Conference Call Transcript

VIP Industries

Q2FY18 Results

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Corporate Participants

Mr Dilip Piramal
CMD

Ms Radhika Piramal
Vice Chairperson & Executive Director

Mr Jogendra Sethi
CFO

Questions and Answers

Moderator: Ladies and gentlemen good day and welcome to the VIP Industries Q2 FY18 Earnings Conference Call hosted by Edelweiss Securities Limited. 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 entering '*' then '0' on your touchtone telephone. I now hand the conference over to Ms. Shradha Sheth from Edelweiss Securities Limited. Thank you and over to you Ms. Sheth.

Shradha Sheth: Thank you Melissa. On behalf of Edelweiss let me welcome you all to the Q2 FY18 earnings call of VIP Industries. From the management today, we have Mr. Dilip Piramal – the CMD, Ms. Radhika Piramal – the Vice Chairman and Executive Director and Mr. Jogendra Sethi – CFO of VIP. So without any further ado I will hand over the call to Mr. Piramal for his initial comments post which we will open the floor for Q&A. Thank you and over to you sir.

Dilip Piramal: Good afternoon everyone. We had a good set of numbers this quarter as you might have observed. The company achieved income from operations of Rs. 309 crores against 285 crores in the corresponding quarter of the previous year, registering a growth of 8.6%. But actually this is bit misleading because in the corresponding quarter last year, there was excise duty included.

So I will just explain to you what has happened is that consequent to the introduction of the GST, several indirect taxes including central excise and VAT have been subsumed in the GST. As per the new accounting standard Ind-AS revenue has to be reported net of GST and VAT and inclusive of excise duty hence the results for the current quarter and the corresponding quarter last year are not comparable. VAT rate for luggage in Maharashtra was 13.5% while GST rate is 28%. So GST for the Quarter 2 FY18 was higher by around 31 crores as compared to VAT in Quarter 2 FY17—31 crore higher than the corresponding quarter last year. Excise duty of around 5 crores was also included in the revenue of Q2 FY17 which has been subsumed in GST now and hence is included in the revenue figures hence there is the total difference of Rs. 36 crores. In that case the total revenue would have been Rs. 345 crores if we had added the 36 crores, a growth of around 21%, so that is the real growth. We have had 21% growth over the corresponding quarter last year. While in the books and the SEBI results, it will show a growth of only 8.6%. During the H1 F18, the company achieved income from operations of Rs. 716 crores against 659 crores with the corresponding six months of the previous year, registering a growth of 8.6%. This again is little convoluted because of the above mentioned reasons. So majority of the call I will be referring to a consolidated financial figure.

For Q2 sales growth was achieved from domestic business mainly as international business sales was slightly negative. The domestic business growth is mainly volume growth. We have had a very good quarter. I think better than what I was expecting especially after the GST which was at 28%. But apparently so far, we have been able to manage it, but we are also quite hopeful that government has said that they will bring down the number of items to 18% and we hope and we qualify in all the criteria which the government has lay down from bringing it from 28% to 18%. So I hope that we should be in the 18% band too. Most of our trade partners are transited to GST. GST is expected to benefit the organized sector in the long run even though the rate is 28% currently which is harsh because effective tax rate in the previous regime was close to 18%. GST should definitely improve tax compliance of the unorganized sector leading to reduction and difference in prices of the organized and unorganized sector. The entry-level brands and even the middle brands from our portfolio will become more attractive.

I would now like to talk about our brands; the Skybags brand is going extremely well. It is also the leading brand for backpack. The VIP brand has started growing. Aristocrat's latest collection has also been very well received and sale of Aristocrat is doing very well. Carlton brand has also done well in the Quarter 2. Caprese, our ladies handbags brand is also doing well and grown well during the quarter and margins are also very good.

