quarter. Profit before tax and profit after tax reduced from a loss of Rs. 4.2 crores in Q1 FY17 to a loss of Rs. 2.4 crores in Q1 FY18. Of this loss about Rs. 84 lakhs is on account of exchange rate fluctuation, previous year was a gain of Rs. 8 lakhs. And a one-time write-off of Rs. 56 lakhs for the credit of various cesses that carried forward in our books but have been finally not allowed to be carried forward by the GST rules. Adjusting these would actually reduce the loss by Rs. 1.4 crores. The reason for this loss despite an increase in sales is on account of the decline in gross margin by about 4% points. This being the direct effect of the GST rules under which the rate of watches is fixed at 28% as against the current VAT in the pre-GST period of 12.5% to 14% and the need to maximize liquidation of transition stock to avoid even higher losses that can occur due to transition stock.

We are continuing to liquidate the transition stock until 31 December, 2017. But we are confident that after this period the margins will recover and strengthen sharply. We have already negotiated with several important brands to compensate the higher tax rate and we also expect consumer discount to fall significantly after 31 December, 2017, when the full GST era kicks in.

Our initiatives in terms of better working capital management, focusing on the operation of profitable stores, focusing on house brands is contributing to improved performance. Our current store count stands at 36 stores. We recently opened three stores, the Ethos Watches Tissot Boutique was opened at the Sea Woods in Mumbai, two other stores one at Jaipur and one at Sea Woods Grand Central Store in Navi Mumbai was also opened. At the same time we closed two stores in Khar in Mumbai which were not profitable for us.

We are glad to report that our brand exclusivity strategy is playing well. With the growth in FY17 we are witnessing continued traction in increased sales on these exclusive brands. This segment helps us to improve efficiency in terms of inventory plus helping us in our market positioning and also increasing profitability.

Our online presence continues to move up. The number of visitors for Q1 reached a record 3 million, establishing us as the preferred go-to website for luxury and premium watches. Online billing stood at Rs. 34.6 crores, up 32% YoY whereas as a percentage of sales it stood at 31.2%. Our repeat billings more than doubled on YoY basis to Rs. 29.9 crores.

We believe we have restarted our journey. The fundamentals of our company have been strong enough to weather the tumultuous past of the last 12 months. Our focus and belief on the watches segment has allowed us to reengineer our mode, the results of which are going to be an improved performance in every passing quarter.

With this, I open the floor for question-and-answers that you may have.

Moderator: Thank you. Ladies and Gentlemen, we will now begin with a question-and-answer session. We take the first question from the line of Dinesh Iyer from Dinesh Capital. Please go ahead.

Dinesh Iyer: Sir, we have recently, like you said, opened stores in Jaipur and Navi Mumbai and we have plans for Pune. So, what is the strategy here, do we see these cities contributing more in the overall growth?

Yashovardhan Saboo: Dinesh, as you have seen in the last 18 months we have closed down a couple of stores, but at the same time we are now re-embarking on our strategy of growth in stores, especially in cities or in areas where we are not present. Our indications are that; Jaipur is an excellent city for premium watches and we have opened there. Similarly, Navi Mumbai, the new mall over there very well fits in with our strategy of growth. And the same for Pune. Pune, you may recall if you go back, it was one of the cities where we established one of our very early stores, in fact not one but two stores. We were unlucky because the locations that we chose at that time they did not continue and we actually had to exit Pune. It has been long overdue and we are very glad to be back over there, it is part of our strategy to spread out more in non-metro cities where we believe there is a lot of untapped potential.

Dinesh Iyer: Okay. Sir, another thing, recently there was news for demerger of Ethos, so what is the strategy here?

Yashovardhan Saboo: Dinesh, I expect that this question is going to common for a lot of people because indeed it did flash up. So, let me answer this and I hope others who may want to ask this question are also listening in. So, basically from time to time we have all kinds of deliberations on strategies to unlock value and for increasing shareholder value, this has been going on internally and even informally at Board level for quite some time. However, there is no formal proposal on which any decision has been taken, so it is really a thing that we have been considering but there is no timeline, there is no definite framework yet decided. And when it is we will surely share it with everybody, including the stock exchanges.

Moderator: Thank you. We have the next question from the line of Arshad Mukadam from Vibrant Securities. Please go ahead.

