V.I.P. Industries (VIP IN)

Rating: BUY | CMP: Rs444 | TP: Rs579

Bag it for a sky ride

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Contents

March 25, 2019

Company Initiation

Key Financials (Consolidated)

	FY18	FY19E	FY20E	FY21E
Sales (Rs. m)	14,096	17,917	21,897	26,695
EBITDA (Rs. m)	1,934	2,249	2,934	3,764
Margin (%)	*13.7*	*12.6*	*13.4*	*14.1*
PAT (Rs. m)	1,268	1,453	1,920	2,481
EPS (Rs.)	9.0	10.3	13.6	17.6
Gr. (%)	*48.8*	*14.7*	*32.1*	*29.2*
DPS (Rs.)	3.0	3.4	4.2	5.5
Yield (%)	*0.7*	*0.8*	*0.9*	*1.2*
RoE (%)	*25.6*	*25.0*	*26.6*	*27.8*
RoCE (%)	*36.9*	*35.4*	*38.2*	*40.0*
EV/Sales (x)	4.4	3.5	2.8	2.3
EV/EBITDA (x)	32.0	27.5	21.0	16.2
PE (x)	49.5	43.2	32.7	25.3
P/BV (x)	12.8	10.7	8.7	7.0

Key Data	VIPI.BO | VIP IN
52-W High / Low	Rs. 647 / Rs. 300
Sensex / Nifty	38,165 / 11,457
Market Cap	Rs. 63 bn/ $ 910 m
Shares Outstanding	141m
3M Avg. Daily Value	Rs. 425.67m

Shareholding Pattern (%)

Promoter's	53.46
Foreign	10.54
Domestic Institution	8.06
Public & Others	27.94
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	3.2	(12.7)	43.7
Relative	(3.0)	(15.7)	24.8

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Bag it for a sky ride

We initiate coverage on VIP Industries Ltd (VIP) with a BUY rating given market leadership (~50% revenue share) in the organized luggage industry, well-diversified product portfolio (six brands and multiple SKUs exceeding 1,500) and solid brand salience (brand-ex is ~5-7% of sales). Strong distribution network (~11,000 touch points), GST implementation (narrowed pricing gap with unorganized players resulting in up-trading) and entry into the under penetrated ladies hand bags and backpack market is likely to drive sales/PAT at a CAGR of 23.7%/25.1% over FY18-21E. While headwinds from currency & crude volatility prevail, product premiumisation (rising share of Caprese and Carlton) and increase in production from captive facilities at Bangladesh will aid in 40bps EBITDA margin expansion over FY18-21E. We expect premium valuations (32.7x FY20E and 25.3x FY21E) to sustain given strong growth prospects, debt free BS, high return ratios (RoE/RoCE of 25.6%/36.9% in FY18; to expand by 230bps/310bps over FY18-21E), and healthy dividend pay-out (average 41% over last 5 years). Initiate with a BUY and TP of Rs579.

GST has proved to be a boon for the industry: Luggage/backpack/handbags market is dominated by unorganized players with a share of ~67%/<67%/~90-92% respectively. GST implementation has brought unorganized players within the tax net and reduced the pricing gap making organized players more competitive. However, our channel checks reveal that transition is still a work in progress and the market is highly fragmented making full compliance a long drawn process.

Handbags & backpacks are key growth levers: Given changes made in price point and revamping done in the distribution channel, we expect Caprese's revenues to increase at a CAGR of 35.0% over FY18-21E. Further share of backpacks is likely to improve from ~15-20% of sales in FY18 to 22.1% in FY21E as two additional brands have been launched, merchandize has seen improvement and penetration is low.

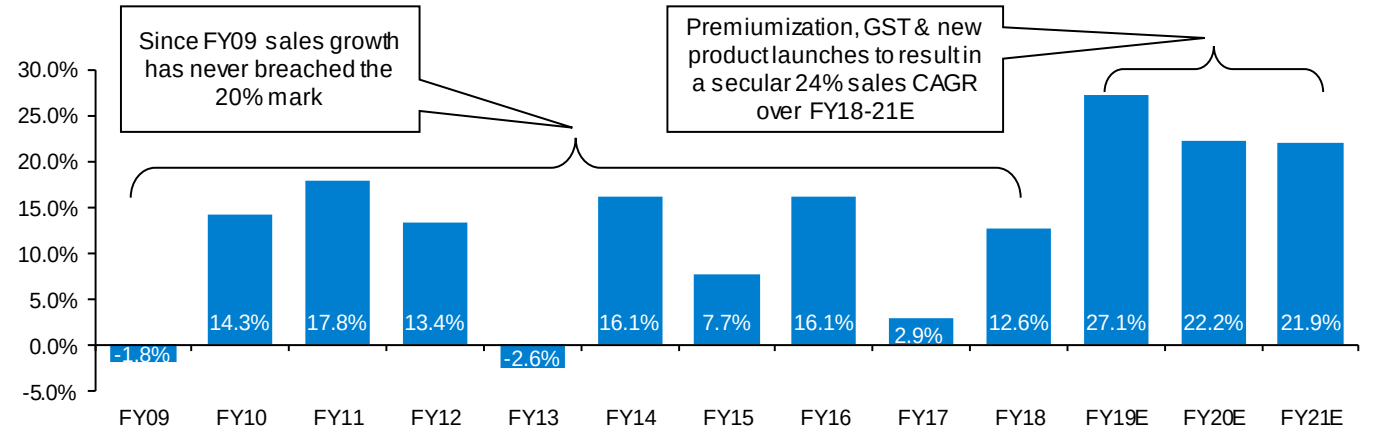
Bangladesh expansion to improve profitability profile: As Bangladesh operations gain scale dependency on China is expected to come down and improve the profitability of VIP due to 1) better control over sourcing 2) accrual of manufacturing profit within the company 3) labour cost arbitrage and 4) import duty advantage.

Channel checks indicate brand pull for Skybags is high: Our channel checks indicate that brand pull for Skybags is high, Carlton is extremely sturdy product, and trade margins are highest for unbranded products. Further, Safari has strong presence in hyper markets while quality issue on Samsonite's products is fairly low.

Outlook & valuation: Valuations at 32.7x FY20E and 25.3x FY21E reflect the brand premium and size of opportunity pie (transition towards organized market) VIP has at its disposal post GST. We value the stock at 33x FY21E EPS in light of strong growth prospects (sales/PAT to grow at a CAGR of 23.7%/25.1% over FY18-21E), ensuing product premiumisation and rising share of Bangladesh operations which will be margin accretive. Initiate with a BUY and TP of Rs579.

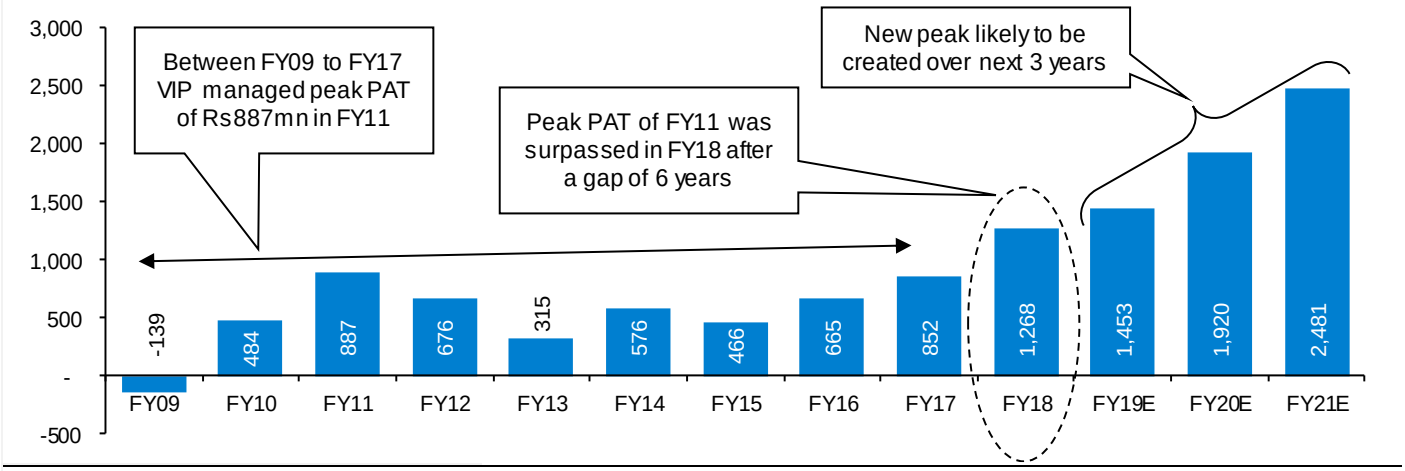
Story in charts

Exhibit 1: Sales to grow at a CAGR of 24% over FY18-21E



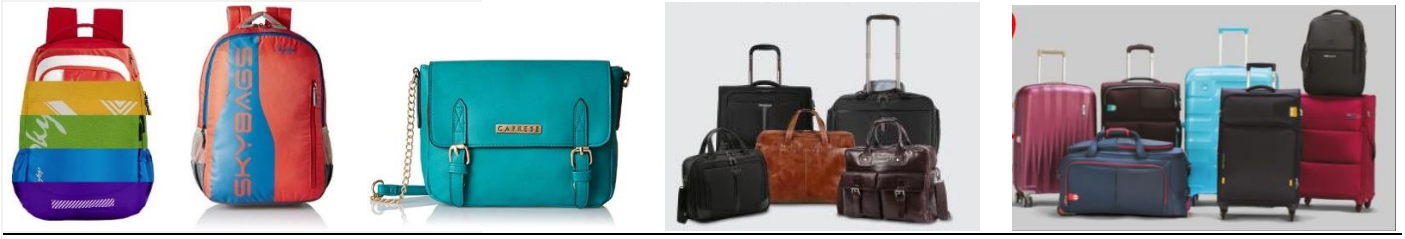
Source: Company, PL

Exhibit 2: Secular earnings expansion is on the cards (Rs m)



Source: Company, PL

Exhibit 3: Strong portfolio comprising of luggage, backpacks and handbags



Source: Company, PL

Exhibit 4: Segmentation of luggage Industry

Segment classification	Approximate price point	Competitive intensity	Peer standing
Premium	Upwards of Rs6,000	Moderate	Samsonite is the market leader
Economy/Value	Rs4,000-6,000	Moderate	VIP is the market leader
Mass	Less than Rs4,000	High as maximum upscaling has happened in this segment post GST	Safari has made strong in-roads in the last few years

Source: PL

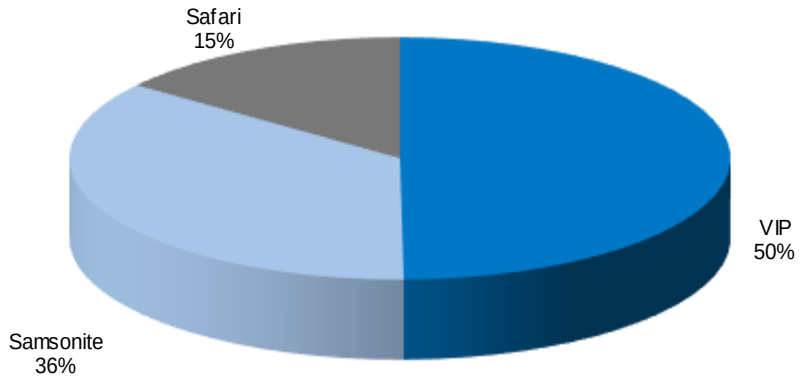
Company Overview

VIP is a formidable play on luggage market in India

VIP is the market leader in organized segment with a revenue share of ~50%. Samsonite is the second largest player followed by Safari with a share of ~36% and ~15% respectively.