During the quarter, modern trade channels have grown very well in spite of the high base. E-commerce channel has also picked up pace. I will now talk about profitability. Our EBITDA was at Rs. 39 crores up from Rs 30 crores that is a growth of about 30%. Overall our EBITDA is 12.7% in this quarter as compared to 10.5% of the second quarter last year which is a good improvement. EBITDA has improved due to higher gross contribution and controlled overheads. Gross contribution has also improved due to product mix and strong rupee. Advertisement and marketing expenses were around 6% which is a norm. For the half year, first half, our EBITDA was at Rs. 103 crores up from Rs. 81 crores that is a growth of 27%. Overall our EBITDA is 14.4% in H1 as compared to 12.2% of H1 last year which is a good improvement. Our profit before tax for Q2 was Rs. 36.4 crores up from Rs. 26.5 crores during Q2 last year which is a growth of 37%. For H1, our profit before tax was at Rs. 96.9 crores up from 73.6 crores last year which is a growth of around 32%. Fixed overheads are well under control. VIP Bangladesh which is a 100% subsidiary had lower sales in the second quarter due to lower demand in Q1 in India due to expected introduction of GST. A new company VIP Industries BD Manufacturing Private Ltd. has been incorporated in Bangladesh on 28th September, 2017. We have formed a new company because there is a seven-year tax holiday. So to qualify for this tax, we have to form a new company and we are expanding our production in Bangladesh that is why we have formed a new company. With that I now invite questions from the floor. Thank you.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. We have the first question from the line of Chirag

Lodaya from Value Quest. Please go ahead.

Chirag Lodaya: My first question is towards top line growth. 21% top-line but if you can spend some more data points on why such kind of high-growth so there was CSD impact also sitting in this quarter, so what led to overall growth?

Dilip Piramal: CSD in fact is the only weak point in our entire portfolio but I feel that all our guns otherwise are firing extremely well. Our brands are doing very well which means basically our advertising is good and the brand is very strong. Our products are exceptionally good. You just have to go to any of our retail shop but you will have to go to more than one to see the entire range because no one shop has all our brands. At the most it will have two or sometimes even three brands but our collection is exceptionally good in all the brands across all brands. And our distribution is good; our dealer relationships are good so except for the CSD aspect which is weak for everybody and which is weak throughout with all the companies, so it doesn't affect our market share. But we are really firing on all cylinders

Chirag Lodaya: Will you be able to quantify negative impact of CSD in the quarter?

Dilip Piramal: Now it's very difficult because now CSD has not been selling much in the last six months or even nine months it's not been very good. So I think some of it is also coming into the civil market. So that is why our overall sales growth is very good.

Chirag Lodaya: And is it do with more of a restocking in trade or secondary sales are also upbeat?

Dilip Piramal: Our pipeline is very small that way, so there are hardly any restocking or anything.

Chirag Lodaya: And how are we seeing upcoming marriage season trend?

Dilip Piramal: I think it should be good. The only slight fear is that October Diwali was very early so October sales have been good and maybe there might be a slight reduction in sales in November, December we have to see that.

Radhika Piramal: One of the reasons, why Q2 sale was strong, was because Diwali was early this year and Dussehra was also in September. Hence, sales were better than usual, partly due to the early festive season.

Chirag Lodaya: And second on gross margin; so now couple of quarters we have seen there is improvement in gross margins Y-o-Y, this quarter also we saw very sharp improvement, so how one should look at this trend? Are we seeing sourcing cost going up with reversal in INR one trend or this benefit will continue going ahead?

Radhika Piramal: Gross margin % is gross margin over revenue that denominator has become smaller because of showing net of tax, so that is one reason we have maintained our margins. It's not that they have improved so much more than what the numbers suggest for the same reason of the GST tax. Our costs have been well under control. In last 2 to 3 months, we are beginning to experience some cost pressures once again from China. It is due to the appreciation of the currency and also oil is coming back a little bit. So our goal is to certainly maintain the current level of margins but that sort of continuous strengthening what we have seen in the last 3-4 quarters may not continue to strengthen further in the next 2-3 quarters.

Chirag Lodaya: One more point on margin, so last quarter we were anticipating some margin pressure because of GST, you took just 6% price hike and we suppose to take one more price hike?

Radhika Piramal: We did on November 1st. We have taken much smaller one and it is in specific brands and channels, so we have not taken it across the board for example we've obviously not taken any price increase In CSD. We have not taken price increase in Aristocrat brand which is a price sort of warrior brand. But having said that with all of these price increases that we have taken is to maintain the current margin.

Chirag Lodaya: So there is no major negative impact of GST in margin at this point of time that is fair assumption?

Radhika Piramal: We are experiencing cost pressure. I am sure many of you who also do consumer durables calls may have experienced the feedback from the others too. We may have to take further price increase due to cost pressures.