Arshad Mukadam: Sir, there has been a sharp growth in repeat sales, any reason for that?

Yashovardhan Saboo: Sorry, could you repeat that again please?

Arshad Mukadam: So, you said the repeat sales have more than doubled, is there a reason for that?

Yashovardhan Saboo: Our sales through the loyalty program that has increased and that we say because the communication of the loyalty program has become more vigorous. And also, as I mentioned that especially since May there has been an increased focus on liquidation of transition stock, that is another question that I guess a lot of analysts, audience may be interested, so let me address that right away. So, as you know, it is a little bit of a indirect answer to your question but I will get to your question at the end of this. GST rates for watches was fixed at 28%, this is as against the pre-GST i.e., VAT which ranged between 12.5% to 14%. More important, more significant, the rules for transition stocks are such that for imports made by us prior to one year or for local purchases we are not likely to get the full benefit of the tax paid on transition stock. And therefore it is necessary to liquidate as much of transition stock as possible, a lot of it before 30th June and definitely before 31st December because that is the end of the six tax periods until which any offset is allowed. Now this is not unique to the watch business, this is true for all retail. And that is the reason why we have seen a lot of liquidation going through.

Now, why I am saying this is that one of the most important weapons to get to liquidation sales was to use our database. And that effective using of database was that the repeat sales have gone up very sharply. What it does is, it also focus on the power of our database and our loyalty program to actually implement effective communication for future program, that is a great learning that we have from this experience.

Arshad Mukadam: Okay. So the short-term business de-grew, could you split the standalone business by Manufacturing and Precision Engineering and comment on the margins as well?

Yashovardhan Saboo: I am going to let Mr. Sanjeey Masown answer that.

Sanjeev Masown: I think this Mr. Saboo has already shared in his speech earlier that as far as our watch component business is concerned, in this quarter there is a decline compared to the corresponding quarter of last year around 6%. But compared to the previous quarter there is a growth of almost 14% in this, that is the Watch Component business segment. Whereas the Precision Engineering component in this quarter we have grown by 10% compared to the previous year. And overall 5% revenue decline is there in this quarter compared to the last year corresponding quarter. I hope I have answered your question?

Arshad Mukadam: Could you possibly tell me what the margins of these two businesses?

Sanjeev Masown: Basically that is something at a business-to-business level, we never share, this is something confidential, we would like to not disclose that.

Arshad Mukadam: Another thing is, I was going through the annual report and I was a bit confused about the shareholding that we have in Ethos, at one place I read 82% and at another place I read it was around 73%. So is that because of diluted holding?

Sanjeev Masown: Yes, your understanding is correct.

Arshad Mukadam: Okay. And could you tell me how much Mahim Distribution owns in Ethos, does it still have a stake in Ethos?

Yashovardhan Saboo: 15.4%.

Arshad Mukadam: And who else holds the stake in Ethos other than us?

Yashovardhan Saboo: There are number of other shareholders You are asking shareholders of Ethos other than us?

Arshad Mukadam: Yes, the big ones.

Yashovardhan Saboo: So, they are individual investors, there are no funds over there.

Arshad Mukadam: Okay. Another thing is, 15 crores of preference shares that we were planning to issue, I think Rs. 8 crores was issued. Is there any status on the remaining Rs. 7 crores?

Yashovardhan Saboo: You are talking about equity in Ethos?

Arshad Mukadam: No, the preference shares, there was an issue. You all said that you will issue Rs. 15 crores of preference shares, so could you tell me, so I think Rs. 8 crores was already issued so is the remaining Rs. 7 crores, has that been issued as well?

Yashovardhan Saboo: Yes, Rs. 7 crores of the remaining is being prescribed that is Rs. 7 crores is of equity.

Sanjeev Masown: I think you are confused with preference and equity, these Rs. 15 crores of equity was to come and in addition to that Ethos had proposed for separate Rs. 15 crores of preference. So, whereas Rs. 8 crores which were subscribed by KDDL was relating to the equity and the balance Rs. 7 crores is being done in the next one week.

Yashovardhan Saboo: There is one correction that I just want to make, there is a fund also invested in Ethos. I had said that there are individual shareholders and there is a fund as well.

Moderator: Thank you. We have the next question from the line of Rohit Balakrishnan, individual investor. Please go ahead.

