



“VIP Industries  
Q2 FY2020 Earnings Conference Call”

November 07, 2019



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*VIP Industries Limited*  
*November 07, 2019*

**Moderator:** Ladies and gentlemen, good day and welcome to the VIP Industries Q2 FY2020 Earnings Conference Call, hosted by Edelweiss Securities Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “\*” then “0” on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Shradha Sheth from Edelweiss Securities Limited. Thank you and over to you Madam!

**Shradha Sheth:** Thanks Janis. On behalf of Edelweiss, let me welcome you all to the Q2 FY2020 earnings call of VIP Industries. From the management today, we have Mr. Dilip Piramal, the Chairman, Ms. Radhika Piramal, the Executive Vice Chairperson, Mr. Sudip Ghose, the MD and Mr. Jogendra Sethi, the CFO. 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 evening everybody and thank you for dialing in. I would like to talk for about 5 to 10 minutes about results, sales, gross margins, expenses and talk briefly about the change in the accounting standard with changes in few line items in our P&L. Thereafter, we will turn to Q&A. All the figures pertain to consolidated results as there we are four companies in Bangladesh which are 100% subsidiaries.

Our consolidated revenues of Rs. 412 Crores which is a 3% growth up from Rs. 402 Crores in Q2 of last year. Wherever the comparisons are made, it is for Q2 of last year and if there are any exceptions, I will mention.

Sales growth is short of the target we had set for ourselves and this has been due to decline in air travel, lackluster marriage season, overall decline in consumer demand, decline in footfalls and consumer confidence.

Luggage is a discretionary product and affected more during period of poor market sentiment. We have a healthy balance of sales among different channels. Our distribution channels are a good mixture of general trade, retail trade and modern trade which performed less than our expectations.

**Radhika Piramal:** My apologies for disturbance in connectivity. We were talking about our various sales channels. Before that, I will talk about the lower sales growth. Our volume growth, which is a little bit higher at about 6%. It means consumers are down trading a bit. Sales in hyper markets remain a bit stronger and obviously in ecommerce remain a bit stronger than sales



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in our dealer channel. We have a good mix of distribution channels. Main channels are dealer and distributor what we call general trade and we have retail sales which are run by the Company plus franchises run stores. We are selling to CSD and ecommerce. We also have B2B sales. All of these across the board are much less than what we had targeted and I am not altogether surprised. We compare ourselves to some other FMCG companies and we also look at the domestic passenger air traffic where growth is on lower side. Growth rate especially in domestic air traffic is much lower than last year so it is not altogether surprising that we have had a challenging quarter. Some of you may be wondering while the Q2 a bit less than our Q1. In Q1, number of marriage days were good and we had a very good sort of sales in April and May assuming that the marriage dates will lead to the secondary sales and the secondary sales meaning sales to our customers and new consumers.

So expected pickup that was required in June, July and August did not happen to that extent that we wanted. So that was part of the reason for relatively lower sales in Q2 due to moderation of inventory levels by our customers and you will also see that our inventory is a bit higher than what we had wanted. It is because that sales was less than what we had expected at the start of the year. We have moderated our expectations for rest of the year. I would say at this time that we expect the current sales trends to continue. Nothing has happen in October to suggest that next six months is going to be much different from last six months.

Brands are doing fine. Nothing much has changed at premium end. VIP, Aristocrat and Skybags are main section. Aristocrat growth was a bit higher than Skybags and VIP. Not surprising as there has been a bit of down trading. Caprese our ladies handbag brand continues to do well but its growth has slowed down. I think that it is more to do with discretionary market demand than to do with the brands strength.

Our margin profile in Q2 was better than last year primarily because we were able to negotiate cost reductions from Chinese suppliers as we all know Chinese factories are facing reduced demand from United States due to the tariff situation and they are keen for increase orders from other customers especially from India, Europe, etc. We have been able to do some good negotiations and we expect current margin profile to continue for the foreseeable future that is of course assuming that the rupee does not depreciate. It would be a little bit challenging to take a price increase in this demand environment but assuming that there are no major raw material price increases which we do not anticipate assuming the rupee does not depreciate We should be able to continue with this margin profile without taking any price increase.