VIP is a strong play on huge growth opportunity in the Indian luggage market given rising discretionary spends on travel and tourism, emergence of backpacks as a key accessory for students and rising demand for premium handbags amid increasing proportion of working women in population. VIP's product portfolio consists of diverse range of hard-sided and soft-sided luggage which includes strollys, suitcases, duffel-bags, backpacks, executive cases, overnight travel solutions and school bags. It has two manufacturing units located at Nashik and Haridwar for manufacturing hard luggage while soft luggage is imported from China. The company has also set up a wholly owned subsidiary in Bangladesh which serves as a captive manufacturing unit (soft luggage) for the parent. VIP exports (~4% of revenue in FY18) to more than 31 countries including UK, Europe, UAE, Qatar, Kuwait, Asia Pacific etc.

Exhibit 5: VIP is the market leader in luggage industry



Source: Company, PL

PS: Market share is calculated on latest fiscal revenue of all the 3 players

VIP has six brands in its portfolio viz; Carlton, VIP, Skybags, Aristocrat and Alfa in luggage and Caprese in handbags. Samsonite and Safari have 8-10 brands concentrated at premium and mass end of the industry respectively. While VIP is more or less well diversified across regions Samsonite is strong in South and Safari is strong in North.

Exhibit 6: VIP has even geographic presence versus competition

VIP	Safari	Samsonite
More or less similar across geographies	North	South
	West	North
	East	West
	South	East

Source: Company, PL

Exhibit 7: Brand portfolio of the luggage players

Company	Brands	5 year average EBITDA margin	Our inference on margin profile	5 year revenue CAGR	Our inference on revenue growth
VIP	Carlton, Caprese, VIP, Skybags, Aristocrat, Alfa	9.8%	Has presence across both mass & premium segments (margin is higher than Safari but lower than Samsonite)	11.0%	Has a relatively stable market share; growth in line with industry
Samsonite	Samsonite, Samsonite red, American tourister, High sierra, Hartman luggage, Tumi, Speck, Kamiliant, Lipault, Gregory, Saxoline (Chile only brand)	14.7%	Is a premium player (highest margin)	9.1%	Has a relatively stable market share; growth in line with industry
Safari	Safari, Genius, Magnum, Egonauts, Gscape, Activa, Orthofit, DBH, and Genie	6.6%	Is a mass player (lowest margin)	34.8%	Has gained market share (growth above industry average) from unorganized players since it has mass offerings

Source: Company, PL

VIP's sales and PAT have grown at a CAGR of 10.4% and 39.6% respectively over FY15-18. We estimate sales and PAT to grow at a CAGR of 23.7% and 25.1% over FY18-21E given 1) strong tailwinds from GST 2) ability to straddle across segments and price points 3) depth and width of distribution network and 4) benefits from rising production from low cost destination (Bangladesh). Debt free balance sheet and RoE/RoCE of 25.6%36.9% respectively in FY18 makes VIP as one of the best plays on discretionary spends in India.

Exhibit 8: Key timeline of events for VIP Industries

Year	Event
1986	Alfa brand launched
1992	BP Ergo launched
1996	Elanza variant launched
2000	Delsey JV (Delsey products were stocked in VIP outlets. In 2010, the JV got terminated)
2001	Bangladesh JV (50:50 JV with Nitol Group)
2004	Carlton brand acquisition, Opened office in Hong Kong
2005	Retail focus, brand identity revamp, Haridwar plant
2008	Merger of Aristocrat with VIP, launch of coupe twin section bag
2009	Launch of water & stain resistant bags with Teflon, Ranked amongst the top 100 most trusted brands
2011	Skybags launch, Started manufacturing PC cases
2012	Manufacturing of printed PC cases
2013	Caprese launched, manufacturing of hybrid PC cases
2014	Bangladesh operations began
2017	Set up a subsidiary in Bangladesh
2018	Followed it up with another subsidiary in Bangladesh

Source: Company, PL

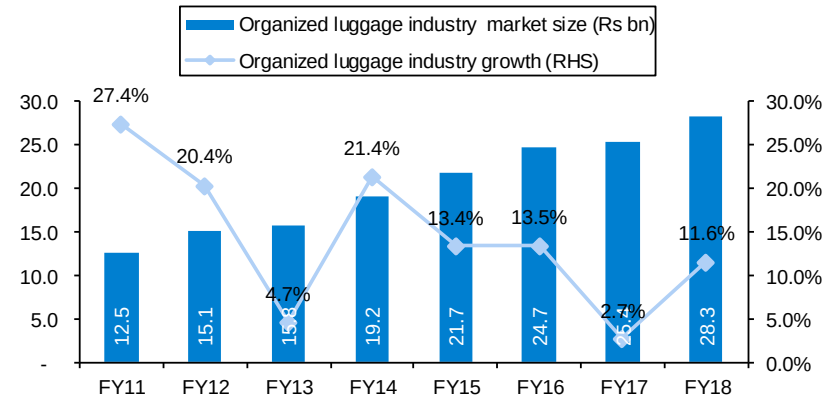
Investment Argument

Organized luggage industry on cusp of higher growth

The Indian luggage industry with a market size of ~Rs75-80bn (wholesale level) is dominated by unorganized players (~67% value share & ~80% volume share). The market size for back packs (growing by ~30% annually) and hand bags is ~Rs>30bn and ~Rs70bn respectively.

The organized luggage sector (VIP, Samsonite & Safari used as a proxy for the sector) has grown at a CAGR of 12.4% over the last 5 years (FY13-18). While Safari has grown at a CAGR of 35%, VIP and Samsonite have registered a growth of 11% and 9% respectively over the same period indicating that Safari has gained market share from unorganized players since it has mass offerings.

Exhibit 9: Organized luggage industry has doubled over the last 5 years



Source: Company, PL

Dominance of unorganized players on a wane

Unorganized players dominate the luggage industry in India. Dominance of unorganized players in back packs market is in line with luggage (<67% share). However, the hand bags market is even more fragmented with unorganized players having a higher share of ~90-92%.

Exhibit 10: Organized players have lowest penetration in the hand bags market

Category	Industry size	Share of organized
Luggage	Rs75-80bn	~33%
Backpacks	>Rs30bn	<33%
Hand bags	Rs70bn	~8-10%

Source: Company, PL, Media articles

On an average, branded luggage sells at a 100% premium. However, typical premium of an entry level (mass segment) branded offering is 15-20%. For back packs and hand bags pricing difference is in excess of 30%. Poor quality and rampant under invoicing to evade taxes makes unorganized sector a cheaper option.

Exhibit 11: Unbranded sells cheap due to poor quality & under invoicing

Category	Average discount to an organized player
Luggage	40-50%
Back packs	~50%
Hand bags	>30-40%

Source: Company, PL

Over the last 1-2 years, penetration of organized players in all the 3 categories has improved amid improving lifestyle, rising brand consciousness, better quality and attractive price points. We expect organized players to further increase their penetration and market share led by: -

- **Ability to innovate and launch variants:** Organized players have significantly increased innovations and new variant launches in recent past. We have seen more innovations flowing in the polycarbonate segment which has seen launch of vibrant colors and new designs specifically targeting female and children. Soft luggage has seen a lot more variety in fabric and accessories which unorganized players would find hard to match.

- **Lifetime replacement warranties**: Further, the fact that organized players offer warranties (typically 5 years in case of luggage and 1 year in case of backpacks) makes them a preferred choice for buyers. More importantly, domestic players have started highlighting the importance of warranties as it would be very difficult to get any product repaired/warranty enforced in case of unorganized brands.

  We note that Safari has started offering replacement warranties rather than repair warranties which has added to the attractiveness as an entry level luggage at just 15-20% premium. VIP has also started offering lifetime warranties for Carlton edge in the premium segment. We believe lifetime warranties will go a long way in increasing the sales of organized players.

- **GST led gains:** GST implementation will bring unorganized players within the tax net and reduce pricing gap making organized players more competitive. In pre GST era excise on local production was 12.5%, cess was 0.5% and VAT stood at 14% resulting in blended tax rate of ~27%. However, the effective indirect tax rate was ~18% given excise exemption at Haridwar plant, higher share of soft luggage sales which is imported & hence did not attract excise and differential VAT rates. Given that the GST rate is reduced from 28% to 18% recently, the overall tax impact on the luggage industry post implementation of GST is neutral.

Exhibit 12: Tax incidence pre & post GST era

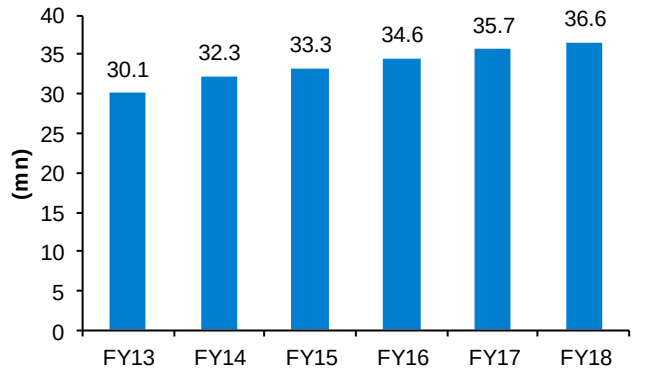
Particulars	Tax rate
Tax incidence pre-GST	18%
Tax incidence post-GST	Earlier the GST rate was 28% which was brought down to 18%

Source: Company, PL

Strong macro tailwinds to support industry growth

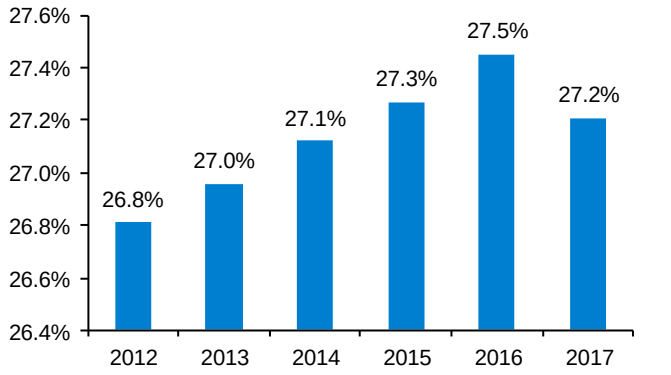
Growth in the luggage/backpack/handbag industry is linked to factors like 1) employee work force/student growth (linked to backpack demand), 2) increasing ratio of working women which induces discretionary spend (linked to handbag demand) and 3) air traffic which is a function of growth in tourism & business travel (linked to luggage demand).

Exhibit 13: Student enrolment in higher education rises at 4% CAGR over FY13-18



Source: AISHE, PL

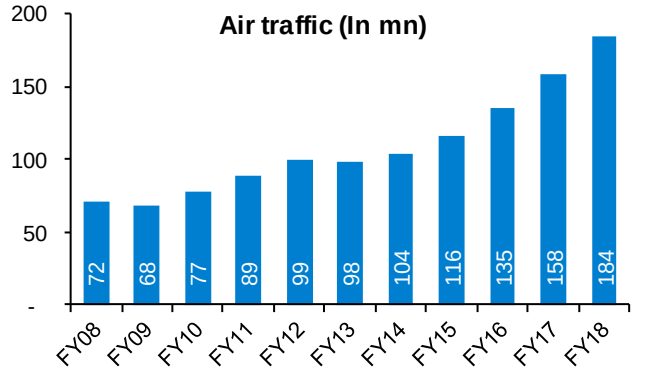
Exhibit 14: Female labour force participation is on a steady rise



Source: World Bank, PL

Air traffic in India has grown at a CAGR of 9.9% over the last 10 years. Further, domestic expenditure on tourism and number of domestic tourist visits have grown at a CAGR of 7.2% and 9.6% respectively over the last 5 years.

