VIP INDUSTRIES LIMITED

"VIP Industries Limited Q2 FY 2017 Conference Call"

November 11, 2016

VIP INDUSTRIES LIMITED

Edelweiss
Ideas create, values protect

CHORUS CALL®

ANALYST: **MS. SHRADHA SHETH – EDELWEISS SECURITIES LIMITED**

MANAGEMENT: **MS. RADHIKA PIRAMAL – MANAGING DIRECTOR – VIP INDUSTRIES LIMITED**
MR. JOGENDRA SETHI – CFO – VIP INDUSTRIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the VIP Industries Q2 FY2017 Conference Call, hosted by Edelweiss Securities Limited. 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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Shradha Sheth from Edelweiss Securities. Thank you and over to you!

Shradha Sheth: Thank you Rio. On behalf of Edelweiss, let me welcome you all to the Q2 FY2017 earnings call of VIP Industries. From the management today we have Ms. Radhika Piramal, the Managing Director and Mr. Jogendra Sethi, the CFO of VIP. So, without any further ado I will hand over the call to Ms. Radhika for her initial comments post which we will open the floor for Q&A. Thank you and over to you madam.

Radhika Piramal: Thank you so much Shradha. Good afternoon everybody, thank you for joining our phone call. I am pleased to present the results to you.

Our sales for Q2 were around Rs. 285 Crores, which is 3% down from around Rs. 295 Crores in Q2 of last year. Even it looks a 3% decline, I would like to bring to the attention of everyone that during last Q2 we had a very large institutional order from Haj Committee of India, which has changed our Q2 base. Haj tender was for about Rs. 50 Crores most of which was serviced in Q2 of the last year. It was a onetime order. Haj Committee did not tender this year so there was no opportunity to bid for it or win it. If we ignore Haj order in last year sales, our sales grew by about 16%, which seems to be good. It has been a good quarter because without taking into account sales and profitability of significant Haj order. We exceeded our profits of Q2 of last year. Our EBITDA grew to Rs. 29.2 Crores, which is up from Rs. 27.8 Crores last year, which is up significantly compared to the profits what we had done last year without the Haj order. Our profit before tax increased from around Rs. 24 Crores to around Rs. 26 Crores and again without the Haj order which is a significant increase in our profits. I would like to explain the reasons of increase in profits. Major reason is margin expansion. Margin has gone from 44.6% last year to 46.3% this year because margins we earn on our regular sales are higher than the margins we would have earned on Haj order. Haj order was a significant institutional order at very competitive pricing. Other income was at Rs. 2.91 Crores as against just Rs. 42 lakhs in Q2 of last year. Other income includes dividend income from VIP Industries Bangladesh P Ltd. which is expected to be a recurring item as long as sales and profits of the subsidiary are good. I will be referring sales growth of 15% in terms of our usual operating business as this is much more indicative of our actual sales performance than Rs. 285 crs against around Rs. 295 crs.