With that, I turn to our fixed expenses. Our employee benefit expenses which are a considerable part of our P&L has grown at 19% which is higher than optimal given flat sales. The reason for this increase is primarily because of our growth in Bangladesh. Our India employee expenses are manageable in the 10% to 12% range. The reason for overall 19% increase is Bangladesh employee expenses which have been more than doubled since Q2 of last year but our sales have also doubled over Q2 of last year. There were elections in Bangladesh during last November and during elections in Bangladesh, there was a big increase in minimum wages which happens once in five years. So, there was a 40% increase in the minimum wage towards the end of last year which we had to give to our workers in Bangladesh but after one time increase of 40% has happened, we expect the current minimum wage to remain stable for next two to three years. So, one time increase will be absorbed to the higher sales as our sales and production in Bangladesh increases.

Overall, despite this increase in minimum wage and employee cost in Bangladesh, Bangladesh added a good profit to our bottom line. Now, I turn to finance costs. Our finance costs are higher than Q2 in previous years but that is linked to the impact of the Ind AS 116, new accounting standards with respect to leases and depreciation. The finance cost of Rs. 7 Crores and depreciation of Rs. 21.2 Crores, which are together Rs. 28.2 Crores is much higher than 3.9 Crores in Q2 of last year. We have leases that relate to our company run stores, our offices and our warehouses. Now, we have to account for these leases in finance cost and depreciation instead of rent. I am sure everybody on the call is well familiar with the reasons. If anybody has query, Jogendra will answer specifically later.

Other expenses have de-grown as compared to Q2 last year. The important reason is reduction in rent but that is also linked to new accounting standard, IND AS 116. Even after taking out the impact of the accounting standards, there are some areas where we have tried to moderate our fixed overheads. We have reduced traveling and some other overheads. We kept our advertising range broadly between 5% and 7% of sales. We have not reduced advertising as a percentage of sales in order to contain our costs.

Overall, our PBT of Rs. 40.8 Crores compared to Rs. 49.2 Crores in Q2 of the previous year is down 17%. Our PAT was higher. PAT was at Rs. 34.3 Crores which was higher by 5% compared to Rs. 32.8 Crores in Q2 of the last year. So, we ran a promotion in October called the impossible offers, some of you may have seen that. We will be continuing to focus on sales focus promotion activities. We are also not very satisfied with this 3% sales growth and obviously, we will keep a keen look on our costs but at the end we want to improve our profits.

I will comment on two more topics before turning over to the Q&A. The first is Bangladesh operations. Bangladesh sales were much higher than Q2 of last year. Sales from Bangladesh



were at Rs. 51.3 Crores as compared to Rs. 26 Crores in Q2 last year so it has been doubled which is also the reason for increase in manpower cost.

Everybody knows that we had a fire in Ghaziabad warehouse in Q1 and took an exceptional loss of Rs. 48.5 Crores in Q1. Procedure for claiming our insurance is underway and it takes time. It is a high amount and it will take several more quarters before that is successfully concluded. With that, I turnover to Q&A. Thank you.

**Moderator:** Thank you very much. Ladies and gentlemen, we will now begin with the question and answer session. We take the question from the line of Chirag Lodiya from Value Quest. Please go ahead.

**Chirag Lodiya:** Thank you for the opportunity. My first question is on overall competitive intensity. So have you seen any increased discounting promotions in this slowdown?

**Sudip Ghose:** Yes, markets are under pressure and therefore there has been discounting. It was very tempting situation for us. We have to choose between gross margin and the topline. We, as an organization, have always preferred gross margins and we have restrained ourselves from giving discounts. We could have gained maybe 2% or maybe 3% points by discounting which we did not. There has been discounting specially in e-com but we have maintained our prices and therefore you can see the impact on the gross margin.