Rohit Balakrishnan: Sir, what is the overall market size of luxury watches in India and what is our share?

Yashovardhan Saboo: So, we sort of have to first define how you put luxury watches. The way we define it is price points above Rs. 10,000 and our estimate is that we currently have about 13% to 14% market share in this market. So, we estimate the size what we call the premium luxury market to be about Rs. 2500 crores to Rs. 2800 crores.

Rohit Balakrishnan: And how has this market grown in the last two years?

Yashovardhan Saboo: In the last two years this market has not really grown, in fact on the luxury end in the last 12 months there is evidence that the market itself has contracted. The reasons are clearly related to the regulatory changes that have happened. On the lower end of this segment there is growth but I think there is single-digit growth, the estimates are between like middle single-digit growth in the last 12 months to 18 months.

Rohit Balakrishnan: And sir just like we are doing some online plus offline model of selling watches, is there anyone else who is also doing like that?

Yashovardhan Saboo: I think online omni channels these are buzz words, so if you look at other retailers in the premium and luxury space you will find websites everywhere. But in terms of traffic, with 3 million visitors a quarter we are sort of several notches above anybody else. Not only that I think we are very conscious the word of omni channel retailing is moving away from laptop and websites to mobile platforms, social media, Instagram and so on. So, traffic on the website is of course a very, very important metric but how you are being followed on other social stuff like Instagram and so on is something that we have to measure. So, we are sort of measuring all these metrics now. There are other retailers who sort of offer a similar platform, but I think we are not only several notches above but we are actually increasing the lead with the way we are going. So, if you spend some time on our website you will see what is actually happening over there, it is not really a transaction focused website but the way of the future is that it is an information focused website which is essentially answering queries for interested consumers. Consumers now across the world they are actually researching on the web and transacting omni channels, the transactions could be on the web or in the store and even more true for premium in luxury products and that is what we are enabling.

Rohit Balakrishnan: Okay. Sir, one more question, if we look at our Ethos performance over the last may be three years, so we are quite struggling there. Just wanted to understand from you what is the plan now to improve the performance over the next three to four years?

Yashovardhan Saboo: Right. So, Rohit, first I think it is very true that the last 18 months I would say have been quite a struggle. We have been dealing with series of regulatory changes and soft consumer commissions starting with requirements, PAN card disclosures which obviously impacts luxury sales, then demonetization and now the GST transition and all of this.

However, first of all you can see that it is bottoming out. Second, our strategy has been anticipating this and creating and remodeling what we want to do. What are the elements of this strategy? First and foremost, getting out of the very, very high luxury price points. So, we had a very significant presence in luxury watches in the price points above 10 lakhs - 15 lakhs. Over last year we consciously vacated large parts of this segment, so brands like Brege, Lange, these are brands which are coveted brands worldwide but we believe that that price point segment particularly in the new regulatory environment is not something that would actually benefit us. So, we exited that. Instead, we decided to focus on the aspirational price point which is really between Rs. 50,000 to Rs. 5 lakhs which we believe is going to be where a lot of demand is going to grow as the aspirational segment of India's population increases.

The other thing which was creating a cache of exclusive brands, brands that are available only at Ethos or with a very restricted distribution. We negotiated with these brands much higher vendor margins which is possible because we have the exclusive rights for these brands, in return we offer them higher sales, we offer them investments in marketing and we offer them lower distribution cost, so we got this margin in. And because distribution was limited, we are not having to compete for discounts. So, this started to create a margin advantage for us. These brands which we call house brands, two years ago the percentage of their business in our overall sales in Ethos was less than 4%. In the previous year it went up to 8.4% I think. This year our target is that 13% of our sales will come from this cache of exclusive brands, we are tracking that figure quite well, we are at about 12.8% in the first quarter. Going forward we expect these exclusive brands to be about 25% of our business over the next two to three years which will have a very significant impact on our overall margins.

Third important point, operational leverage. We have been closing down stores which do not have high potential for growth. We need to get high growth without having to increase our cost base a lot. And this is happening by focusing on our profitable stores and focusing on our omni channel platform. How does the omni channel platform help? If I open a store in let's say Jaipur, it is not only Jaipur but I can get my entire website database to work and get customers into Jaipur, the same for Lucknow, the same for Vashi and Navi Mumbai. So, I leverage my pan-India presence and the stock that I hold pan-India to get across to any customer. That is the reason why you also see a reduction in our overall stock and inventory holding. So, I think with this improved operational leverage, with improved margins due to exclusive brands we certainly expect that our overall margins and performance will go up over the next three to four years.