Our brands have done well except for Alfa, which is our value line where the traditional hard luggage continues to decline. VIP, Skybags and Caprese have shown a good growth. VIP growth is most encouraging. We all know that Skybags, Caprese and Carlton had been growing very well but I am pleased to see that VIP is also growing at double digits rate. In terms of channel wise performance, most channels have done well. E-commerce has really done much better June onwards; we are growing at about 300% in E-commerce. One of the reasons, we have taken some time to really plan out our e-com product assortment, which we have done June onwards and so we expect that will also continue through the rest of the year at this very positive pace. We continue to do very well in the hypermarkets and modern trade and our company run stores. Our general trade has also slightly improved. If you see as a trend, Q1 growth was about 6% or 7% and now we have increased to 15% in Q2 so I am quite pleased with the quarterly results. In terms of competition, we feel that we have taken some market share from Samsonite and American Tourister. We do not exactly have a hang on their sales numbers but we feel that their growth would have been less than 15%. Safari has grown quite well, their Q2 results are already out and their sales grew very fast at about 45% but their profits were more limited around 2 Crores so if you look at the sales and profits of both the companies, we are at 3½ times their sales, but about 10 times their profits and we can see that they are clearly growing sales by offering very aggressive prices in the market. Couple of other points, in terms of GST we continue to look forward to and analyse all the reports, which keep coming our way. At this point it is too early to comment specifically on whether GST will be favourable for the company or not, but as soon as we have full details of the policy we will be commenting on that. The second obviously big impact that has just happened in the last 2 or 3 days is the impact of demonetization. October sales continued in the same positive way as Q2 and in November, it has only been 2 days, but we certainly see a decline in our sales and there are number of reasons for that the dealer channel is one of most important channels for us and whilst our dealers pay us through the banking channels, their customers deal primarily in cash and so we can expect some slowdown there. In terms of our own company run show rooms about half of our sales are in cash and balance are credit card sales. We expect to see some decline. We think that branded luggage is to some extent a discretionary item. Those people who need to purchase it and can do so with credit cards would do so, but in terms of spending cash on branded luggage, people would not make that decision unless it is really a necessity. So, we had a good Q2 in terms of the sales and profits nearly equaling last year despite not having Rs. 50 Crore Haj order but there will going to be some impact on sales due to demonitisation even though it is too early to say how long it will last. I would like to bring your attention to our balance sheet, which is in a very healthy position. I am pleased to say that our inventory is at Rs. 221 Crores down from Q2 of last year. Our trade receivables are down. You would see that we have Rs. 68.6 Crores of current investments, that is all cash surplus that we have invested in liquid funds which has been generated from positive operating cash flows due to the relatively healthy sales and profits in the first half of this year combined with very prudent stock buying which led to this position and with that I will turn over to questions. Thank you.

Moderator: Sure, thank you very much. We will not begin the question and answer question. We have the first question from the line of Tejas Shah of Spark Capital. Please go ahead.

Tejas Shah: Hi Radhika.

Radhika Piramal: Good evening, hello.

Tejas Shah: Congratulations on good set of numbers.

Radhika Piramal: Thank you.

Tejas Shah: Just wanted to clarify, if I recall correctly what is the part of this 50 Crore order which was spilled over in the third quarter as well, last year.

Radhika Piramal: Very little, the total order was for Rs. 51 Crores and around Rs. 50 Crores was in Q2 and balance was in October.

Tejas Shah: Okay. And what will be the breakup of volume and value growth in this quarter out of this 15%.

Radhika Piramal: It is about 7 and 7.

Tejas Shah: Okay, so did we take price hike in recent quarter?

Radhika Piramal: We did. We took a price increase in July.

Tejas Shah: And that was how much.

Radhika Piramal: It has been around 3% on 60% of the business and 2% for balance.

Tejas Shah: Okay. And second question on gross margin. You mentioned that it expanded on Y-o-Y because of higher institutional order last quarter, but if you see it has also expanded sequentially versus first quarter this year.

Radhika Piramal: That's right. I will clarify it. One is because of the nature of that Haj order. Secondly, we took the price increase and rupee has been stable. We have also got some benefits from our Chinese vendor as the China macroeconomic situation remains under pressure. It is combination of all of these things. All the benefits of all these efforts have shown up in this quarter.

Tejas Shah: Okay, so gross margins are stabilized at this level at least.

Radhika Piramal: Yes.

Tejas Shah: And lastly other expenses degrew Y-o-Y so just wanted to know…

Radhika Piramal: Sure, de-growth in other expenses actually relates to secondary freight on Haj related sales which is a variable cost. As per Haj order, we had to deliver at N number of districts. Reduction in other expenses is not some reduction in fixed costs. It is absence of the secondary freight which was spent for Haj order.

Tejas Shah: Okay. So there is no reduction in ANP spent.