**Chirag Lodiya:** In terms of gross margin so last two quarters we have seen very impressive improvement from say 47%, 48% level we are at 53.3% level so just wanted to understand this gross margin improvement is because of higher inventory of a lower cost sitting in our books or newer procurement is also happening at this kind of levels and when you see you will be able to maintain gross margins you are talking about 53% odd levels or we have to take first half average going ahead.

**Radhika Piramal:** Take first half average. New inventory is coming at lower cost.

**Sudip Ghose:** From September last year onwards, we have been pushing Chinese suppliers in a much bigger way including our own suppliers in a hard luggage factory. It is a continuous effort. Fresh round of negotiations have happened. Chinese currency has also been little supportive in this whole thing and we have been able to push down the costs further.

**Chirag Lodiya:** Sir just on balance sheet side so networking capital days last year it has gone up sharply so by this yearned do we think we will be again back to our say FY2018 kind of levels in networking capital days?



**Radhika Piramal:** That is the goal. We may not achieve it. In fact, we wanted to get back to that in this September but we could not achieve because sales in the first half was much less than what we had expected.

We are not far away from it as we have moderated our purchases in line with single digit sales growth rather than double-digit sales growth. Although we do not publish our balance sheet in December and June which is always better than September and March due to the seasonality. Higher inventory is very much on the radar of the management and concrete steps are being taken to resolve it.

**Chirag Lodiya:** Just last question on so over a lower end of the segment was growing at a pretty brisk pace I last couple of quarters you mentioned this quarter there has been some down trading so pace of that growth has slowed down materially or that segment is still growing at that business?

**Radhika Piramal:** All segments have slowed down materially compared to one year ago but the economy segment is still growing a bit faster than medium and upper segment.

**Chirag Lodiya:** Traditional channel which we say inventory levels have stabilized or we may see further down I mean further reduction of inventory at a dealer level.

**Radhika Piramal:** It is stabilized.

**Chirag Lodiya:** Thank you and all the best.

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

**Tejas Shah:** My first question is, first of all thanks for very detailed opening summary on all the aspects. Just one question on channel wise growth scenario where there any channels which degrew and pressure was materially high versus other channels?

**Sudip Ghose:** Yes, only channel which really grew in this quarter was e-com. As you see, e-com's two big billion days of both Flipkart and Amazon happened in quarter two. All channels have not shown the kind of growth that they were showing in last two years. Dealer channel have declined and to some extent even the hyper channels have declined.

**Tejas Shah:** In terms of demand sentiment has demand scenario is it still the same or are we seeing some sequential improvement at ground level?

**Radhika Piramal:** It is too early to comment on that. We have done a successful offer in October but demand sentiments have not picked up.



- Tejas Shah:** On gross margin advantage that we spoke about since we are and it seems that it is much more stronger than what number suggest because in spite of down trading we reported good gross margin. So is there a scope to cut prices to revive demand or the demand is not that elastic to respond?
- Sudip Ghose:** There was a pressure on the margin in quarter four and we have come out of it with lot of effort. With the kind of organization and the overheads that we have, we do not think we would be in a position to go below current margin profile that we are operating in. We will try to maintain this.
- Tejas Shah:** Sure and if I can squeeze in one more any comment on backpack versus luggage growth environment at the momentum?
- Sudip Ghose:** Yes, this quarter two happens to be midsize. During last year quarter two, backpack business was quite decent. In current year quarter two, backpack business also got impacted. We have a concept call short haul and long haul. Long haul is luggage that you buy and shortfall is backpack which is for short travel. Both segments have got impacted in this quarter.
- Tejas Shah:** Thanks. That is all from my side and all the best to the team.
- Moderator:** Thank you. We take the next question from the line of Amerjit Moriya from Angel Broking. Please go ahead.
- Amerjit Moriya:** Sir just wanted to ask you a few questions. What is the current mix between the hard luggage's versus soft luggage and what is the trend like shifting toward a hard luggage or soft luggage and what is the market share in your hard luggage segment?
- Radhika Piramal:** Firstly, there is not much difference in our margins between soft luggage and hard luggage and therefore we do not give out the specific details. Having said that hard luggage is now growing faster. Hard luggage used to be old suitcase which was heavy rather new polycarbonate bright colorful.
- Amerjit Moriya:** So what is your view on the market shares like in whatever your market share in the hard luggage and this is growing or stable or what is the trend and that will be the number like in that sense?
- Sudip Ghose:** Hard luggage as a category is not. Unbranded players are not operating in hard luggage because it is difficult to manufacture and difficult to bring so we have always been strong on both hard luggage and soft luggage split wise. We are strong in both.