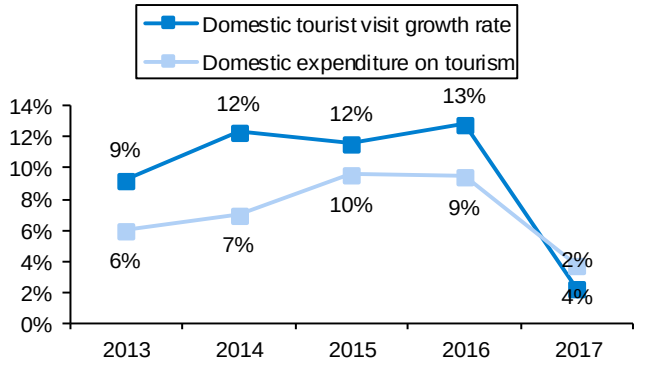
Exhibit 15: Air traffic rises at a CAGR of 9.9% over FY08-FY18



Source: DGCA

PS: The traffic data includes inbound/outbound traffic of domestic & international carriers

Exhibit 16: Rising discretionary spends aiding tourism



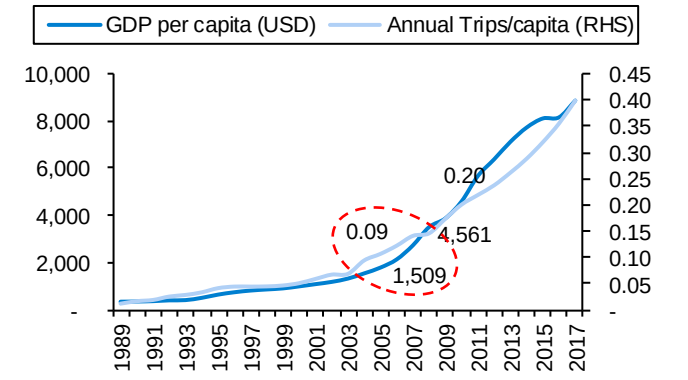
Source: IBEF & Ministry of tourism

Despite growth of its air travel market over the past decade, India still has one of the lowest air travel penetration rates in the world, as defined by annual domestic carrier seats per capita.

India's air passenger traffic is at a phase observed by China in 2004 when it's GDP per capita crossed the $1,500 mark for the first time. With a GDP per capita of $1,509 China's annual trips per capita stood at 0.09. Over the next 6 years in spite of global turmoil in 2008, China's annual trips per capita doubled to 0.20 and has been growing at a steady state ever since. Taking this cue, India having entered this phase only in 2014 is set to witness strong growth in passenger traffic over the coming few years.

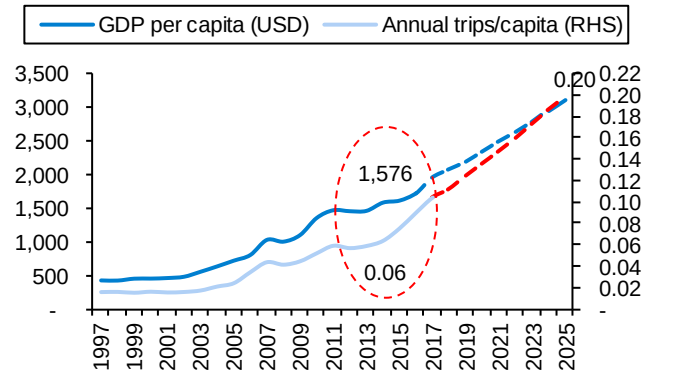
We believe that confluence of all macro factors like rising mass of students/ workforce, working women and rising disposable income will enable luggage industry to surpass the 12.4% compounded growth witnessed in the past 5 years.

Exhibit 17: China entered strong growth phase in 2004



Source: World Bank, PL

Exhibit 18: India's annual trips/capita at an inflection point



Source: World Bank, Airbus, PL

VIP all set to ride the growth phase in luggage industry

VIP is well poised to ride tailwinds evident in the industry led by strong entry barriers like 1) well diversified portfolio with multiple brands that straddles across price points 2) superior distribution network 3) manufacturing efficiency that comes with increasing scale of Bangladesh operations and 4) strong growth potential visible in the handbags & backpacks market.

Multiple brands straddling across price points

VIP has a well-diversified product portfolio comprising of six brands and multiple SKUs. Prime advantage of having a well-diversified portfolio is presence across all three price segments viz: premium, economy and mass which enables VIP to serve customers across price points. Carlton & Caprese are premium brands with highest margin while Aristocrat & Alfa cater to mass segment with lowest margin. VIP and Skybags are value/economy offerings.

While Samsonite's product portfolio is equally well diversified with presence across premium (Samsonite), economy/value (American Tourister) and mass brands (Kamiliant) focus is more on the premium side. Safari has predominantly a mass portfolio with limited presence in the premium category.

Exhibit 19: Well diversified product portfolio across categories

Brand	Year of launch	Typical price point	Brand positioning	Key competitors	Product type	Channel dominance	Revenue contribution	Margin hierarchy
Carlton	2004	Rs6,000-8,000. Carlton Edge range is higher	Premium	Samsonite	Luggage	EBOs	~7-8%	Both Carlton & Caprese have highest margin within the product portfolio
Caprese	2013	Rs1,500-4,000	Premium	Lavie, Baggit, Esbeda, Unorganized	Handbag	Modern trade, EBOs, E-com		
VIP	1971	Rs4,000-6,000	Economy	American Tourister, Samsonite, Safari	Luggage, backpacks	NA	~70-75%	Lower than Carlton & Caprese but higher than Aristocrat & Alfa
Skybags	2011	Rs4,000-6,000	Economy	American Tourister, Samsonite, Safari	Luggage, backpacks	NA		
Aristocrat	2008	Sub Rs4,000	Mass	Safari, Kamiliant, Unorganized	Luggage, backpacks	Hypermarket, E-com	~20%	Lowest margin within the product portfolio
Alfa	1989	Sub Rs3,000	Mass	Safari, Kamiliant, Unorganized	Luggage	Traditional dealer channel		

Source: Company, PL, Media articles

PS: 1) The company does not share brand wise sales figures. Hence, revenue contribution figure is arrived based on information available in public domain 2) Typical price point figures are based on our channel checks.

Given bulky nature of the product (increases retailing cost) and low inventory turn (luggage is bought infrequently over 4-5 years) SKU management becomes a challenging task. Lower SKUs will limit the choice for customer while having higher SKUs can result in dead stock increasing storage & inventory costs.

In terms of SKUs, Safari has done incredibly well over the last few years with more than 100+ SKUs for a revenue size of Rs4.1bn as of FY18. VIP's SKU count is >1,500 and more than Safari as it has presence in handbag segment which requires higher SKUs (random search on Amazon for travel bags under VIP brand gives 290 listings, the count rises to 3,000 for handbags under Caprese brand). Also, in the backpack segment, VIP has added a lot more designs (increases the SKU count) that have been well appreciated (Skybags is a leading brand for backpacks within 5-6 years of its launch) within the dealer/distributor channel.

VIP has strongest distribution network amongst peers

Apart from the traditional dealer/distribution channel there are numerous other sales channels in the luggage industry like canteen store department (CSD), modern trade, EBOs, MBOs, E-com etc. Every channel has a different operating characteristic (ex: e-com is a highly discounted channel, CSD credit is longer, EBO is a high cost channel where in-store merchandiser is required). Even the product assortment varies quite a bit to avoid channel conflict. Diversity in distribution channel creates a huge barrier for the new entrant.

VIP has a well-entrenched distribution network comprising of CSD, modern trade, EBOs, MBOs, E-com. The company has about ~1,000 active dealers, 100 active distributors (which in turn reach to 1,000 retailers), ~250 EBOs and ~250 franchises. The company also has presence across ~1,000 modern trade outlets. Total point of sale is ~11,000.

Exhibit 20: Modern & retail trade dominates the distribution network for VIP

Distribution channel	Revenue contribution for VIP	Revenue contribution for Safari	Revenue contribution for Samsonite
Modern & general trade	Data not available but the category has highest share in revenues. Both modern trade & general trade are at par.	~50% (Modern trade & general trade account 25% each)	NA
CSD	~20%	~25%	NA
Institutional	Data not available but has the third highest share in revenues	Both e-com & institutional contribute ~25%	NA
E-com	~6%		~14%

Source: Company, PL, Media articles

In comparison to VIP, Safari's penetration in dealer/distribution network is low. However, the CSD share is higher. Safari has 40-50 EBOs (lower than VIP) but is planning to expand the stores in high footfall areas. In all, Safari has >3,500 customer touch points. On the other hand, Samsonite has more than 350 stores across India.

Both Samsonite and Safari have a higher share of E-com as they do not have a vast dealer network like VIP. Since E-com is a highly discounted channel unless the manufacturer has a different product assortment, it can create a channel conflict with traditional channel partners. (Dealers can refuse to stock inventory as the same product is sold on other channel at a discounted price).

Despite having strongest distribution network amongst peer's VIP is facing a structural challenge as consumers are moving away from traditional dealer/distribution channel (where VIP is stronger than peers) to other channels like modern trade, e-com, EBOs etc which offers a better environment to shop. However, in line with evolving shopping trends, VIP has improved its presence meaningfully in other channels (E-com revenue share has increased from 3% to 6%; focus on expanding via EBOs/franchise is also rising) to ensure that it does not lose market share to competitors. Typically margins across channels are similar, however, EBO's have highest margins while E-com has lowest margins.

Share of CSD going down with rising penetration in other channels

CSD is a Government of India enterprise which provides access to quality products (household requisites, watches & stationery, general use items etc) of daily use at below market rates to the armed forces. The department has 34 depots and 3,000 odd canteens located all over India.

Since there is no trade margin, prices in CSD are lower (there is a tax advantage too which further helps in price reduction). However, establishing presence in the channel is difficult as it takes about 9 months to get the design approved and listed. Also, taking a price hike in the channel takes a bit longer than other channels as there is a process which needs to be followed to get the approvals. Pricing & product assortment for CSD happens at HO and there is no need to negotiate with each CSD individually. As seen in exhibit 20, Safari's revenue share in CSD is higher than VIP Industries given Mr Sudhir Jatia (CMD and an ex-MD of VIP Industries) has strong relationship with CSD officials (CSD business is dependent on relationship).

CSD remains as one of the key distribution channels although its share in industry sales has started declining in past 3-4 years. This follows quantitative restriction on consumer purchases, lower CSD allocations by ministry and working capital issues. In addition, better shopping experience, higher discounts and convenience is taking consumers towards emerging channels like e-com, modern trade etc.

Efficiencies in manufacturing & procurement provides competitive advantage

Increasing share of captive manufacturing from Bangladesh will increase efficiencies in production while scale advantage that comes from bulk China sourcing provides huge competitive advantage to VIP.

Bangladesh expansion to improve profitability profile

In order to reduce dependency on China as it is witnessing wage inflation, VIP has set up a captive soft luggage (SL) manufacturing facility in Bangladesh. VIP has 3 subsidiaries in Bangladesh viz; VIP Bangladesh Ltd (established in 2012), VIP Industries BD Manufacturing Pvt Ltd (established in Sep 2017; has a 7-year tax holiday) and VIP Luggage BD Pvt Ltd (established in 2018) with a capacity of 2.1mn units. The plan is to increase the capacity to 3.5mn units by end of FY19.

Currently, China is the largest SL sourcing destination for VIP. However, as Bangladesh operations gain scale dependency on China is expected to come down and improve the profitability of VIP due to 1) labour cost arbitrage 2) better control over sourcing and 3) import duty advantage.