Radhika Piramal: No, there is no reduction in A&P but there is good control. There is no significant increase either. Employee benefits increased by about 15% which is partly due to yearly increments. Increment come into effect July onwards. Other expenses are stable.

Tejas Shah: Okay, but the delta between standalone and consol also indicates that Bangladesh operation is also contributing to this…

Radhika Piramal: Absolutely, It is contributing and. We accounted around Rs. 2 Crores dividend in Q2 from VIP Industries Bangladesh which is expected to be recurring.

Tejas Shah: So it would be fair assumption that the healthy run rate of margins for the first half at least should show for the second half this year, is that correct.

Radhika Piramal: There is some amount of uncertainty in absolute level of sales.

Tejas Shah: But you just said that October started on a good foot and the season has not been there.

Radhika Piramal: Correct, but it has been quite an unusual move in the last two days. So, I just want to urge some caution this year.

Moderator: Next question is from the line of Sanyam Jain of Edelweiss Securities. Please go ahead.

Manoj: Hi Radhika, this is Manoj here from Edelweiss. My question is on this recent development, in fact I think after this recent development till the time cash gets available, do you think that it will completely shift. Especially in tier 2, tire 3 cities all kind of discretionary purchases and luggage is a discretionary purchase. In fact I think in tier 1 cities, metro people do use credit cards and all. So what is your feel, what kind of data you are getting from your dealer?

Radhika Piramal: It is too early. Obviously it is the most top of mind question. In the short term, there is going to be an impact on sales, what that percentage is difficult to say. I cannot say based on two days. In the long term, I think that a move towards GST, a move towards white money and a move towards banking system all this helps branded goods in relation to unbranded goods. Small businesses are expected to start paying taxes and prices of their unbranded luggage will go up a bit and as the price gap between unbranded and branded reduces, the branded luggage becomes relatively more attractive. It would be difficult to grow in Q3. It is hard to judge at this stage whether it will continues till Jan, Feb or March. Fundamentally both these moves, GST as well as this clean up of our currency are positive for branded players.

Manoj: Radhika, one more question I have basically on the gross margin. This quarter we have seen good expansion in your gross margin. If you can elaborate on that what are the reasons for the gross margin expansion, is it Chinese currency depreciation?

Radhika Piramal: First, we have been able to negotiate some better prices from our Chinese vendors. Secondly, the rupee has remained stable. Thirdly, we took a price increase and fourthly my regular sales are at much higher margin than that Haj order. So these are the reasons.

Manoj: One last question, if I may.

Radhika Piramal: Yes.

Manoj: Looking at the sales growth of your one of the small competitor, Safari do you see some kind of margin pressure, because if I look at their profitability numbers and sales growth, so how you are going to react to that kind of a strategy as well as the other participants in the industry.

Radhika Piramal: As I mentioned in my comments, I think they Safari grew some 8% in Q1 in sales and they have grown at around 46% in Q2, but against that sales growth, they have got a profit of around Rs. 2 Crores. As I said our sales are 3½ times Safai sales, but our profits are 10 times Safari profits. At this point we have a choice, we can continue to focus on margin and margin expansion or we can take some pricing strategies to address their high sales growth which may have some impact on margin.

Manoj: But can it impact your overall blended margins?

Radhika Piramal: Obviously, it can. We are evaluating. It is a bit of a balance between addressing the sales as all the action in the luggage market seems to be happening at the value end. American Tourister and Samsonite have launched a new brand called Kamiliant, Safari is being aggressive and we are fighting back with Alfa and Aristocrat.

Manoj: Sure. Thanks a lot Radhika for taking my questions.

Radhika Piramal: Sure, thank you.

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

Tejas Shah: Hi, sorry, I got disconnected earlier.

Radhika Piramal: That is okay Tejas.

Tejas Shah: Just wanted to know, you said that GST obviously has not very clear as of now, how it will impact, but you would have calculated what is your current incidence of indirect tax rates, so just wanted to understand.