- Amerjit Moriya:** Sir how much you manufacture in the hard luggage segment how much is the manufacture and how much is the outsourced?
- Sudip Ghose:** 100% is manufacturing.
- Amerjit Moriya:** So from India or Bangladesh I mean what is that.
- Radhika Piramal:** We manufacture all our hard luggage in India and we manufacture soft luggage in Bangladesh. We also buy soft luggage from Indian vendors and from Chinese vendors.
- Amerjit Moriya:** Thank you so much.
- Moderator:** Thank you. We take the next question from the line of Rajinish Joshi from Prabhudas Lilladher. Please go ahead.
- Rajinish Joshi:** In the opening remarks you mentioned that the volume growth was 6% but the overall topline growth is about 2.5% so does it mean that we have taken a price cut in this quarter.
- Radhika Piramal:** No. It means that we saw more of the economy segment than the premium segment, down trading between brands.
- Rajinish Joshi:** Total receivables are around Rs. 350 Crores with major proportion pertains to CSD. Inventory reduction has been reduced by about Rs. 100 Crores as compared to March quarter but still there is some high cost inventory sitting in the book.
- Sudip Ghose:** In receivables, the major chunk is actually sitting in CSD. I am happy to mention that we have managed to collect a lot of the money from overdue subsequent to 30<sup>th</sup> September. CSD is a government organization and its payments are sporadic. It is very safe money and sometimes it takes a little while but as we talk most of it has been collected. We have reduced the inventory from last March but it is higher as compared to last year. The plan was to get it back in shape by quarter two but we missed it due to lower sales. We have now moderated our purchases for the second half so that we are able to control the inventory.
- Rajinish Joshi:** I mean you also mentioned that, I just wanted the PAT figure of Bangladesh operations the sales figure has been shared if you can just help me with the PAT number?
- Sudip Ghose:** PAT for Bangladesh for second quarter was at Rs. 5.7 Crores.
- Rajinish Joshi:** Thank you so much.





**Moderator:** Thank you. Next question is from the line of Sajan D from Frontline Capital. Please go ahead.

**Sajan D:** Congratulations for a good gross margin. I just have only one question. All other things I am agreeing like demand get slowdown is there so growth is now there in revenue. Only one thing I am not able to understand like other expenses not reduced by 9 Crores compared to last year same quarter and as you said that it is mainly due to the Ind AS 116 and it has gone down to depreciation and interest but will I am comparing depreciation and interest it has increased by 24 Crores and reduction in other expenses is only 9 Crores if you see the last quarter June quarter this difference was 16 Crores was the reduction and 20 Crores was the addition in the depreciation and interest, this quarter it is very wide what is the reason behind that?

**Radhika Piramal:** Mr. Sethi will answer your question in detail.

**Sajan D:** Yes, finance cost and depreciation mainly what you said that due to Ind AS other expenses has gone reduced ad as because due to Ind AS it has gone to interest and depreciation but interest and depreciation charges has increased by 24 Crores compared to the last quarter last year and this other expenses got reduced only by 9 Crores so there must be something more in depreciation and interest.

**Radhika Piramal:** One is genuinely we have been investing in Bangladesh so the depreciation will be there secondly we have some borrowing so our interest cost is also higher than this time last year where we did not have.

**Sajan D:** Bangladesh capex may not be that much which can justify the 21 Crores of type of depreciation. I have basically I just want to know due to Ind AS how much difference is there and otherwise how much is the difference?