Exhibit 21: China dominates the sales mix for VIP

Country	Contribution to sales	Comments
China	>50% of sales	Mostly SL. Fully outsourced
India	~25-30% of sales	Mix of HL & SL. HL is manufactured in-house while SL is sourced from vendors
Bangladesh	~4-5% of sales	Mostly SL. Own manufacturing

Source: Company, PL

Labour cost arbitrage: Rising wage inflation in China is the primary reason for setting up manufacturing operations in Bangladesh. Roughly, labour cost in China is 4x of Bangladesh. SL is highly labour intensive (in order to manufacture the current quantum/value of SL internally VIP would need additional 10,000-12,000 employees; (current strength as of FY18 including contractual labour is 5,069 employees) and thus there is a huge labour arbitrage in shifting Bangladesh.

With Bangladesh operations, in addition to distribution margin, manufacturing margin would also accrue within the company.

Exhibit 22: Sales & profitability profile of Bangladesh operations

Particulars (Rs mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	FY17	FY18	FY19E	FY20E	FY21E
Sales	138	50	184	198	252	259	389	490	570	1,300	1,690	2,197
PAT	32	1	30	32	40	27	61	83	95	221	287	373
PAT margin	23.2%	2.0%	16.3%	16.2%	15.9%	10.4%	15.7%	16.9%	16.7%	17.0%	17.0%	17.0%
Bangladesh's sales a % of total sales	3.5%	1.6%	5.4%	5.5%	4.9%	6.4%	9.0%	3.9%	4.0%	7.3%	7.7%	8.2%
Standalone PAT	378.2	242.4	240.8	324.4	598.5	310.4	198.6	763.9	1,185.7			
Standalone PAT margin	9.5%	7.8%	7.1%	8.9%	11.6%	7.7%	4.6%	6.1%	8.4%			

Source: Company, PL

As seen in the table, except for 2QFY18, where in VIP Bangladesh's performance was impacted due to disruption in production, average PAT margin of Bangladesh operations over the past 8 quarters is ~2.1x of standalone operations of VIP. As contribution of VIP Bangladesh improves from 3.9% of sales in FY17 to 8.2% of sales in FY21E with capacity addition, incremental contribution to profits will rise considering the PBT margin delta is ~5-6%, if the production is outsourced from Bangladesh rather than China.

Better control over sourcing: With own manufacturing at Bangladesh plant, VIP can exercise better control over sourcing the raw material (PP of particular blend and quality can be purchased, can pre-stock raw material if prices are down etc). In the current scenario, where finished goods are imported there is limited control over sourcing as Chinese have better bargaining power due to scale.

Import duty advantage: In Sep 2018, import duty on luggage was increased from 10% to 15% by the GoI. However, Bangladesh is exempted from import duty resulting in direct tax savings.

Scale advantage in sourcing

China is the world capital for soft luggage (SL) manufacturing due to abundant RM availability and labour (SL is labour intensive). Most players import their SL requirements from China and manufacture hard luggage (HL) in house. Given Chinese operate on a large scale they have a better bargaining power. Thus, unless a buyer sources huge quantity getting the desired quality, discount (bulk purchases), and favorable payment terms may not be possible. As of FY18, VIP's sales are 1.4x higher than Samsonite (only India sales are taken into consideration) and 3.4x higher than Safari presenting a huge scale advantage moat when it comes to sourcing SL from China. Size also helps in getting favorable payment terms as reflected by payable days of VIP, Samsonite and Safari at 55, 71 and 41 respectively as at FY18**.**

Creating twin levers of growth

VIP has been synonymous with suitcase and luggage in India. However, over the last few years it has laid lot of focus on emerging segments like backpacks and ladies handbags to accelerate the growth. Backpacks currently contribute ~15-20% of sales while Caprese has achieved sales in excess of Rs1bn.

Backpacks – huge potential given low penetration

Having entered the market only about 4-5 years ago, Skybags today is the leading backpack brand for VIP. Aggressive pricing to begin with, good product assortment and attractive price points in the range of Rs1,000-2,000 has enabled Skybags to gain market share. Back pack as a category has grown at a CAGR of more than 30% for the last 3-4 years and is expected to sustain the growth momentum as:

- Backpacks are more light weight and in demand as they are stylish, comfortable and hassle-free. Further, their demand is linked to 2W, organized workforce and student strength which has seen a rise over the last few years. We see the trend continuing, till a new substitute emerges.
- Penetration is less than luggage and it is a repeat item (new backpack is bought once every 2-3 years as compared to luggage which is bought every 4-5 years)
- Backpack market is led by local and unorganized segment, as the product has gained wide acceptance in past 5-7 years only. Branded segment has huge scope led by increased distribution and consumer up-gradation.

Exhibit 23: Backpacks: A brief overview

Brands	Skybag, Aristocrat, VIP
Price point	Rs1,000-2,000
Margin profile	GM is in line with luggage but less than hand bags
Is the brand being advertised?	Yes
Brand Ambassador	Varun Dhawan for Skybags
Key competing brands	American Tourister, High Sierra, Safari, Wildcraft, Fast track
Seasonality	Yes, majority of the sales happen in 4Q
Category growth	>30%
Revenue contribution	~15-20% of sales

Source: Company, PL

Share of backpack in overall revenues has increased from 12% in FY16 to ~15-20% in FY18 and is expected to rise further to 22.1% in FY21E as two additional brands viz; Aristocrat (value pricing) & VIP backpacks (premium pricing) have been launched, the merchandize has seen improvement and penetration is low.

Caprese to grow at a CAGR of 35% over FY18-21E

VIP Industries entered the ladies hand bags market with the launch of Caprese in 2013. Caprese is positioned in the synthetic leather segment to compete with the likes of Lavie, Baggit and Esbeda and is a premium brand targeting the core age group of 20-45 years. Despite initial challenges in establishing the brand, setting the right price point and revamping the distribution, Caprese has achieved sales of Rs1bn (47% CAGR since inception) in FY18 and it is amongst the top 5 handbag brands in India.

Product and price positioning

Initially the hand bag was priced in the range of Rs4,000-5,000 but it did not get the desired response (margins in unbranded are higher) and thus the price was lowered (average price now is in the range of Rs2,000-3,000) which increased affordability. Given branding plays a big role in the ladies' handbags market, VIP has hired Alia Bhatt to endorse its brand. Further, entry into the mass premium segment ruled by unorganized players will further open the playing field for VIP.

Modern trade, EBO's & E-com hold key

Caprese has presence in ~200 modern trade outlets and ~300 EBOs. It also has presence in department stores and e-com. However, it has negligible presence in the traditional dealer/distribution channel where VIP is strong. If VIP is able to milk this channel to its advantage (convince dealers to sell Caprese as against unbranded/private label products), we believe Caprese could be a far bigger brand like VIP and Skybags. However, high margins in the unbranded category (little incentive to stock Caprese) and fundamental shift towards hyper markets & modern trade for shopping (puts pressure on dealer channel as footfalls come down) are key challenges to expand in the traditional channel. We believe as penetration in EBOs, modern trade and e-com rises the brand will gain further credence.

Exhibit 24: Caprese: A brief overview

Brand name	Caprese
Launch date	2013
Product type	Hobo, clutch, satchel, laptop satchel, sling, tote, wallet, handbag, crossbody, sleeve
Price point	Rs 1,500-4,000
Brand size	Over Rs1bn
Margin profile	EBITDA positive, GM is better than luggage & backpacks
Is the brand being advertised?	Yes
Brand Ambassador	Alia Bhatt
Distribution model	Modern trade, EBOs, E-com. Little presence in traditional dealer/distribution channel
Key competing brands	Lavie, Baggit, Esbeda. Hidesign and DaMilano are in genuine leather segment and hence not direct competitors.
Touch points	More than 1,000; >40% of sales is from E-com

Source: Company, PL

Given changes made in price point and revamping done in the distribution channel we expect Caprese's share in revenues to rise from ~7.1% in FY18 to ~9.2% in FY21E (35% revenue CAGR over the next 3 years). Rising share of Caprese will uplift the EBITDA (high margin product than luggage) profile of VIP.

Channel checks indicate brand pull for Skybags is high; Carlton is a sturdy product

Key findings from our visits to MBOs, EBOs, hypermarkets of VIP, Safari and Samsonite indicate that 1) trade margins are in the region of 20-30% with unbranded having the highest margin 2) brand pull for Skybag is high and collection is well accepted by the market 3) Carlton is extremely sturdy product (limited possibility of lifetime warranty to be invoked) with no discounts being offered 4) Caprese had limited shelf space in Carlton EBOs. In hypermarkets, collection of Lavie and Baggit was at par/sometimes even better than Caprese 5) VIP EBOs were offering cash back (not present in other channels) 6) Quality issue on Samsonite product was low (limited customer complaints) 7) Safari is offering highest credit period to dealers/retailers.

Exhibit 25: Channel check - Feedback from our visit to EBOs, MBOs & hyper markets

Particulars	Our observation	Comments
Visit to hyper markets	Safari's shelf space was more or less equal when compared to the other two giants	Hyper market is a discounted channel for sale of mass products. Since Safari has a strong mass portfolio it covered more or less equal shelf space as VIP & Samsonite.
	Huge discounts visible	As end of season sale was around the corner, huge discounts were in the offing.
	Low end brands visible	Aristocrat, Safari and Kamiliant had high visibility. Even Skybags had decent shelf space. Alfa was virtually non-existent.
Visit to Carlton EBOs	No product discounts; in all 5 series were available	Price range was Rs7,000-25,000.
	Carlton edge offered lifetime warranty including accidental damage	Density of PC used to manufacture Carlton products was high but weight was light. Product was extremely sturdy.
	Caprese had some shelf space	Scope for improvement remains
Visit to VIP EBOs	Premium products on display	NA
	Cashback offer was available	Since EBOs offer premium products cashback offers were available only in this channel to persuade customer to buy high end products.
	PP shelf space was low	Management commentary by both listed luggage players over PP to PC movement was quite evident
	Skyback collection was appealing	Our interaction with the PoS personnel suggests that brand pull for the product is high
Visit to a small temporary Safari outlet inside the mall	Safari was providing a 5 year warranty including product replacement in some cases	NA
	Backpack collection was limited, however, luggage collection was dominated by SL (both nylon & polyester)	NA
Visit to Samsonite EBOs	Backpack collection started from Rs 1,900	Collection was at premium end
	Product quality was superior with many options on display	NA
	Had only 1 PoS person in a ~300-400 sq ft shop	Indicates brand pull is high
Visit to MBOs	Safari is offering highest credit period to dealers/retailers followed by VIP and then Samsonite.	Credit period for Safari is high as it wants to establish itself in the market
	Trade margins are in the range of 20-30%. Margin hierarchy is as follows:- 1) Unbranded 2) Safari 3) VIP 4) Samsonite	Unbranded offers high margins while brands command low margins
	Warranty for backpacks is 1 year across brands. Warranty for luggage was 5 years for VIP and Safari and 3 years for Samsonite	NA
	Shelf space for Safari was negligible	Since we visited metro EBOs shelf space for Safari was low. Our interaction with PoS personnel suggests Safari has strong presence in teir 2/3 markets

Source: PL

Competitive landscape of the luggage industry

While VIP is a market leader in the organized luggage industry, Safari (35% sales CAGR over the last 5 years) has emerged as a strong competitor over the last few years. At the premium end of the market (price point above Rs6,000) Samsonite is a formidable player. VIP has a well-diversified portfolio to compete against both Samsonite and Safari at premium and mass end of the brand hierarchy.