Rohit Balakrishnan: Sir, just a follow-up on this. You mentioned the second point, one of the points you mentioned was that our aspirational, we are moving to the price points where the customer is more aspirational i.e., Rs. 50,000 to Rs. 5 lakhs. So, earlier when we were selling watches greater than 10 lakhs which was one of our USP and there was not much competition, but now we would also face higher competition in this category, like Helios is there and smaller other players who are regional, they are also there. So, how do you see that panning out for us?

Yashovardhan Saboo: So, Rohit, on the contrary, I must say the actual reality is quite different from what your impression is. See, at the very high price point there is actually a little bit more competition, I will tell you why. See, our competition is with a lot of local city based retailers who have been retailing expensive watches for the last 20 - 30 years as part of their family business. This is from a time even before the import of watches was allowed. Now, typically these are retailers who have connections with the very wealthy, the ultra ultra HNI who are the clients for these Rs. 20 lakhs and Rs. 30 lakhs watches and more. They typically have a few stores based in one city, they are not really scalable and therefore in order to be profitable they have to focus on the very high end. And also because their costs are lower they are not scaling up, they can actually give very high discounts on that. So, that is actually a segment that is not very profitable for us. In addition what is happening is due to the regulatory changes we expect a lot of buying of these very expensive watches to actually shift outside India because a lot of customers, ultra HNI customers who still want to buy a Rs. 50 lakhs watch they are saying why should I buy it in India, I will have to disclose so many things, I will just buy when I am abroad because all of them have a lot of wealth abroad. So, that is something that we are expecting to happen and we actually have anecdotal evidence of that happening. On the other hand, in the price segment between Rs. 50,000 to Rs. 5 lakhs there are not so many players and the fact that we have finalized these exclusive brand arrangements with a lot of the brands in this segment means that we have a real chance of dominating this segment better than any other retailer. The last point which you mentioned was other competition in this price point, actually there is very little. Most of Helios which also has a very professional chain of stores, but their focus is actually below the price point of Rs. 50,000.

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

Vikram Suryavanshi: Sir, basically just the inventory days what we have come down to about 5.5 months, a lot of I think will have to do with the liquidation of this and restructure of inventory at different price points. So, going ahead, at what level we see the inventory level to be sustainable?

Yashovardhan Saboo: Vikram, that is a great question. Yes, a part of this is because of liquidation and I wish we could hold on to this line. However, I believe there will be some increase but no way that they are going back to eight months. And our long-term goal is to get this below six months. So, I believe over a next two to three years period a level of about five to six months is definitely doable.

Vikram Suryavanshi: Okay. And do we have number for same store sales growth in this quarter?

Yashovardhan Saboo: So, in this quarter the same store sales growth was 32%.

Vikram Suryavanshi: And in manufacturing side if you can give the breakup, overall what was the import and export mix and if you give the absolute number that would be helpful.

Yashovardhan Saboo: Sorry, can you repeat that question?

Vikram Suryavanshi: Our standalone business in the manufacturing, if you can give what was import and export mix?

Yashovardhan Saboo: I do not understand, there is no import.

Vikram Suryavanshi: Sorry, what was the share of our export and domestic in manufacturing?

Yashovardhan Saboo: Okay. I do not have the exact figures, now around 60% is the export revenue which we have.

Moderator: Thank you. We have the next question from the line of Jeetu Panjabi from Young Capital Advisors. Please go ahead.

Jeetu Panjabi: So, a couple of questions. One is, can you just take us through what your estimates are in terms of this current Diwali season and wedding season? And obviously last year you went through demonetization at the same time, so there was a surge and then sales collapsed. So, assuming there is nothing exceptional coming what is your estimate for this next three months, do you feel comfortable or how do you think about it?

Yashovardhan Saboo: Jeetu, what are your other questions, this one I am going to take some time to answer, but tell me the other question.