**Jogendra Sethi:** Please refer to Note No. 8 to the results which has calculations showing that rent cost has been shown at Rs. 4.55 crs as compared to actual rent of Rs 37.72 crs for six months ended 30<sup>th</sup> September, 2019 and difference has been shown in interest cost and depreciation in compliance with IND AS 116.

**Sajan D:** I will just look into it and I will come back again in the queue.

**Jogendra Sethi:** If you still have any query, please come back in the queue again.

**Moderator:** Thank you. We take the next question from the line of Manish Oswal from Nirmal Bang. Please go ahead.



- Manish Oswal:** My first question on the input basket price environment during the quarter and what is the outlook going ahead?
- Radhika Piramal:** Can you repeat the question please?
- Manish Oswal:** Input basket price environment during the quarter and what is the outlook going ahead?
- Radhika Piramal:** You mean the raw material cost.
- Manish Oswal:** Yes Madam.
- Radhika Piramal:** We were able to secure some reduction from our Chinese vendors for finished goods. In terms of the hard luggage RM, we do not see any change and we expect the current trend to continue in Q3 and Q4.
- Manish Oswal:** Secondly this total expenses on the new brand related promotion what is the first half numbers Madam?
- Radhika Piramal:** Advertising expenses are between 5% and 7% of sales.
- Manish Oswal:** Because this is the one time activity so there could be one off kind.
- Sudip Ghose:** We are talking about the advertising?
- Manish Oswal:** No, no, not advertising this new brand of VIP related expenses?
- Radhika Piramal:** Which brand are you referring to?
- Manish Oswal:** We have changed the brand of the VIP.
- Sudip Ghose:** No, we have not gone beyond 5% to 7% of spend that we do. Overall cost of advertising remain the same as we do every year.
- Manish Oswal:** Lastly in the last call, you said that you have not seen this kind of slowdown in the economy now what is your assessment after the so many needed by the government?
- Sudip Ghose:** We are all seeing it across all companies. FMCGs have reported lower single digit between 5% to 6% growth. There is overall slowdown. Please understand that luggage is a discretionary category. It is not an essential product so it does get impacted if the slowdown happens to this extent.



- Manish Oswal:** I understand what is your assessment going ahead Sir that is my question?
- Radhika Piramal:** It is too early for us to comment on that.
- Moderator:** Thank you. We take the next question from the line of Aditya Bapat from Research & Ranking. Please go ahead.
- Aditya Bapat:** I wanted to know if I can get a revenue split between luggage backpack and handbag?
- Sudip Ghose:** No.
- Aditya Bapat:** Okay, but any ballpark number for FY2019.
- Radhika Piramal:** No.
- Aditya Bapat:** The next question is if you can guide on what will be the capex for this year and for FY2021?
- Radhika Piramal:** It should be in line to what we have done in the last one or two years. Capex has increased compared to previous years that is purely because a Bangladesh and secondly we are overall getting warehouse and factory infrastructure.
- Aditya Bapat:** So like around 50, 60 Crores is what we can expect?
- Radhika Piramal:** We are in investment cycle planning for next year.
- Aditya Bapat:** Thanks a lot that is it from my side. Thank you.
- Moderator:** Thank you. We take the next question from the line of Karan Khanna from Ambit Capital. Please go ahead. Next question is from the line of Nidhi Agrawal from Sunidhi Securities. Please go ahead.
- Nidhi Agrawal:** I have few questions. First of all there is item right to use of 240 Crores in the balance sheet?
- Radhika Piramal:** Right to use in the balance sheet is relating to the new accounting standard.
- Jogendra Sethi:** Ind AS 116 has been introduced from April 1, 2019 which is related to leases. According to Ind AS 116, we have to capitalize rent for the term of the agreement for the leases and we have to create a corresponding lease liability in our books so what you are seeing is right to use of that lease rent multiplied with the number of years of lease. There is a corresponding



liabilities created in the current liability. Instead of showing as a rent expense, depreciation is charged on this right to use asset and also there is an interest on corresponding liability.