Exhibit 26: Comparative analysis: VIP leads in terms of size; Samsonite has higher margins but Safari has long way to go

Particulars	VIP					Samsonite					Safari				
	FY14	FY15	FY16	FY17	FY18	CY13	CY14	CY15	CY16	CY17	FY14	FY15	FY16	FY17	FY18
Sales	9,728	10,477	12,165	12,515	14,096	7,787	9,110	9,748	9,412	10,045	1,665	2,159	2,769	3,423	4, 154
YoY Growth	*16.1%*	*7.7%*	*16.1%*	*2.9%*	*12.6%*	*20.0%*	*17.0%*	*7.0%*	*-3.4%*	*6.7%*	*78.2%*	*29.7%*	*28.2%*	*23.6%*	*21.4%*
Gross margins	**45.3%**	**45.3%**	**45.5%**	**46.0%**	**49.5%**	**42.7%**	**45.8%**	**46.5%**	**45.4%**	**48.2%**	**45.4%**	**42.3%**	**42.8%**	**41.1%**	**45.7%**
Rent expenses (as a % of sales)	3.8%	3.7%	3.6%	3.8%	3.5%	1.6%	1.4%	1.2%	1.6%	1.9%	3.3%	3.4%	3.3%	2.8%	2.6%
A&P spend (as a % of sales)	5.9%	6.0%	5.8%	6.1%	6.4%	4.2%	6.3%	5.7%	5.1%	6.2%	4.1%	2.2%	2.0%	2.3%	1.9%
Employee expenses (as a % of sales)	9.6%	10.5%	10.3%	11.2%	11.3%	8.8%	8.6%	7.8%	8.6%	10.0%	10.5%	10.5%	10.5%	11.7%	12.7%
Freight & Octroi (as a % of sales)	5.0%	5.4%	5.2%	4.8%	4.9%	3.5%	2.9%	2.8%	6.8%	5.8%	6.8%	6.2%	5.5%	6.7%	6.3%
EBITDA margins	**8.3%**	**7.4%**	**8.9%**	**10.6%**	**13.7%**	**11.3%**	**15.1%**	**17.2%**	**13.7%**	**16.2%**	**4.1%**	**5.6%**	**6.5%**	**7.0%**	**9.8%**
PAT margins	**5.9%**	**4.4%**	**5.5%**	**6.6%**	**8.9%**	**5.7%**	**8.9%**	**10.6%**	**8.5%**	**10.6%**	**0.1%**	**2.0%**	**2.8%**	**2.8%**	**5.0%**
Working capital management															
Debtor days	36	39	45	35	46	69	58	63	56	72	70	68	72	62	91
Inventory days	66	79	86	82	82	56	52	56	61	68	102	101	101	100	107
Payable days	37	41	48	42	55	56	55	55	49	71	66	23	29	50	41
Cash conversion cycle	64	76	83	75	73	70	55	64	68	70	105	145	143	112	157
BS & CF variables															
RoE	20.1%	15.2%	18.4%	20.4%	25.6%	31.2%	40.7%	36.9%	25.3%	36.1%	0.9%	5.6%	8.5%	9.5%	12.1%
RoCE	20.9%	17.8%	24.9%	29.1%	36.9%	33.0%	57.3%	54.5%	36.3%	51.6%	8.7%	8.3%	9.3%	13.3%	15.3%
D/E	0.1	0.1	0.0	-	-	0.5	0.1	-	-	-	4.2	0.4	0.6	0.4	0.3
OCF (Rs mn)	503	136	534	1,265	859	745	1,075	781	797	889	(25)	(321)	(130)	241	(480)
Dividend payout ratio	41.7%	45.5%	42.6%	39.8%	33.4%	NM	24.0%	18.9%	44.4%	100.1%	NM	9.3%	6.4%	8.2%	5.0%

Safari is the biggest beneficiary of GST transition. Samsonite's growth has been in single digits (last 3 years) since upscaling has happened at the mass segment. VIP's growth has been in line with industry due to well diversified portfolio

Samsonite has lowest rent expense since it has adopted franchise model

Safari has lowest A&P spend since it hasn't signed any brand ambassador

Samsonite has lowest employee cost given strong brand pull (less people required at PoS to push the product)

VIP has best collection cycle given it is a well-established brand (lends better bargaining power with dealers/distributors). Safari's collection cycle is lengthiest amongst peers as brand parentage is yet to evolve.

Inventory days tend to be high across industry given 1) luggage is bought infrequently (inventory turn is low) 2) it is a bulky item & requires high SKUs, and 3) average lead time for SL to arrive from China is 3 months.

Credit period is a function of scale. Larger the scale better the bargaining power with Chinese suppliers and longer the credit period. This is evident from the fact that both VIP & Samsonite have better credit terms than Safari.

PAT margin expansion is driving RoE's. Given low capital intensive nature of the industry, FAS turnover is another RoE lever.

Both VIP & Samsnoite are debt free. Safari being a new entrant has debt on books predominantly to meet the working capital needs

Safari's OCF is negative due to lengthy working capital cycle.

Source: Company, Ace equity, PL

As seen in the table, VIP's 5-year average EBITDA margin is higher by 320 bps than Safari but lower by 490 bps than Samsonite. Factors that result in margin diversity amongst peers include differences in 1) rent expenses 2) A&P spend 3) employee expenses.

Samsonite has lowest rent expenses due to franchise model

Rent expense is a function of EBOs. VIP has ~250, Safari has ~40-50, while Samsonite has more than 350 stores (exact EBO count not available). Samsonite has lowest rent expense amongst peers since most of its stores are on franchise model. VIPs rent expense is marginally higher than Safari as it has higher number of EBOs in tier 1 markets where the rent expense is higher.

Safari has lowest brand-ex amongst peers

VIP and Samsonite's A&P spend is more or less similar in the range of 5-7% while Safari is lower by ~400bps as compared to the peers. Since there is no manufacturing moat in luggage business (SL is imported from China) branding (both VIP and Samsonite have brand ambassadors) is extremely critical to achieve scale. This is evident by the fact that Samsonite despite being a global brand & VIP being in existence in India for 48 years continues to invest heavily in brand building.

Exhibit 27: VIP leads the branding game vis-à-vis peers

Company	Brand Ambassador
VIP Industries	Alia Bhatt for Caprese, Varun Dhawan for Skybags, Rohit Sharma & R Aswhin for Aristocrat, Hrithik Roshan for VIP
Samsonite	Virat Kohli for American Tourister
Safari Industries	NA

Source: Company, PL

Samsonite has highest revenue per employee

Despite having more than 350 stores (requires in-store merchandiser which is absent in traditional dealer distribution model) Samsonite's employee cost is lowest amongst peers signifying the impact of brand pull (less people required at point of sale to push the product). As Safari has lowest A&P spends and limited brand re-call, employee cost is highest amongst peers. For VIP, employee expenses have been rising over the last 3 years as presence across modern trade & EBOs have increased.

Exhibit 28: Samsonite has highest revenue per employee

Company	Number of permanent employees as of FY18	Revenue FY18/CY17 (Rs mn)	Revenue per employee (Rs mn)
VIP	2,099	14,096	6.7
Samsonite	1,000	10,045	10.0
Safari	1,147	4,154	3.6

Source: Company, PL

PS: 1) The employee count does not include contractual labour 2) Samsonite's employee count is not publically available. We take higher number from the range (500-1,000) available on LinkedIn

As seen in the above table, VIP is 3.4x the size of Safari Industries in terms of revenues has 2x the number of employees. The revenue per employee for VIP is 1.9x Safari. However, while VIP is 1.4x the size of Samsonite, the revenue per employee is lower than Samsonite given that the latter has a strong brand pull.

Safari has longest cash conversion cycle

VIP had cash conversion cycle of 73 days in FY18 as compared to 70 days for Samsonite and 157 days for Safari. Strong brand parentage (improves bargaining power with dealers/distributors) and scale/size advantage (lends bargaining power against Chinese vendors) enables VIP and Samsonite to have a better cash conversion cycle than Safari.

Financial projections

Brand salience (brand-ex is ~5-7% of sales), strong distribution network (~11,000 touch points), GST implementation (narrowed pricing gap with unorganized players and resulted in up-trading), entry into the under penetrated ladies hand bags & backpack market, product premiumisation and rising share of Bangladesh operations is likely to drive sales/PAT at a CAGR of 23.7%/25.1% over FY18-21E.

VIP's sales to grow at a CAGR of 23.7% over FY18-21E

Since FY08, VIP's sales growth has never breached the 20% benchmark. In fact, since FY04, there have been only two instances, one in FY07 (34.9% YoY growth) and another one in FY08 (30.0% YoY growth), where sales growth has breached the 20% benchmark.

Exhibit 29: Sales to grow at a CAGR of 23.7% over FY18-21E driven by backpacks & handbags

Particulars (Rs mn)	FY18	FY19E	FY20E	FY21E
Luggage	10,629	13,286	15,678	18,343
YoY growth	*NA*	*25.0%*	*18.0%*	*17.0%*
As a % of sales	*75.4%*	*74.2%*	*71.6%*	*68.7%*
Backpacks	2,467	3,281	4,396	5,891
YoY growth	*NA*	*33.0%*	*34.0%*	*34.0%*
As a % of sales	*17.5%*	*18.3%*	*20.1%*	*22.1%*
Handbags	1,000	1,350	1,823	2,460
YoY growth	*NA*	*35.0%*	*35.0%*	*35.0%*
As a % of sales	*7.1%*	*7.5%*	*8.3%*	*9.2%*
Total sales	**14,096**	**17,917**	**21,897**	**26,695**
YoY growth	*12.6%*	*27.1%*	*22.2%*	*21.9%*

Source: Company, PL

PS: The company does not share exact range/category wise revenue numbers. Backpacks/handbags contribution is ~15-20% and ~7% of sales respectively in FY18. We use our judgment in arriving at the approximate figures.

We expect sales to grow at a CAGR of 23.7% over FY18-21E as 1) GST implementation has led to reduction in price differential between organized & unorganized players resulting in up-trading by consumers especially at the mass end 2) backpack as a category is expected to grow at CAGR of 33.7% over FY18-21E given low penetration and lower replacement cycle 3) given the changes made in price point and revamping done in the distribution channel; handbag category is expected to grow at a CAGR of 35.0% over FY18-21E.

Exhibit 30: Impact of GST on mass segment of the luggage industry

Particulars	Comments
VIP Industries	Aristocrat brand (mass offering of VIP) has grown by ~79% in FY18 and is expected to grow by at least 70% in FY19. During 3QFY19 call, management stated that Aristocrat has grown at a healthy pace.
Samsonite	Kamiliant brand (mass offering of Samsonite) was launched in late 2016 but crossed the Rs1bn mark in first year itself. In 2018, Kamiliant was the highest focused brand & the plan is to double sales for next few years.
Safari Industries	Entire portfolio is considered mass. 9MFY19 revenue of Safari was up 44.3% YoY.

Source: Media Articles, Company, PL

Exhibit 31: Low penetration driving backpack sales

Particulars	Comments
VIP Industries	Backpack contributes ~15-20% of sales, category growing at 30%+
Samsonite	NA
Safari Industries	Backpack contributes ~<=10% of sales, category growing in the range of 40-50%

Source: Media Articles, Company, PL

Exhibit 32: Increasing ratio of working women & rising fashion quotient aiding handbag market

Particulars	Brand Ambassador	Comments
Caprese	Alia Bhatt	Crossed Rs 1bn mark, has grown at a CAGR of ~47% since launch
Hidesign	Kalki Koechlin	Target is to achieve Rs2bn in sales in FY19.
Baggit	Shraddha Kapoor	Touched Rs1.6bn in sales in FY18 and aiming 25% growth in FY19. PAT growth is expected to be in double digits in FY19. Produces 1.5 lac pieces a month, and has plans to increase the production by 50%.