Radhika Piramal: I would rather give a comment on this when I can give a complete comment than giving half information at this time. Thank you.

Tejas Shah: Okay. And you mentioned that this quarter, this run off other income was high because of dividend from Bangladesh subsidiary.

Radhika Piramal: Yes.

Tejas Shah: So is it now regular stream of inflow, which we can build in our numbers?

Radhika Piramal: Yes. Only in Q2, it is an annual dividend that comes after the AGM of that company.

Tejas Shah: Lastly in this quarter, channel check it is very limited and perhaps, but we saw VIP being present in hypermarkets as well, so as we understand the brand constitutes perhaps, Skybag was made for hypermarket and VIP was for a slightly higher format, so I just wanted to understand if we have changed any brand construct over there?

Radhika Piramal: We have added a few lines of VIP at a fairly high price than Skybags in modern trade. Modern trade as a channel is also evolving and it is not only a value seeking customer or discount seeking customer in the modern trade. It is a channel that is growing so fast that we thought that it is better if VIP, Skybags and Aristocrat all participate in this. A few select lines of VIP have been launched in Modern trade at a fairly high price than Skybags. We are seeing very good traction from the chains by launching VIP in hyper markets.

Tejas Shah: Okay, and lastly any comments to share or any numbers to share on Caprese.

Radhika Piramal: Caprese continues to grow well. I am very pleased with the results of Caprese because margins are good. Fundamentally, the market is big; it is growing at around 60%. The potential in the e-commerce remains high. The potential in modern retail remains high. So, I really see this as a great growth driver for our company.

Tejas Shah: Okay, and last quarter you were very upbeat about growth and you back packs. So I just wanted to understand how it turned out this quarter.

Radhika Piramal: Yes, it continues to be good.

Tejas Shah: It is largely in VIP brand or Skybags.

Radhika Piramal: It is largely in Skybags brand. Skybags has the biggest backpack portfolio.

Tejas Shah: Okay, great, thanks and all the best.

Radhika Piramal: Thank you.

Moderator: Thank you. We have the next question from the line of Tushar Sarda of Athena Investments. Please go ahead.

Tushar Sarda: Yes, my question was also related to GST since you said?

Radhika Piramal: Just wait one or two more quarters. We will be happy to discuss in detail once we have the information.

Tushar Sarda: Thank you.

Radhika Piramal: Thank you.

Moderator: Thank you. We have the next question from the line of Yashas Bhatt from LKP Securities. Please go ahead.

Yashas Bhatt: Good evening. I actually have a question regarding your online segment. I wanted to ask how much percentage of revenue does it have currently. I understand it is a small figure.

Radhika Piramal: It is very small; it is less than 5%.

Yashas Bhatt: Also now we can see that the discounting game is not to be there for the long term. And especially knowing with the curbs that you know policy makers is keeping. So how do you see this segment growing?

Radhika Piramal: It is very beneficial for us because obviously if the discounting is very high and the price is the main thing, it helps new and small players. As soon as there is some discipline in the market, the bigger brands do better. So, I remain very optimistic about the potential of e-commerce.

Yashas Bhatt: Alright and which categories do you see the most growth and there would be handbags and backpacks is what…

Radhika Piramal: Growth in handbags and backpacks are more than luggage.

Yashas Bhatt: Alright and you have kept a separate product assortment in order to prevent any kind of a competition or cannibalization from your existing traditional channels.

Radhika Piramal: We are keeping a distinct assortment, whereas at the same time we are offering sufficient varieties so that the customers can get what they want.

Yashas Bhatt: Okay, all right, that is all from my end. Thank you.

Radhika Piramal: Thank you.

Moderator: Thank you. The next question is from the line of Aksha Vora of Raj Financial. Please go ahead.

Aksha Vora: Madam, I might have joined the call a bit late, can I get a mix of the brands we have and the growth in the same.