- Nidhi Agrawal:** Sir, can you indicate how many stores you have used to arrive at this calculation?
- Jogendra Sethi:** We have several rent agreements which includes company run stores, offices and warehouses.
- Nidhi Agrawal:** My next question is that polycarbonate raw material have come down 30% to 40% on volume basis so has this high upon that hard luggage cost reduction?
- Radhika Piramal:** You are saying that polycarbonate raw material prices have come down 40% that is what you are saying.
- Nidhi Agrawal:** Yes, if you look at the Chinese index for polycarbonate that indicates that the prices has come down so the same material that we used in our luggage hard luggage?
- Sudip Ghose:** We have negotiated well with the Chinese vendor and raw material cost in our own factories have also come down. Answer to your question is yes because of that we are also having good gross margins.
- Nidhi Agrawal:** So this gross margin includes that fall.
- Sudip Ghose:** These are consolidated figures.
- Nidhi Agrawal:** My third question is little on the advertising side if you look at Samsonite they have started using emotional kind of advertising in most of the ads so are we also going to go in the same direction or we have continue to going brand celebrity?
- Sudip Ghose:** Every brand has its own way of communication otherwise all brands will look the same in this world. If someone has taken a route of emotion, it is to them. I am not the person to comment on it. As far as we are concerned, we are very happy the way we are advertising and our advertising is working. I do not think that we need to change course because somebody else is doing and it will be actually suicidal because brands behave very differently at different stages in India.
- Nidhi Agrawal:** Thanks a lot for taking my question.
- Moderator:** Thank you. We take the next question from the line of Amerjit Moriya from Angel Broking. Please go ahead.



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- Amerjit Moriya:** Sir just wanted to understand this festival like 15 days, 20 days or whatever so what was the growth this time compared to the last year same period on the return front as well as wholesaler front both?
- Sudip Ghose:** At the retail front, we have seen some growth but as Radhika said that these are infused growth that we have done. We did a very good campaign. You must have heard of our impossible offers campaign which we did. In this artificial way, we get market share but that also cost money so beyond the point we cannot continue it. The natural maximum demand has to come back and that is what we are waiting for.
- Amerjit Moriya:** Thanks.
- Shradha Sheth:** Radhika just one question from my side, just wanted to understand how is this Bangladesh new capacity scaling up what is the kind of utilization?
- Radhika Piramal:** Yes, at the current capacity, we are about 70% to 75% utilization and with that we have doubled compared to one year. So there is scope to further increase supply without further capex for the next six months at this point.
- Shradha Sheth:** Can you just share what is the capacity and the utilization as you said 75% is on the new capacity, the utilization right?
- Radhika Piramal:** It is actually on the total. We have built more than we have produced because of the lower sales demand environment. We have 75% utilization not because of anything else but because of the lower demand which means essentially if we did Rs. 50 Crores of sales. We could go upto about Rs. 60 or may be Rs. 70 Crores sales in a given quarter without further capex.
- Shradha Sheth:** Can you just share what is the capacity of Bangladesh now?
- Radhika Piramal:** No.
- Shradha Sheth:** Fair enough. No problem. Any closing comment from your side Radhika this is the last question.
- Radhika Piramal:** At this time, I would like to thank everybody for participating in this call. I am sorry about the disruption in the start of the call due to the technical issues in Chairman's line. It has been a difficult quarter and I would like to request Sudip to give the closing comments this time.



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**Sudip Ghose:** The way the year is happening it is more of a year where we have to manage costs so topline growth would definitely be in single digits that is how we are also gearing up all our expenses and our spends in every form whether it is fixed or variable. We have to manage costs and get the bottomline work better for us than topline growth. I do not think that we can have growth similar to last two years. We would try to keep the single digit growth coming. Thank you.

**Moderator:** Thank you. Sir we can conclude right.

**Sudip Ghose:** Yes, thank you.

**Moderator:** On behalf of Edelweiss Securities we conclude today's conference. Thank you for joining. You may now disconnect your lines now.