Source: Media Articles, Company, PL

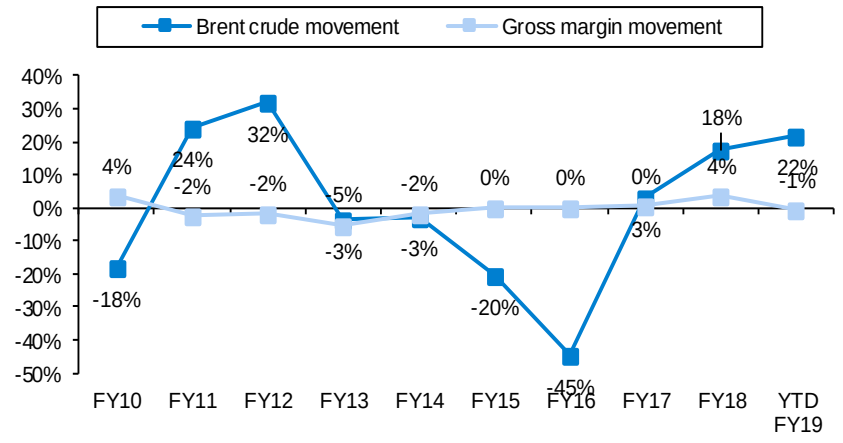
Calibrated price hikes & better product mix to offset gross margin headwinds

VIP's gross margin is higher than Safari Industries given the latter's focus on mass products but more or less at par with Samsonite which has premium offerings. In fact, in FY17 & FY18, VIP's gross margin was better than Samsonite by 60 bps and 130 bps respectively. Better product mix and a 10% hike taken in FY18 has enabled VIP to surpass Samsonite.

Since FY08, VIP achieved peak gross margin of 55.9% in FY10 (crude was down 18% while dollar was up by 3.5% during the year). Key factors that influence gross margin include 1) raw materials 2) rupee/dollar exchange rate & wage inflation in China 3) ability to take price hike.

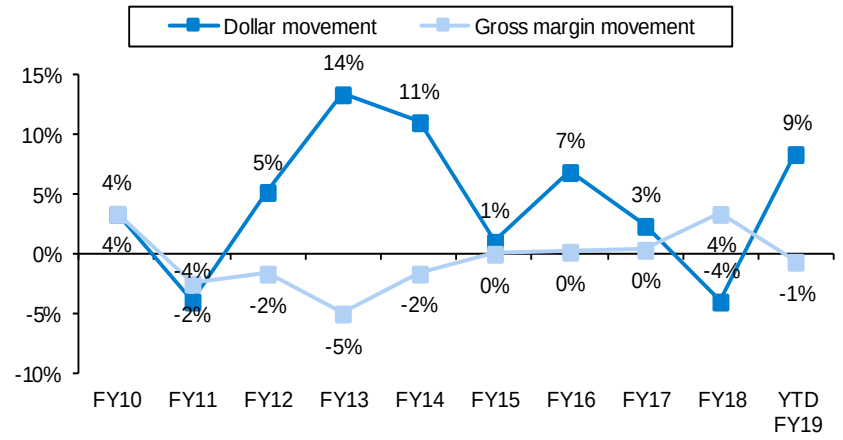
Key raw materials used to manufacture luggage include PP, PC, aluminum sections and components & other materials. Price of RMs is influenced by crude derivatives to a large extent. Since SL is imported from China, rupee/dollar exchange rate and wage inflation in the dragon nation are two additional factors that weigh on margins. Since ability to take price hike is limited considering stiff competition crude and rupee/dollar exchange rate are the most critical factors that influence margins.

Exhibit 33: Gross margins are inversely correlated with crude prices; product mix& price hike results in exceptions



Source: Bloomberg, PL, Company

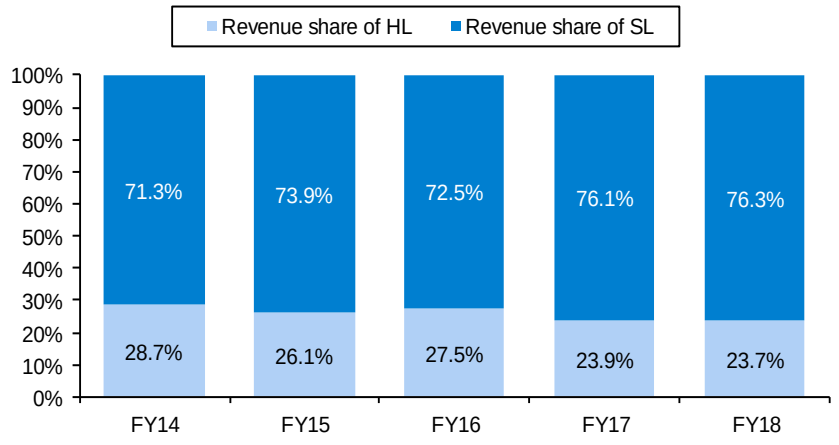
Exhibit 34: Gross margins are inversely correlated with rupee/dollar exchange rate; product mix & price hike results in exceptions



Source: Bloomberg, PL, Company

As seen in the above chart, crude is up 22% YTD while USD has appreciated by 9% YTD in FY19. Increasing share of SL in the portfolio will further dent margins as wage inflation in China is rising. However, calibrated price hikes (10% hike taken in FY18 and 7% YTD in FY19) and better product mix (increasing share of high margin products like Carlton & Caprese) should partially offset the impact of crude and rupee volatility. While the gross margin is expected to decline by 110bps to 48.4% in FY19E amid RM cost inflation, high cost inventory and increase in import duty we expect an expansion of 40bps each year to 48.8%/49.2% in FY20E/FY21E respectively.

Exhibit 35: Higher share of SL makes VIP susceptible to rupee volatility



Source: Company, PL

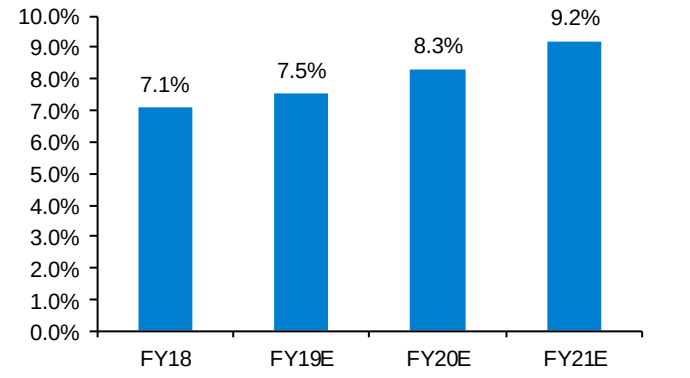
Product premiumisation to aid in EBITDA margin expansion

While EBITDA margin is expected to compress by 120bps to 12.6% in FY19E amid increase in import duty, adverse product mix (increasing share of mass brand aristocrat) and inability to take sufficient price hike in line with RM cost inflation & rupee depreciation we expect margins to expand 90bps/70bps to 13.4%/14.1% in FY20E/FY21E led by: -

- Launch of new product range (Laptop cabin strolly, duffle strolly, satchel strolly and a whole new range of designer backpacks) which would drive scale and thus operating leverage
- Increasing share of Carlton and Caprese which rank higher in the margin hierarchy
- Reduction in rent expenses from 3.5% in FY18 to 3.2% in FY21E given preference towards franchise model
- Reduction in freight & octroi expenses from 4.9% in FY18 to 4.5% in FY21E due to introduction of GST which has resulted in reduction in number of warehouses (earlier warehousing decision was based on the tax structure of various states). Post GST, it is based on proximity to customer/supplier.
- Reduction in employee expenses from 11.3% in FY18 to 10.8% in FY21E as operating leverage benefits would start kicking in with improving scale.

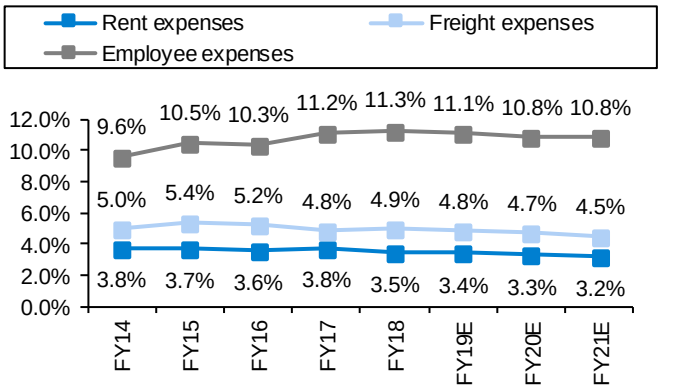
Consequent to the expansion in EBITDA margin (24.9% CAGR over FY18-21E) we expect the PAT to grow at a CAGR of 25.1% over FY18-21E.

Exhibit 36: Caprese share in sales to rise to 9.2% in FY21E



Source: Company, PL

Exhibit 37: Rent, freight & employee expenses to decline 30bps, 40bps,50 bps over FY18-21E

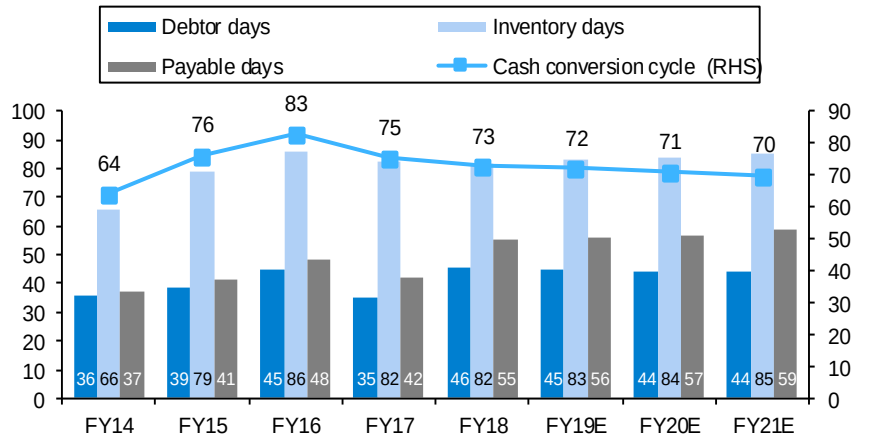


Source: Company, PL

Improvement in cash conversion cycle to drive OCF at a CAGR of 21.0% over FY18-21E

VIP's cash conversion cycle is expected to improve from 73 days in FY18 to 70 days in FY21E as we expect payable days to increase from 55 in FY18 to 59 in FY21E once scale of the business increases (revenue CAGR of 23.7% over FY18-21E). Debtor days are likely to improve marginally from 46 in FY18 to 44 in FY21E as share of CSD sales has been declining which has longer credit period. However, we expect the average collection period for next 3 years to be higher than the past 5-year average of 40 days as competition has intensified in the luggage industry over last 2-3 years due to emergence of Safari. Inventory days are likely to increase from 82 in FY18 to 85 in FY21E with increasing share of handbags and backpacks which require higher SKUs.

Exhibit 38: VIP's cash conversion cycle to improve to 70 days in FY21E



Source: Company, PL

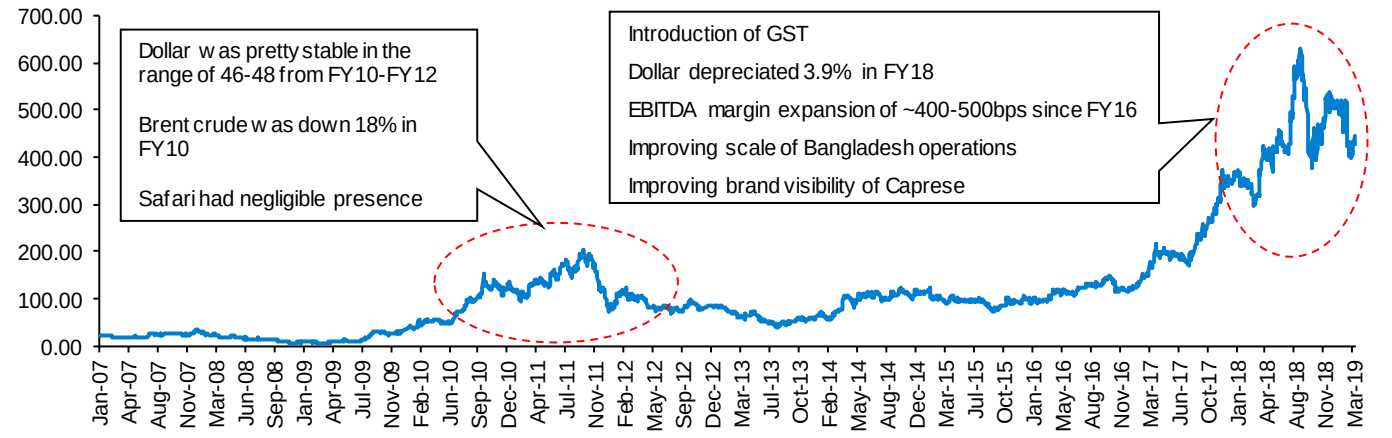
Improvement in cash conversion cycle is likely to drive OCF at a CAGR of 21.0% over FY18-21E. With minimal capex needs (SL expansion would require Rs200-250mn), FCFF generation is likely to be at Rs421mn/Rs932mn/Rs1,252mn in FY19E/FY20E/FY21E resulting in higher dividend pay-outs. We expect average pay-out ratio to be closer to ~32% over the FY19-21E.