Chirag Lodaya: Just last question on these other expenses if I look at your other expense, so in previous quarter we were seeing stable other expense YOY. This quarter, its 73 crores versus 63 crores, so what explains this?

Radhika Piramal: It's a little bit of advertising. We spent a little more. We made a few ads. We have a new Caprese ad which is out on television right now so the production cost of that was there, so more or less in line as we grow our business.

Chirag Lodaya: It's more to do with A&P, right?

Radhika Piramal: Yes. A&P and little bit of overheads also but in line with our company growth.

Moderator: We have the next question from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: Just wanted to know the growth rate that we mentioned is it reflection of industry growth rates or are we gaining market share from organized players?

Radhika Piramal: It's a little tough to comment precisely because we do not have the competitive figures. The industry has been good and it's also possible that we would have taken some share from our major competitor that is Samsonite, American Tourister. We are growing well in modern trade and we are growing well in dealers. We are really growing quite fast in e-com. We were well behind in e-com a couple of years ago and we worked hard to catch up there. So these are the big channels and September definitely was good demand from market with secondary sales. It's really not inventory pipeline thing. Even our Q1 was also good like we didn't have the same tuff June that a lot of other companies experienced so it's not an inventory re-piling up kind of thing.

Tejas Shah: Has the unorganized to organized shift start or is it too early to discuss that?

Dilip Piramal: It's too early. It's possible because of sales growth is good at 20% and it's a good growth and Q2 is not typically such a strong quarter for the luggage industry. So, we will see when our competitor's results come out, either we are gaining share or the market is moving from unorganized to organize.

Tejas Shah: The biggest surprise for the quarter was on margins and you explained that it should not be seen in numerator and denominator term. But even in absolute it is actually 38% growth YOY without other income, so that...?

Radhika Piramal: We took price increases on June 1st. Brand mix is good. Skybags brand continues to grow well and now has the same gross margins as VIP. So there is some effect of the brand mix there, as e-commerce grows it's a good channel, so there is a bit of channel mix effect there too.

Dilip Piramal: I want to make one point about this shift from unorganized to organized sector. What happens is that when the penetration of a category is not very high like in our case I think the penetration is only about 30%. So what really happens is that there is no shift but our organized sector, the market increases like some people do come from the unorganized to the organized but then there are customers who are not—there are people who are not customers of luggage at all—they enter the unorganized market. So if you sort of imagine or visualize the triangle and so people who are below the luggage market were not using luggage, they come into the unorganized sector and some part of the unorganized sector moves up to the organized sector. So as such the ratio remains more or less the same, only when the consumption when the penetration goes beyond 60%-70% then there is a real shift from one sector to the other.

Tejas Shah: If I again come back to margins, just two years back we were at 7.3% kind of margins and we have done a phenomenal job of now even if I remove this quarter's impact but then also last year we exited that 11% margin. And we have set some targets for margin improvement but I see ourselves achieving those targets pretty early clearly a one on this distorted base. So as an organization where are we seeing this goal moving for us now?

Radhika Piramal: By now you know we don't give too much forward guidance. The main reasons why the margins have improved in the last two years as we know is combination of the Indian rupee being stable, commodity prices being low and oil being low. Recent RMB appreciation is very recent so for the bulk of 2016 and first half of 2017, the RMB was also depreciating and we got those benefits in the form of lower buying cost. So when all of that was going in our favor I see the cycle beginning to change a bit. Having said that I think we have good share in the market so decent position where we can take price increases, we have seen that also. We took price increase April 1st, June 1st and November 1st and we have not seen any deterioration of volumes. So I feel pretty good about a lot of cost pressure maintaining and if the cost pressures are not as bad as we fear then possibly continuing in the positive way.

Tejas Shah: Our current price increase covers till what level of INR-dollar scenario?

Radhika Piramal: We can expect to continue as it is hard to put an exact figure on improvement.

Moderator: We have the next question is from the line of Shradha Sheth from Edelweiss Securities. Please go ahead.

Shradha Sheth: Just a question on the industry growth, are we also on a macro level starting to see broader industry growth coming back like mid-teens or high-teen kind of?

Radhika Piramal: I would think so.

Shradha Sheth: It's a top down kind of growth also, right?