Jeetu Panjabi: The other one was around the inventory side, I think I wanted to say that it is excellent to hear that you have gone inventory from 8 to 5.5 months and that is what you had guided about a year back saying this is our target and this is the way we are going to make it go forward. So, question there is really like what is your expectations on steady state inventory, is this where it is and do you expect to get more improvements here? And third and final question was, do you need more capital at the Ethos level and how are you thinking about capital within the subsidiary?

Yashovardhan Saboo: Right. So, Jeetu, regarding the Diwali season, frankly we are sort of debating this and every 15 days we are sort of trying to look at indicators and trying to project and I must say I have never sort of encountered the kind of ambiguity in the overall market situation as we are seeing today. On the one hand you have a situation with this whole transition stock which we have to maximize liquidation of, on the other hand retail sentiments still seem to be soft. Whatever I am saying may completely change in three days because Navratri starts today. We are also waiting to see what is going to be the effect of this Billion Day sale and so on. So, it is really very hard to hazard a guess as to how the markets would behave. We still believe that compared to last year this season should give us at least a single-digit growth. We will be running programs with promotions and sales to push this liquidation out. So, on the back of that we do expect overall sales to be better. I am not sure whether there is significant margin recovery will happen before 31st December, so that could still be testing times.

However, after December we are very sure that we will see a very sharp margin recovery for the two reasons that I already mentioned in my speech. Number one, we are seeing a decline in discounts, if we eliminate the promotions that we are doing for liquidation, if you eliminate that there is a very clear sign of discounts coming down, and you know the discounts in the market was one of the reasons this competitive discounting was one of the reasons why margins in India are among the lowest in the world. So, that is coming down, and that is also coming down because retailers everywhere are now, I think we are increasing our market share and we are getting a more dominant position, especially in the price segments in which we operate, so that is one thing which will happen. And second thing, we have negotiated with the main vendors to actually compensate for this extra taxation. So, apart from the losses that are going to happen due to this incomplete set-off of the prior taxation on the transition stock, apart from that I think post 31st December we will see not an improvement in sales, I have no doubt about that. Also remember that there is a benefit that will get you to the set-off of the service tax, that benefit is forever but it comes slowly. Burden of the loss on transition stock is a one-time loss which we are going to have to absorb until 31st December. So, post 31st December the loss is absorbed and the gain due to set off of service tax kicks in so we expect the margins to improve much better after 31st December. Until 31st December, Diwali season big hope **will be** over there, I do expect sales will be better, margins would still be a struggle until 31st December, to be very frank.

Coming to the inventory part, 5.5 months as I mentioned to Vikram who was asking the same question, one part of this is clearly because of the liquidation that has happened. However, we are very clear that our goal is to get the inventory to below six months, I think that will be a period of one or two years before we get down to 5.5 months - 6 months which is probably going to be the steady state. Please remember that in the watch business worldwide, if you benchmark with other retailers, the equivalent inventory holding over there is 10 months to 11 months.

Jeetu Panjabi: Right, because their cost of capital is very different from us?

Yashovardhan Saboo: Their cost of capital is very different from us, we have been waiting for last two years for our cost of capital to start going down. But RBI could help further I believe. And your last point was regarding the need for capital?

Jeetu Panjabi: Correct

Yashovardhan Saboo: As of now we are waiting for this whole transition period to get over. We have made out a plan for expansion in Tier-II and Tier-III cities where we see a lot of traction coming through internet and mobile traffic but we are really waiting for this whole transition period to get over and how this higher GST rate would impact. Once that is through we would sort of finalize the plans and then we would really come to know whether we need additional capital or not. If we have increased to 40 stores as a current plan in sort of, we are working on that kind of a plan, we would need probably some additional capital. And that is when we would have to look at how are we going to structure it to get it into the subsidiary company.

Moderator: Thank you. We have the next question from the line of Sachin Gupta from Value Partners. Please go ahead.

Sachin Gupta: So, sir just want to understand, in terms of our ecommerce strategy, so if you look at on the fashion side the retailers are actually if not bigger at least equivalent to the brands. So, on the luxury side, not in India but globally that has not yet sort of played out. So, I just wanted to get your views on how do you see this overall channel for the luxury watches sort of playing out? And then how do you see that playing out in India?

Yashovardhan Saboo: I did not understand your question. Are you asking how do you believe the sale of luxury watches will play or internet will impact luxury watches, will it be the same way it has impacted fashion?

