RESULT UPDATE

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VIP INDUSTRIES LTD

PRICE: RS.301
TARGET PRICE: RS.325

RECOMMENDATION: ACCUMULATE
FY19E PE: 28.0X

Strong performance continues

VIP has reported second straight strong quarter with significant improvement in revenues, operating margins and earnings. This is on the back of improving luggage penetration in the country and sustained efforts by the company to improve its performance. Sales was reported at Rs 3.09 bn (+8% YoY). EBIDTA margin was reported at 11.3% (+210 bps YoY) with improving volumes and realisations and lower raw material cost. Consequently, PAT was reported at Rs 242 mn (+33% YoY). We estimate the company to be a major beneficiary of increasing penetration of luggage bags and back-packs in the country and increased air and rail travel. We estimate revenue CAGR of 17% and earnings CAGR of 28% over FY17 to FY20E with improvement in operating margins and return ratios. Due to the rally in the stock price since our initiating coverage, we are now recommending ACCUMULATE (from Buy) with an unchanged TP of Rs 325 at 30x FY19 earnings

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	12,752	15,744	17,919
Growth (%)	4.8	23.5	13.8
EBITDA	1,319	1,940	2,275
EBITDA margin (%)	10.3	12.3	12.7
PBT	1,244	1,857	2,188
Net profit	849	1,290	1,520
EPS (Rs)	6.0	9.1	10.7
Growth (%)	25.2	51.9	17.8
CEPS (Rs)	6.9	10.1	11.8
Book value (Rs/share)	28.6	34.1	40.6
Dividend per share (Rs)	2.2	3.0	3.5
ROE (%)	21.0	26.7	26.5
ROCE (%)	29.3	37.2	37.0
Net cash (debt)	60	81	538
Net Working Capital (Days)	77.2	70.9	74.4
EV/EBITDA (x)	30.4	20.9	17.9
P/E (x)	50.2	33.0	28.0
P/Cash Earnings	43.6	29.7	25.5
P/BV (x)	10.5	8.8	7.4

Source: Company, Kotak Securities – Private Client Research

Quarterly performance

(Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Net sales	**2854**	**3074**	**3080**	**3997**	**3092**
Raw material cost	1533	1604	1590	2179	1626
Employee cost	373	352	357	372	385
Other expenses	686	858	818	834	732
Total Expd	2592	2814	2765	3385	2743
EBIDTA	**262**	**260**	**315**	**612**	**349**
EBIDTA %	9.2	8.5	10.2	15.3	11.3
Depreciation	34	33	33	30	25
Other income	29	5	0	23	38
Interest cost	0	0	4	0	0
PBT	**257**	**232**	**278**	**605**	**362**
Taxes	75	75	88	195	120
PAT	**182**	**157**	**190**	**410**	**242**

Source: Company

Quarterly highlights

- Sequential comparison is not desirable as Q1 is the strongest quarter for VIP, while Q2 weakest in any financial year
- Sales was reported at Rs 3.09 bn (+8% YoY). It is important to note that the sales of Q2FY17 included excise duty of Rs 50 mn and VAT of Rs 310 mn, while the Q2FY18 sales is net of all taxes.
- Management is hopeful of reduction of GST from the peak of 28% to 18% in the current pruning of GST rates by the GST council.
- Management indicated that the domestic segment remains strong for the company, while international segment was stable.
- Promotion expense was at 6% of revenues during the quarter.
- EBIDTA margin was reported at 11.3% (+210 bps YoY) on the back decreasing raw material cost and improving realisations. The company had taken a price hike of 6% across categories in July and another hike of 3% from November1st 2017.
- Consequently PAT was reported at Rs 242 mn (+33% YoY) and vs. our expectation of Rs 256 mn.
- We interpret the results as healthy.