Radhika Piramal: I think so. If domestic air passenger traffic remains high. It's about 20% volume growth there. So it's in fact the price difference between unorganized and organized producers, definitely leisure travel business travel is on the up in the country, its good. And the other thing is modern trade and e-commerce as channels are increasing very fast. There are number of new chains who are opening stores, who are aggressively expanding and luggage is definitely an important part of their general merchandise category. So as long as we are active with our new customers, I think we can take full advantage of this demand potential.

Shradha Sheth: Just one more question on the GST. What are the factors in case the rates have come down for us to classify in that 18% tax bracket?

Radhika Piramal: There are few factors what the government has said and we have to just wait and see whether we qualify or not. But what the government says is that they only want luxury goods and not necessities to be in the 28%. One can argue that our luggage is a fairly basic item rather than luxury. The same what you consider television, so luggage can be considered like that. and the second thing is luggage as an industry is not a very big revenue source for the government, so in that sense because we are not a very big industry at all and there are only very few organized players so the amount of revenue loss they would have also through moving out from 28% to 18% would not be very high and yet at the same time then they can say that there is one more item that's in the 18%. Having said all of that we will have much more information by Friday.

Shradha Sheth: Lastly on the Bangladesh subsidiary if you could give some details on what are the utilization levels we are running at and what will be the new capacity?

Radhika Piramal: The existing factory is now four years old and some of you may recall first two years it took good amount of time and management bandwidths to get up to capacity and in the last two years we have been running at capacity which is why we have decided to expand. So we are trying to at the same amount of capacity again, the first factory was not very large because we like to grow slow and steady. So the second company will be the same size again which means doubling our capacity. But still as a total percentage of our sales definitely China remains 60% to 70% of our buying base.

Shradha Sheth: And Bangladesh will be scaling up to what kind of level?

Radhika Piramal: So more than we are, so let's say maybe 10% to 20%. So right now we are at 10% we can hope to become 20% in the next 2-3 years.

Moderator: We have the next question from the line of Chirag Lodaya from Value Quest. Please go ahead.

Chirag Lodaya: Some bookkeeping question, what would be the tax rate for this year?

Radhika Piramal: It's a full tax rate.

Chirag Lodaya: And have you received any dividend from Bangladesh first half?

Jogendra Sethi: Bangladesh Company has declared dividend on preference shares in their AGM in September.

Chirag Lodaya: What would be the CAPEX required for doubling the capacity in Bangladesh?

Radhika Piramal: On the first company, we spent Rs. 20 crores and we should spend about again Rs. 15 to 20 crores.

Chirag Lodaya: So now as on September we are having cash of almost (+120) crores, what are the plans of using this cash?

Radhika Piramal: We will get back to you on that. There is no acquisition opportunity that we see. We remain focused on our Indian domestic market as well as there is little CAPEX that we need for Bangladesh. But as you saw the number it's not a huge amount, so the cash pile remains.

Moderator: We have the next question from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: Couple of follow-ups, so first on Caprese, you mentioned that the brand is doing well. So if you can help us understand qualitatively also where we stand in terms of competitor positioning and pricing?

Radhika Piramal: The brands doing well that is growing in terms of competitive position. We are in the top 5 ladies handbag brands in India and others would be Lavie, Baggit, Esbeda. I'm not counting Hidesign and Da Milano, they are in the genuine leather segment which is much more premium but including the most of 5-6 brands. So Caprese is going well at the same time it is not like a 300 crores or 500 crores brands which remains our ambition for Caprese so we have to really think about how we can get the brand to that scale. The margins are good, the growth rate is decent but how to reach that big level of scale remained something whether through our retail network or dealer network, hypermarkets. We have to explore really more aggressively. I think additional distribution channels if we really want to get the brand to scale.

Tejas Shah: Last to last quarter we were showing very good numbers in growth rate in backpacks. Just wanted to know how is that segment panning out for us?

Radhika Piramal: Yes, it continues to do very well and in fact so it's going well, the margins are fine and the difference in backpacks and handbags. In backpacks, we have very good product assortment priced at Rs. 1000 to 2000 including really attractive products like Rs. 1500-1800 which we don't have in handbags. Handbags really the core range is Rs. 2000 or 3000 and I think to get that additional 100 crores sales from the segment we have to crack that price point without which it becomes difficult to scale. So I think that's the challenge for Caprese which somehow we have linked in backpacks.