Radhika Piramal: I do not give specific brand wise growths but all our brands have done well. Skybags, Caprese, and Carlton continue their good growth and VIP in fact has improved its growth rate since Q1.

Aksha Vora: For VIP it would be close to double digit?

Radhika Piramal: Yes, it is in double digit now.

Aksha Vora: All right, thanks.

Radhika Piramal: Thank you.

Moderator: Thank you.

Shradha Sheth: Radhika just a followup from my side. Could you through some light on you know what is leading this double-digit growth in VIP, some light in the sense channel wise what has contributed to this kind of a growth.

Radhika Piramal: Yes, sure. First, obviously we launch a few lines of VIP in modern trade which is growing. Secondly, the assortment that we offered in April for VIP has been very good. As you may recall, month of May was very poor. That one month affected all our brands. So, I would say that VIP is actually doing better April onwards with the exception of very poor May. So, if you just take April, June, July, August, September, our VIP brand is doing much better.

Shradha Sheth: And this must be after couple of quarters that we have grown in double digit?

Radhika Piramal: Yes, we can say that we advertised a lot. We had Hrithik Roshan campaign April onwards. New product assortment has been doing well. We have also launched a line of backpacks in VIP in June. So it is number of things that all planned out and we could see working well in Skybags and we are planning some of these same principles in VIP.

Shradha Sheth: Also if you could talk about the ad spends going forward do we look at similar kind of a range?

Radhika Piramal: Yes, we are little more aggressive closer to 7%. I always say that it is ranged between 5% and 7%, but certainly this year we seemed to have some good momentum. We have some good margin expansion which I would rather plough back into advertising if we can continue our sales growth and grow our brand.

Shradha Sheth: Thanks. Operator you can take the next question.

Moderator: Sure, thank you. The next question is from the line of Harshid Patel from Equirus Securities. Please go ahead.

Harshid Patel: I just wanted to ask you, I just saw one thing. So this is just a book keeping question, as compared to 1Q our 2Q employee expenses have gone up significantly so any particular reasons for that.

Radhika Piramal: Yes, our increment cycle is July onwards, it is that simple. We run from July through June, not April through March.

Harshid Patel: Okay. Another thing I wanted to ask you on Bangladesh subsidiary. I just wanted to ask you, like say what would be our capacity right now over there and what would be our monthly run rate if you can tell me.

Radhika Piramal: Sure. Jogendra you want to comment on that specifically Bangladesh.

Jogendra Sethi: Yes. We have a capacity of around 90,000 pieces and utilisation of capacity is roughly around 60-70%.

Harshid Patel: Okay. So just from a longer-term perspective, when would we look to expand the capacity over there.

Radhika Piramal: The numbers are actually looking pretty good for Bangladesh so at this point, certainly we have enough conviction to ramp up and now we have to add some more product lines in that factory in order to achieve this.

Harshid Patel: Okay. And my last question would be on VIP, so what we have seen since the last one year is that the brand was struggling in terms of growth across various channels, like you had also mentioned in the previous calls. So how are things looking up over there and how confident do we seem that we can retain good growth over there, because I think that it would also be one of the reasons why our gross margins would have improved.

Radhika Piramal: Sure. Q2 was good and as I said that October continued in lines with Q2. Let us see for next 3-4 months. There is a sort of disruption in the retail channel in general let us see what happens. We are doing well for the brands in terms of the advertising and product mix. Let us see what happens.

Harshid Patel: Okay, and maybe till what USD - INR levels would we be comfortable maintaining similar kind of a gross margin considering a similar product mix also.

Radhika Piramal: May be up to 68.

Harshid Patel: Okay sure. That is it from my side.

Radhika Piramal: Thank you.

Moderator: Thank you. We have the next question from the line of Minal Vora from Value Quest. Please go ahead.

Minal Vora: Hello. Hi Radhika, congratulations on a good set of numbers.

Radhika Piramal: Thank you.