Sachin Gupta: Okay. So, two parts to the question actually. First part was that, how do you see the online channel growing or impacting the luxury watches? And apparel if you see, luxury fashion online has really picked up there, all these people have really grown on the online side. That has not sort of played out on the luxury watches side yet. So, globally I wanted to hear your perspective on that. And as a consequence how do you see that in India and what is the role that you see Ethos playing within that?

Yashovardhan Saboo: Right. So, what we observed and let me explain what is happening in India and then related to the global phenomena. What we observe in India is that online sales of watches is healthy and it is growing but there is a cap on a price point and currently that cap is around Rs. 10,000 price point. That means online sales of watches below this price point happens but above this price point in general consumers are not happy buying directly online, there is a lot of interest in terms of traffic coming in, wanting to discuss, wanting to research the watch but the final purchase is done after touch and feel of the watch in the store. This experience is not different from the rest of the world, the only difference is that the price point elsewhere in the world may be not 10,000 but may be 20,000 or 25,000. Our own model has actually catered to this and therefore we are really focusing on a lead generation model which essentially means that we encourage leads that comes through information center, the information center which has about 47 - 48 persons manning the center, including the backend of it, they are the ones who assist consumers in their research and then eventually direct them to the store where the transaction is consummated. There are brands that we do direct online sale as well, so we are in a good position to track what is going on. And in the past it has happened that we have moved a particular brand which is at a at a price point of Rs. 20,000 from a lead generation model to a direct ecommerce model and we are seeing sales falling rapidly, because consumers want to be able to talk to a person and get the guidance before they actually make the purchase. Below Rs. 10,000 sales in ecommerce is happening, so that is where it stands in India and this experience is not different from the rest of the world.

Sachin Gupta: Understood. So, out of your 31% sales which are online lead, so direct sales would be how much of this roughly?

Yashovardhan Saboo: Direct sales is very, very small, it is probably less than 5% of this 31%.

Sachin Gupta: And you do not expect that to change rapidly in the next couple of years?

Yashovardhan Saboo: We do not expect that to change rapidly, but I think we are in no denial that it will increase, not only the price buyer of 10,000, this will gradually go up to 10, 12, 15, 20. And the number of people in the price segment wanting to buy watches in the 10,000 price segment will also increase, it will increase but I do not think it is going to explode.

Sachin Gupta: Got it. My second question is, can you talk a bit about how would an appreciating Rupee impact your business, if you could talk by segments, so Ethos and then manufacturing?

Yashovardhan Saboo: In a simple way Ethos gains and export is impacted by a strengthening Rupee. So, our manufacturing business is about 60% export, so of course a strengthening Rupee is not good for that. Whereas Ethos is based on imports so a strengthening Rupee is good for us there. Best of all is a stable Rupee.

Sachin Gupta: Got it. Was there any impact in this quarter because of this Rupee appreciating a bit on Ethos?

Yashovardhan Saboo: Well, I think I mentioned over there that there was an exchange rate loss of about Rs. 84 lakhs during this quarter.

Sachin Gupta: Because there was heavy discounting, is that the reason?

Yashovardhan Saboo: No, it was an exchange rate loss. Remember that most of our import and export actually takes place in Swiss Francs and not in US Dollars. So, the Swiss Franc has actually appreciated.

Sachin Gupta: And just couple of more questions, in the past you have spoken about increasing the mix or diversifying the mix beyond watches into other accessories as well. So, in the next two to three years any thoughts on that, on the Ethos side how do you address that part?

Yashovardhan Saboo: Sachin, that is very much on our radar. We have been debating that. There are two essential issues that we have in mind before we finalize steps in that direction. A) we want to make a model that is asset light; and B) we want to focus on categories which are in the affordable luxury segment and not in the very high luxury segment. We have seen that in the very high luxury segment the actual performance in India has not been very good, I am not talking about the watches segment, I am talking about other than the watches segment. So, we believe the greater scope is in the affordable luxury segment, there is a gap over there. And when we go there it will be in an asset light model, so that is something which is definitely on the cards over the next couple of years.

Sachin Gupta: Okay. And any sense that can it be as big as your watches in terms of market size or bigger than the watches market?

Yashovardhan Saboo: It depends on where you start to draw the boundary, watches is a very tight segment which is very clearly defined. The moment you go out it depends on where you want to draw the line. But of course in a larger sense the affordable luxury goods market is certainly much larger than the watch segment.