Tejas Shah: The price hike that you spoke about, has the industry also taken the similar price hike?

Radhika Piramal: I don't think so but the competitor took a bigger price increase than us in July. So I think with this November when we are just sort of catching up to them in terms of our price with competition. So as usual we are in the middle of the sales growth and in the middle of the pricing and profits also. When I say in the middle I mean in between our two competitors.

Moderator: We have the next question from the line of Chirag Lodaya from Value Quest. Please go ahead.

Chirag Lodaya: My question is on supply chain, so now post GST are you doing any changes to our supply chain?

Radhika Piramal: No, we always bought from fairly organized vendors, so we have not had any real issues in our vendors being GST compliant.

Chirag Lodaya: And in terms of distribution warehouse?

Radhika Piramal: No, we are doing another change in terms of shifting central warehouse closer to the port rather than close to the our Nasik factory but that has got nothing to do with the GST but is for internal operational efficiency movement.

Chirag Lodaya: We are buying that warehouse or it's on lease?

Radhika Piramal: On lease.

Moderator: We have the next question from the line of Amit Agarwal from Kotak Securities. Please go ahead.

Amit Agarwal: My question is pertaining to volume like would you be able to comment on the volume growth that the company experienced in both the soft and hard luggage segment in Q2 FY18?

Radhika Piramal: We have had some price growth. I'm quite pleased with that because one concern is always when you take price increases is that whether the volumes will decline and in fact our volumes have continued to grow quite well.

Amit Agarwal: But would you be able to quantify the volume growth?

Radhika Piramal: No.

Amit Agarwal: Once the second plant in Bangladesh is fully operational, how much we estimate soft luggage sourcing from Bangladesh?

Radhika Piramal: As I said right now it is less than 10%, so the goal is for it to become 10% and when its 10 then 15%, ideally if we can do 20% nothing like it.

Amit Agarwal: Would you be able to share your CAPEX plan including maintenance CAPEX for the next two financial years?

Radhika Piramal: Our CAPEX needs are actually quite limited. We buy a lot from vendors, so we are going to spend this 20 crores on Bangladesh, additional 20 crores and then our usual what we spend which has been very consistent for the last 3-4 years so you can see that.

Moderator: We have the next question from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: You have actually steered this company from very troubled times of 2011 to 2017 and now it seems is like in steady shape in terms of cash flow generation, in terms of margins. Slow its slightly critical question but where do you see this company now, all the brands from here in next three years?

Radhika Piramal: I think we have to continue growing with some more aggression. So if there was one thing I would like to do is we see some slightly better revenue growth in the last few months. I do think that the Indian economy has improved and I would like for us to participate with all of that in our brands in a very aggressive manner. I think the one thing we can improve is our sales growth rate which has really started to happen in the last 3 or 4 months, so I want to continue that. Revive VIP brand, it's growing fine but it can do better, make Carlton a bigger brand, participate in the premium segment in a more serious manner, bring Caprese to scale by which I mean 300 or 500 crores which is much more than where it’s at right now. There is opportunity in the Indian consumption space, you have to have finely segmented brands, good distribution strategy, good assortment and just keep working hard on that. There is a certainly great potential for growth.

Shradha Sheth: Also Radhika just lastly one question from my side, more on Bangladesh. Just wanted to understand as we are scaling up further production there from 10% to 20% of our procurement, it potentially means the trading margins coming in-house to manufacturing. So despite the currency pressure we believe these kind of gross margins can sustain because of the model that we are moving towards manufacturing?

Radhika Piramal: We can see that in the last one year on a consolidated basis our EBITDA margin has slightly improved because of Bangladesh, so on that basis we are expanding our capacity. Definitely we see that continuing.

Shradha Sheth: Are there any further questions?

Moderator: No further questions. Ms. Piramal would you like to make any closing comments?

Radhika Piramal: Thank you all for dialing in. I really do appreciate even the multiple questions from the same person. It's a great pleasure to have a continued conversation with all of you who follow our company. It’s been a good run despite demonetization, despite of very high GST rate. I think we have shown a good performance, all credit to the team here and I'm very confident that we will continue to have a good run in the month and quarters ahead. Thank you very much.

Moderator: Thank you. Ladies and gentlemen on behalf of Edelweiss Securities Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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