Minal Vora: I have a followup question on the Bangladesh subsidiary. So what portion of the sales would this factory be contributing.

Radhika Piramal: About 10%.

Minal Vora: Okay so last quarter also it was about 10%, it has not been increased.

Radhika Piramal: We have not increased it. We are working on it.

Minal Vora: Okay, one more question on the tax rate. The last quarter you said that FY2017 you will be having full tax rate of 34%, but this quarter we see only about 29%, so do you think the tax rate would go up in a certain month.

Jogendra Sethi: At annual level, it should be around full tax rate excluding dividend received.

Minal Vora: All right thank you. That is it from me.

Jogendra Sethi: Thank you.

Moderator: Thank you. Anyone else who has questions may press "*" and "1".

Shradha Sheth: Radhika two questions from my side. In our strategy meet you had explained distribution penetration particularly where we are not well penetrated in our growing brands like Skybags and Caprese, if you can throw some light on you know how we have been expanding.

Radhika Piramal: It is an ongoing process. There has not been a steep jump or anything like that in the last quarter, but growth continues at a steady pace. I would like to tell you that distribution expansion is not so much in terms of Caprese because that is happening through modern trade type of channels while Skybags backpacks is more through traditional distribution with the retailers.

Shradha Sheth: Sure, and secondly you know as we were talking earlier, we are observing in terms of strategy of pricing vis-à-vis the competitors so at what level or what threshold level of margins we would be okay to, you know get more aggressive on pricing so just some light into your strategy?

Radhika Piramal: We are pleased with the margin expansion and definitely we want to keep growing in sales. As Safari persists with its current pricing strategy, we are evaluating the options.

Shradha Sheth: Sure, and earlier I think we were guiding for like 8% to 10% sales growth annually.

Radhika Piramal: At this point, it is too difficult to comment.

Shradha Sheth: Okay Rio anymore questions, can go back in the queue.

Moderator: Right we have a followup question from the line of Tejas Shah from Spark Capital.

Tejas Shah: Hi Radhika just one followup. CSD was missing from today's commentary so any update on things.

Radhika Piramal: We have maintained our market share which is one good thing. The overall channel is not growing as much as it was a couple of years ago. CSD is doing some inventory corrections at their end. CSD is facing some competition from e-com. Even CSD has started complaining about e-com as a potential competitive threat to them.

Tejas Shah: That is surprising because I thought 50% trade margin is not there in CSD, surprise competitiveness of that channel versus online must be very high.

Radhika Piramal: On-line is fairly aggressive.

Tejas Shah: If my understanding is correct. The more we expand in CSD it is also linear in terms of feet on the street, which we will require. So if that penetration is done with so should we bill them at least on employee cost going forward it will not be that?

Radhika Piramal: In terms of an overall employee growth rate, I think 15% is a safe bet so whether it is CSD or any other channel,

Tejas Shah: Okay, this is including budgeting if we expand Bangladesh as we go along.

Radhika Piramal: Yes, sure.

Tejas Shah: Okay. That is it from my side. Thank you.

Radhika Piramal: Shradha, I think we are getting the same calls again and again, so I would like to conclude.

Moderator: Yes, actually that was the last question.

Radhika Piramal: I can understand that this is not the day when people have too many questions, because I really think that this is quite a momentous week in the Indian economy and I think the future we will know a lot better in a few months how the rest of this year is going to shape up. I would like to just close by commenting on us overall for the first half of the year. I would say that it has been an extremely positive year if you look at our H1 results over the previous years. We find considerable growth viz; Margin expansion, good profit growth, reasonable sales growth, and not amazing but quite good in the phase of still subdued demand. We hope that this temporary liquidity crunch does not lead to any macroeconomic demand issues in the economy, assuming that the fundamental demand picks up, we actually remain really poise for good sales and profit growth due to the strength of our brands and the current margin expansion and with that thank you for your time. Thank you.

Moderator: Thank you very much, with that we conclude this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.