Sachin Gupta: So, what are the kind of products would you look at or what are you looking at?

Yashovardhan Saboo: Essentially there was a whole range of product which is focused around accessories. So, you can start with jewellery, men's jewellery, men's accessories, ladies accessories, footwear, handbags going on to a lot of other stuff. So, as I said the decision really is on where we want to draw the line.

Sachin Gupta: Understood. And sir just last question from my side, can you talk about the difference in the gross margins between your house brands and the other brands? I mean what would be the broad differential.

Yashovardhan Saboo: So, I would be a little hesitant to give you the specific figures there but I can say that the gross margin on house brands is on an average between 7% to 8% higher than the overall average.

Moderator: Thank you. We have the next question from the line of Nikhil Vora from Six Sense Ventures. Please go ahead.

Nikhil Vora: Yash, just one question. Over the last couple of years we have obviously established a very strong omni-channel network. Our lead generation is now almost one-third of the overall business. We are obviously by far the strongest player as far as trust is concerned in a fairly sensitive business to be in and now we have also got exclusive brands which is becoming meaningful. When does the business now start to clock in margins which are more relevant for the last almost ten years that we have spent in the business now, we are still at almost 0 margins. So, when do we really see a significant click up in margins?

Yashovardhan Saboo: January 2018, Nikhil.

Nikhil Vora: And what gives us that huge comfort to draw that and what is that good margin supposed to be at?

Yashovardhan Saboo: So, as I mentioned, if you analyze the current structure with a comb and the pattern that are hidden are concealed in the overall figures are actually evident when you actually comb through. So, as I mentioned, there is the disposal of this liquidation of stock which is happening, if I remove that then I see what is happening when I am not under this pressure for the liquidation of this GST transition. What is happening on house brands, what is happening on brands when I exclude the very high-end segment which we have now excluded, you see everything adding up. So, when you remove all this the gains start to show up and I believe post December 31 the shaft will be significantly not wholly removed and you will start to see the grain from the first quarter of next year.

Nikhil Vora: So, would it be fair to presume that say a couple of years back we were at a 4% margin and that was without we having established exclusive brands which has also significantly scaled up our omni-channel network and so on. So, is it fair to presume that with all these building blocks in place our margins should be possibly closer towards a 7% - 8% level over the next couple of years?

Yashovardhan Saboo: Our margins should recover to what it was in the next year for sure and then with operational leverage it should go up to the 7% - 8% that you are talking in probably in the subsequent years.

Moderator: Thank you. We have the next question from the line of Arshad Mukadam from Vibrant Securities. Please go ahead.

Arshad Mukadam: So, the total number of shares outstanding of Ethos are how much?

Raja Sekhar: Arshad, it is 1.49 crores as on date.

Arshad Mukadam: That is the number of Ethos shares?

Raja Sekhar: Yes.

Arshad Mukadam: But if I am not mistaken, the share capital is 36 crores, right?

Raja Sekhar: Yes, that includes preference shares which are at different face value.

Arshad Mukadam: Another thing is, could you tell me what is the implied valuation of Ethos after we put in 141 preference share?

Raja Sekhar: It will roughly be around Rs. 200 crores.

Moderator: Thank you. We have the next question from the line of Rohit Balakrishnan, individual investor. Please go ahead.

Rohit Balakrishnan: Just a couple of clarification, you mentioned a FOREX loss of around Rs. 80 lakhs, just wanted to check, where does that show up, does it show up in the raw material cost or below that?

Yashovardhan Saboo: It shows up below that.

Rohit Balakrishnan: And in this quarter we have a decline in our gross margins, I think that would be because of liquidation discount, right?

Yashovardhan Saboo: Correct.

Rohit Balakrishnan: And going forward where do we see our gross margins to be settling in in one or two years?

Yashovardhan Saboo: If you see historically before this 18 - 24 months, our gross margins were in the region of about 24% to 25%. Post December we expect them to recover to that level.

Moderator: Thank you. Well, that was the last question for today. I would now like to hand the conference over to the management for their closing comments.

Yashovardhan Saboo: Thank you everybody for joining us on this call. I hope we have been able to answer the queries adequately. If there are more queries or you require any clarification please contact us or SGA, our Investor Relations advisors. Thank you very much.

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