Currents quarters performance was propelled by

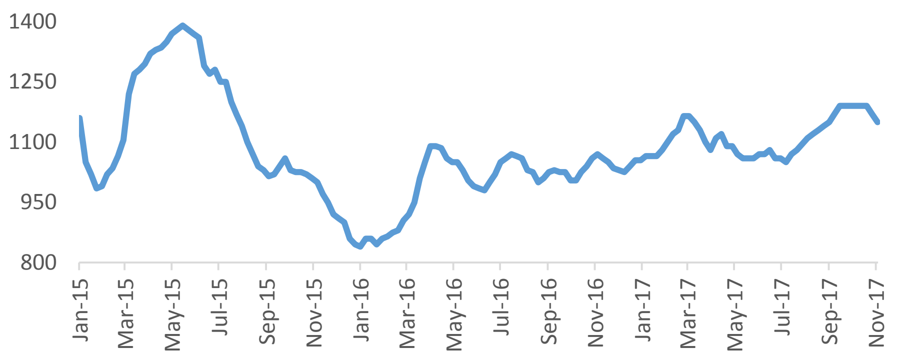
- Increasing penetration of luggage bags
- Shift towards branded products to propel growth
- Substantial brand visibility with wide distribution network
- Diversified product portfolio

Raw material situation

The 2 major categories of inputs - polypropylene (for hard luggage) and polycarbonate were benign for the company for the last 2 years. However, management indicated that the company has been experiencing increasing raw material trend which the company is trying to contain by increasing prices and also by reducing other cost.

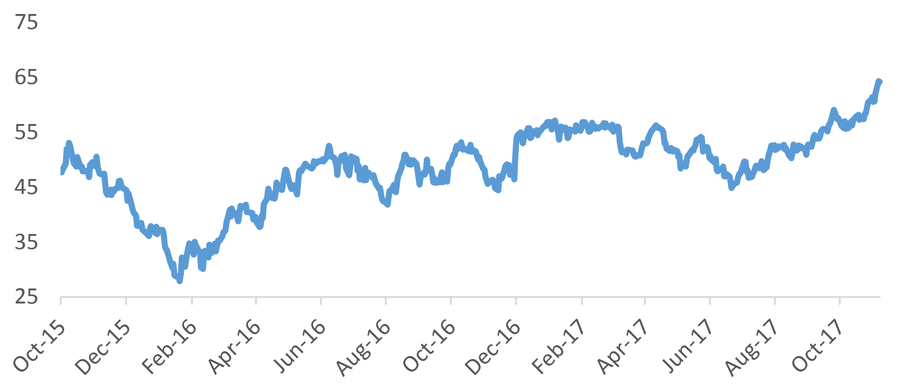
VIP also regularly renegotiates with suppliers on regular basis for supply of raw material at lower prices.

Poly propelene Asia gen purpose (USD/MT)



Source: Bloomberg

Brent crude (USD/bl)



Source:Bloomberg

Strategic decision to shift sourcing from China to Bangladesh

Soft luggage industry is a labour intensive industry with polypropylene as the key raw material. To save on cost, VIP has been sourcing 90% of its soft luggage from China (which is 70% of its revenues) with designing and quality control done by the company itself. Due to increasing labour costs and other reasons such as strengthening of the Yuan vs. INR, the company has decided to reduce dependency on China in the long run and has setup a manufacturing facility in Bangladesh through its wholly owned subsidiary for manufacturing soft luggage. It is also important to note that the Bangladesh subsidiary enjoys full excise and sales tax holiday for a period of 3 years (and 50% tax holiday for another 3 years) beginning FY15.

Going forward, we expect the sourcing of soft luggage to fall from China to 70% with share of Bangladesh increasing to 30% which would aid margins by end of FY20E.

Soft luggage sourcing

(%)	FY17	FY20E
China	90	10
Bangladesh	70	30

Source: Company, Kotak Securities – Private Client Research

Outlook and valuation

We recommend ACCUMULATE on VIP Industries Ltd with a price target of Rs.325

We believe VIP would be one of the largest beneficiaries of lifestyle change in the country. With improving luggage penetration in a populated country like India, healthy GDP growth and increasing purchasing power, increasing leisure and business related travel and desire to use branded luggage, would drive the growth of VIP. We estimate volumes for VIP to grow at 12% CAGR and revenues at 17% CAGR over FY17 to FY20E with improvement in margins and return ratios. We continue to value VIP at 30x FY19E and recommend ACCUMULATE (from BUY) with an unchanged TP of Rs 325. We would upgrade our rating on the stock post sustained quarterly performance in 2HFY18.

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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