Valuations

Premium valuations justified; past history redundant

There have been two sharp rallies 1) one between 2010-2012 and 2) post 2017; over the last 10 years resulting in a 52% CAGR in VIP's stock price. While the first rally was more cyclical in nature (driven by crude & exchange rate) the second one is more structural as it is driven by GST (shift from unorganized to organized), improvement in scale of Bangladesh operations and better brand visibility of Caprese though the role of crude and exchange rate cannot be undermined.

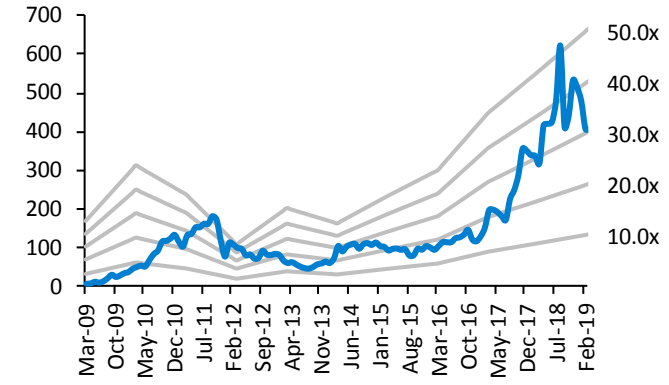
Exhibit 39: VIP's stock price has delivered a CAGR of 52% over the last 10 years



Source: Company, PL

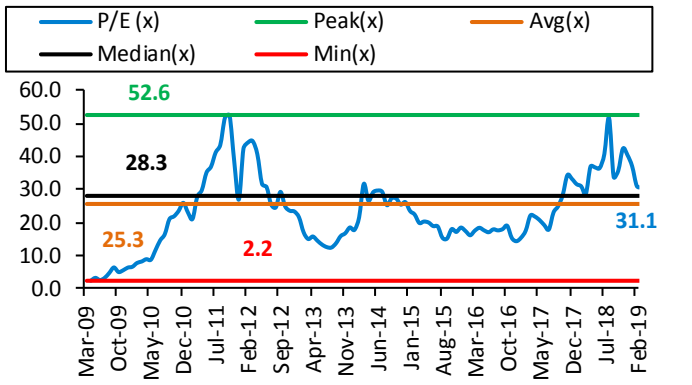
As seen below, the stock peaked out 50x one year forward earnings during the rally of 2010-2012 as well as the one witnessed post 2017 (both the rallies were driven by earnings expansion). From a loss of Rs139mn in FY09, VIP achieved peak profit of Rs887mn in FY11, which was regained only in FY17 (stock price was more or less flat in the interim). The peak of FY11 (regained in FY17) was finally breached in FY18 with a profit of Rs1.25bn (second leg of the rally began).

Exhibit 40: One year forward PE band



Source: Company, Bloomberg, PL

Exhibit 41: One year forward PE band chart



Source: Company, Bloomberg, PL

We value the stock 33x FY21E earnings as we expect PAT to grow at a CAGR of 25.1% over FY18-21E driven by shift towards organized market, premiumisation of product portfolio (rising share of Carlton & Caprese) and increasing share of Bangladesh operations which will improve the profitability profile. We believe the past trading history is immaterial and our multiple of 33x is justified as -

- Unorganized players command ~67% of the market share and have been at a huge structural disadvantage post GST which is not captured in the past regime. Since the implementation of GST from 01 July 2017, VIP has traded at an average TTM multiple of 46x.
- Though Bangladesh operations began in 2014, initially management bandwidth was consumed in managing raw material cycle and getting infrastructure in place (VIP does not have presence in Dhaka/Chittagong which are big export promotion zones). Thus, it took long before Bangladesh operations turned into profit. As a result, past history does not reflect true potential of a shift from China to Bangladesh. With profitability (FY18 PAT of Rs95mn; 9MFY19 PAT of Rs128mn) of Bangladesh operations increasing and scale advantage (plans to increase the capacity to 3.5mn units by FY19) expected to come in, we believe re-rating is on the cards.
- Product portfolio is witnessing premiumisation as share of Carlton and Caprese (highest margin amongst all six brands) is expected to rise (current contribution is ~7-8%) given changes made in distribution channel and rise in number of EBOs (premium products typically sell in this channel). Full reflection of premiumisation is not reflected in the past history as revenue share was miniscule. Rising share of high margin brands is likely to result in re-rating from these levels.

Though one may argue that most of the global listed global peers (except Hermes International), trade at ~50% discount to VIP on a 1 year forward basis and hence the current valuation is unjustified we believe difference in valuation is a reflection of increase in brand premium and opportunity pie (transition towards organized market) that VIP has its disposal post introduction of GST.

Exhibit 42: Global luggage/luxury goods companies financial profile

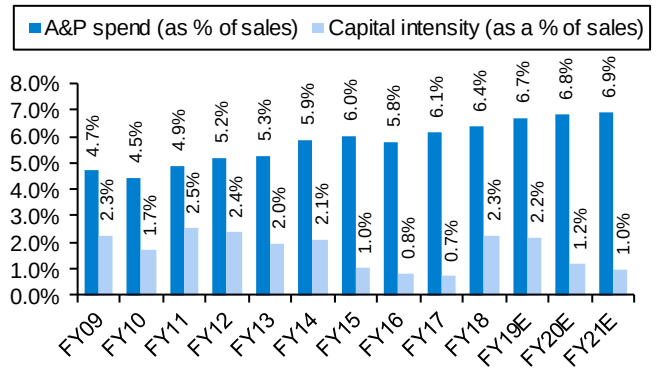
Particulars	Revenue	EBITDA margin	PAT margin	RoE	P/E	Brief profile
Samsonite International (CY17-US$ mn)	3,490.9	16.6%	7.5%	14.2%	18.9	Largest luggage company in the world by market share
Kering SA (CY18- US$mn)	16,140.0	32.5%	20.2%	34.0%	23.9	Owns brands like Gucci, Bottega Veneta, Saint Laurent
Hermes International (CY17 - US$ mn)	6,269.0	39.0%	22.5%	25.9%	45.9	Known for handmade luggage & handbags
VF Corp (CY17 - US$mn)	11,811.2	15.8%	10.5%	14.2%	21.9	Controls 55% of the US backpack market

Source: Company, Bloomberg, PL

At our target multiple of 33x, we arrive at a TP of Rs579 per share (FY21E EPS of Rs17.6). Initiate with a BUY.

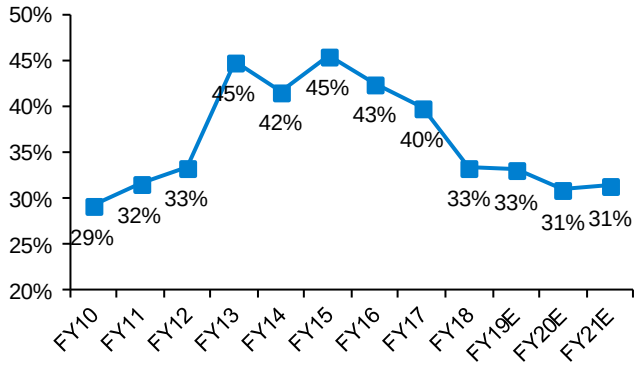
Key tables & charts

Exhibit 43: Absence of manufacturing moat makes brand spends critical for success



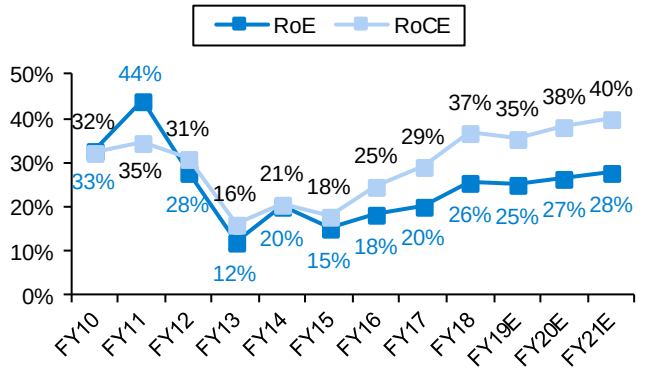
Source: Company, PL

Exhibit 44: Average payout since FY10 is ~38%; we expect pay out to be at ~32% over FY19-21E



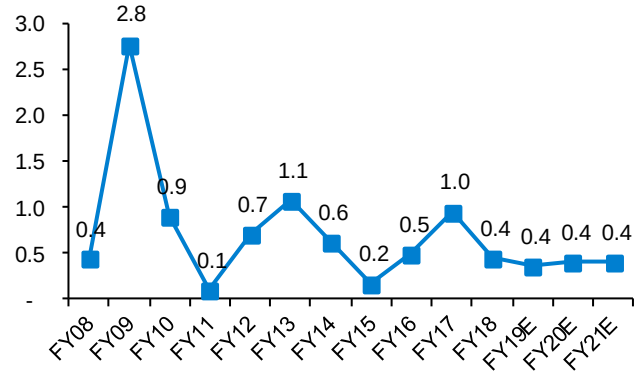
Source: Company, PL

Exhibit 45: RoE & RoCE to expand by 230bps & 310bps respectively over FY18-21E



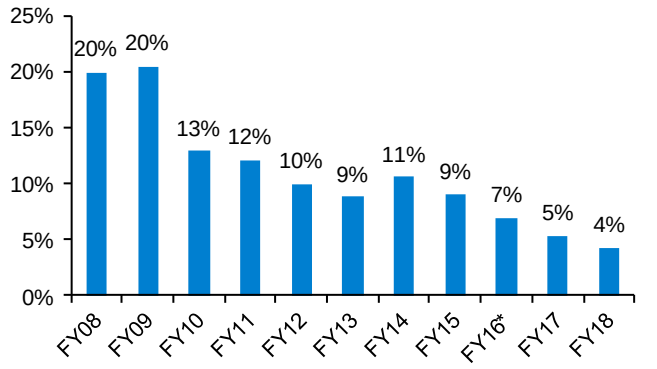
Source: Company, PL

Exhibit 46: Average OCF/EBITDA multiple is 0.8x over FY08-FY18



Source: Company, PL

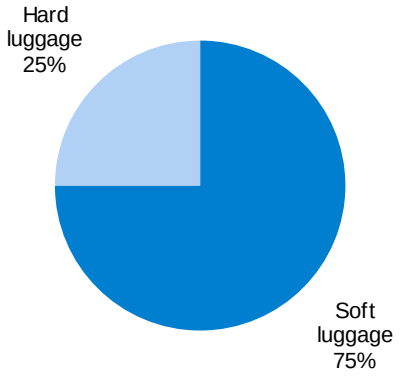
Exhibit 47: Export contribution has fallen to 4.3% of sales in FY18 indicating that VIP has been losing share overseas



Source: Company, PL

*PS: *FY16 figure is a rough approximation as exact share is not available*

Exhibit 48: Industry is dominated by soft luggage



Source: Company, PL

Annexure

HL Vs SL – Key differences explained: While hard luggage (HL) still offers best protection, soft luggage (SL) has become preferred choice for consumers over the years as it offers high flexibility (expandable external pockets) and is light in weight. In West, typical breakdown between HL and SL usage is 50:50 while in India it is 25:75. For VIP and Safari, the share of HL was 24% (42% in FY11) and 23% (69% in FY11) respectively in FY18.

SL is typically made out of 3 fabrics namely ballistic nylon, cordura nylon and polyester. While ballistic nylon is durable and easy to clean it is hard to dye and hence it comes in dark colors. Cordura nylon weighs less than ballistic nylon and is easy to dye and hence there are more color options. Polyester is the cheapest and thus luggage with low price range is made from polyester fabric.

HL is typically made out of aluminum, polypropylene (PP), polycarbonate (PC) and Acrylonitrile-butadiene styrene (ABS). Since aluminum is expensive and heavier to carry it is gradually being replaced by PP, PC and ABS (latter 3 are thermoplastic polymers). PC is impact resistant, durable and resilient to rough handling. PP is lighter than PC but not as resilient as latter. Within HL there has been a shift from PP to PC as latter is not only resilient but also has looks and convenience of SL. ABS is cheapest form of HL and is frequently added to other materials like PP or PC so as to manage weight and durability of the combined material.

Exhibit 49: SL vs HL: Key differences

	Durability (Most)	Weight (Lightest)	Price (Lowest)
Soft Luggage			
Ballistic Nylon	1	2	3
Cordura Nylon	2	1	2
Polyester	3	3	1
Hard Luggage			
Aluminum	1	4	4
PC	2	3	3
PP	3	1	2
ABS	4	2	1

Source: bforbag.com, PL

Typically, SL is imported from China due to abundant raw material availability, scale advantage and availability of labour while HL is manufactured in India.

Exhibit 50: Key Management Personnel

Name	Designation	Experience & Qualification
Dilip Piramal	CMD	BCom. Experienced industrialist with experience of more than 45 years.
Radhika Piramal	Vice-Chairperson & ED	Graduate from Oxford. MBA from Harvard business school. Looks after innovations & technology development.
Sudip Ghose	CEO. To be MD (From 01st April 2019)	Management Graduate from NMIMS, Mumbai. Over 2 decades of experience.
Jogendra Sethi	CFO	CA & ICWA. Over 2 decades of experience.

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
Net Revenues	**14,096**	**17,917**	**21,897**	**26,695**
YoY gr. (%)	*12.6*	*27.1*	*22.2*	*21.9*
Cost of Goods Sold	7,117	9,245	11,211	13,561
Gross Profit	6,979	8,672	10,686	13,134
Margin (%)	*49.5*	*48.4*	*48.8*	*49.2*
Employee Cost	1,594	1,989	2,365	2,883
Other Expenses	3,452	4,435	5,387	6,487
EBITDA	**1,934**	**2,249**	**2,934**	**3,764**
YoY gr. (%)	*46.1*	*16.3*	*30.5*	*28.3*
Margin (%)	*13.7*	*12.6*	*13.4*	*14.1*
Depreciation and Amortization	129	166	182	200
EBIT	**1,805**	**2,083**	**2,752**	**3,564**
Margin (%)	*12.8*	*11.6*	*12.6*	*13.4*
Net Interest	3	9	2	3
Other Income	93	95	116	141
Profit Before Tax	**1,895**	**2,169**	**2,866**	**3,703**
Margin (%)	*13.4*	*12.1*	*13.1*	*13.9*
Total Tax	628	716	946	1,222
Effective tax rate (%)	*33.1*	*33.0*	*33.0*	*33.0*
Profit after tax	**1,268**	**1,453**	**1,920**	**2,481**
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	**1,268**	**1,453**	**1,920**	**2,481**
YoY gr. (%)	*48.8*	*14.7*	*32.1*	*29.2*
Margin (%)	*9.0*	*8.1*	*8.8*	*9.3*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**1,268**	**1,453**	**1,920**	**2,481**
YoY gr. (%)	*48.8*	*14.7*	*32.1*	*29.2*
Margin (%)	*9.0*	*8.1*	*8.8*	*9.3*
Other Comprehensive Income	(17)	20	-	-
Total Comprehensive Income	1,251	1,473	1,920	2,481
Equity Shares O/s (m)	**141**	**141**	**141**	**141**
EPS (Rs)	**9.0**	**10.3**	**13.6**	**17.6**

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
Non-Current Assets				
Gross Block	**1,028**	**1,432**	**1,703**	**1,979**
Tangibles	1,004	1,398	1,660	1,927
Intangibles	25	35	43	52
Acc: Dep / Amortization	**258**	**423**	**605**	**805**
Tangibles	244	403	577	769
Intangibles	14	21	28	36
Net fixed assets	**770**	**1,009**	**1,098**	**1,174**
Tangibles	760	995	1,083	1,158
Intangibles	11	14	14	15
Capital Work In Progress	32	48	40	27
Goodwill	-	-	-	-
Non-Current Investments	182	240	314	461
Net Deferred tax assets	54	61	72	93
Other Non-Current Assets	77	90	109	160
Current Assets				
Investments	714	773	773	773
Inventories	3,165	4,074	5,039	6,217
Trade receivables	1,766	2,209	2,640	3,218
Cash & Bank Balance	238	72	400	840
Other Current Assets	666	842	1,117	1,388
Total Assets	**7,727**	**9,493**	**11,690**	**14,455**
Equity				
Equity Share Capital	283	283	283	283
Other Equity	4,608	5,601	6,928	8,632
Total Networth	**4,891**	**5,884**	**7,211**	**8,914**
Non-Current Liabilities				
Long Term borrowings	-	-	-	-
Provisions	93	131	160	195
Other non current liabilities	1	2	2	3
Current Liabilities				
ST Debt / Current of LT Debt	-	-	-	-
Trade payables	2,125	2,749	3,419	4,315
Other current liabilities	611	722	891	1,020
Total Equity & Liabilities	**7,727**	**9,493**	**11,690**	**14,455**

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Mar	FY18	FY19E	FY20E	FY21E
PBT	1,895	2,169	2,866	3,703
Add. Depreciation	129	166	182	200
Add. Interest	2	9	2	3
Less Financial Other Income	93	95	116	141
Add. Other	(42)	-	-	-
Op. profit before WC changes	1,985	2,344	3,050	3,905
Net Changes-WC	(486)	(826)	(899)	(1,143)
Direct tax	(640)	(702)	(957)	(1,243)
Net cash from Op. activities	**859**	**815**	**1,195**	**1,519**
Capital expenditures	(309)	(394)	(263)	(267)
Interest / Dividend Income	53	-	-	-
Others	(35)	(97)	(8)	(33)
Net Cash from Invt. activities	**(291)**	**(491)**	**(271)**	**(300)**
Issue of share cap. / premium	-	-	-	-
Debt changes	-	-	-	-
Dividend paid	(437)	(480)	(594)	(777)
Interest paid	(2)	(9)	(2)	(3)
Others	-	-	-	-
Net cash from Fin. activities	**(439)**	**(489)**	**(596)**	**(780)**
Net change in cash	**129**	**(166)**	**328**	**440**
Free Cash Flow	540	421	932	1,252

Source: Company Data, PL Research

Quarterly Financials (Rs m)

Y/e Mar	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Net Revenue	**3,626**	**5,178**	**4,018**	**4,301**
YoY gr. (%)	*19.6*	*29.5*	*29.9*	*27.2*
Raw Material Expenses	1,679	2,571	2,020	2,294
Gross Profit	1,947	2,607	1,998	2,007
Margin (%)	*53.7*	*50.3*	*49.7*	*46.7*
EBITDA	**543**	**962**	**511**	**378**
YoY gr. (%)	*83.2*	*56.9*	*39.6*	*(8.2)*
Margin (%)	*15.0*	*18.6*	*12.7*	*8.8*
Depreciation / Depletion	35	37	39	44
EBIT	**508**	**925**	**472**	**334**
Margin (%)	*14.0*	*17.9*	*11.7*	*7.8*
Net Interest	1	-	-	7
Other Income	24	16	20	27
Profit before Tax	**531**	**942**	**492**	**354**
Margin (%)	*14.6*	*18.2*	*12.2*	*8.2*
Total Tax	180	308	164	116
Effective tax rate (%)	*33.9*	*32.7*	*33.3*	*32.7*
Profit after Tax	**351**	**634**	**328**	**238**
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	**351**	**634**	**328**	**238**
YoY gr. (%)	*83.3*	*54.6*	*37.7*	*(11.4)*
Margin (%)	*9.7*	*12.2*	*8.2*	*5.5*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**351**	**634**	**328**	**238**
YoY gr. (%)	*83.3*	*54.6*	*37.7*	*(11.4)*
Margin (%)	*9.7*	*12.2*	*8.2*	*5.5*
Other Comprehensive Income	**(6)**	**16**	**39**	**(35)**
Total Comprehensive Income	**344**	**650**	**367**	**203**
Avg. Shares O/s (m)	**141**	**141**	**141**	**141**
EPS (Rs)	**2.5**	**4.5**	**2.3**	**1.7**

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY18	FY19E	FY20E	FY21E
Per Share(Rs)				
EPS	9.0	10.3	13.6	17.6
CEPS	9.9	11.5	14.9	19.0
BVPS	34.6	41.6	51.0	63.1
FCF	3.8	3.0	6.6	8.9
DPS	3.0	3.4	4.2	5.5
Return Ratio(%)				
RoCE	36.9	35.4	38.2	40.0
ROIC	25.0	23.7	25.1	26.0
RoE	25.6	25.0	26.6	27.8
Balance Sheet				
Net Debt : Equity (x)	(0.2)	(0.1)	(0.2)	(0.2)
Net Working Capital (Days)	73	72	71	70
Valuation(x)				
PER	49.5	43.2	32.7	25.3
P/B	12.8	10.7	8.7	7.0
P/CEPS	44.9	38.8	29.8	23.4
EV/EBITDA	32.0	27.5	21.0	16.2
EV/Sales	4.4	3.5	2.8	2.3
Dividend Yield (%)	0.7	0.8	0.9	1.2

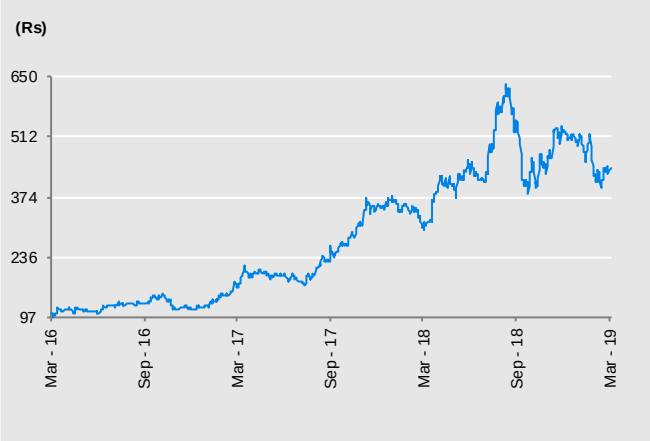
Source: Company Data, PL Research

Notes

Notes

Notes

Price Chart



Analyst Coverage Universe

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Dish TV India	NR	-	74
2	Entertainment Network (India)	BUY	776	548
3	Music Broadcast	BUY	405	288
4	Navneet Education	BUY	157	106
5	S Chand and Company	Hold	234	199
6	Zee Media Corporation	BUY	38	22

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Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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