# V.I.P Industries Ltd./Blow Plast Ltd./Aristocrat Luggage Ltd.

*Management Visit Note*

**December 19, 2006**

We met the management of V.I.P. Industries Ltd. / Blow Plast Ltd. / Aristocrat Luggage Ltd. to discuss the current business scenario and the future growth initiatives of the three companies. Following are the key takeaways:

**V.I.P.-Blow Plast merger to be completed by December end**

V.I.P. had announced the merger of Blow Plast with itself in May 2006, with a share swap ratio of 1:1. Blow Plast is the marketing arm of V.I.P. and was kept as a separate entity for availing sales tax benefits. However, after the levy of VAT, the management decided to merge both the companies. The management expects to complete the merger by the end of December 2006. The merged company would be christened V.I.P. Industries Ltd. Post the merger, the management expects to register improvement in its financials. Post merger, V.I.P.'s equity base will stand enhanced to Rs255mn, with promoters holding ~52%.

**Hard luggage – at negative inflection; Soft luggage – hardening further**

V.I.P. has predominantly been a manufacturer of hard luggage, with a combined annual capacity of ~4.2mn pieces at its plants in Haridwar (Uttaranchal) and Nashik (Maharashtra). The Haridwar plant started operations in April 2006. With hard luggage sales of Rs2.6bn, it holds a 50% market share in the ~Rs6bn organized hard luggage industry in India. Samsonite, the second largest player in India is far behind with a 20% market share. Despite that, it has managed to occupy a larger slice of mind share, especially in the mass premium end of the luggage industry, where V.I.P. is now trying to claw back lost ground.

But the unorganized players command a large chunk of the luggage industry, far greater than the market commanded by the handful of organized players. However, with travel becoming more frequent and sophisticated, the demand for hard luggage is fast being replaced by soft luggage. This trend has got accelerated over the last few years. The unorganized hard luggage sector too is facing stiff competition from Chinese imports and the overall market is seeing sluggish sales.

The key concern is that hard luggage (comprising a bulk of its revenues) has reached a negative inflection point. Sales have dropped faster than anticipated earlier due to the inability to pass on costs as rapidly as the hike in raw material prices, while soft luggage has not grown as rapidly to compensate the fall in contribution from hard luggage. Hard luggage margins have come under pressure.

Soft luggage contributes ~25% to the turnover. With the trend of soft luggage gradually taking over the luggage market, V.I.P. is focusing more on the soft luggage segment (growing at ~42% CAGR). This segment enjoys higher margins of ~9-10% compared to ~5-6% in the hard luggage segment. V.I.P. outsources its entire soft luggage range from China. During FY06, the ratio of hard and soft luggage was at 70:30 and the management expects to take it to 50:50 during FY07, and to 10:90 levels in the future. A shorter life and faster replacement of soft luggage also augurs well for V.I.P. in its endeavour to push soft luggage sales.

**Margins under pressure due to firm raw material prices**

Operating margins have remained under pressure due to firming up of raw material prices like aluminium and crude. From December 1, 2006, the company has taken a price hike of 10% across the board in the soft luggage segment and expects margins to improve going forward. During FY06, V.I.P. could not take a price hike in sales to CSD, which is a large customer, contributing ~20% of sales (Rs1bn) of its revenues. The price increase is expected to be taken by Feb-Mar'07.

**Carlton to drive international business growth**
Exports (both hard and soft) have done very well growing by 26%+. These are done through the company's 100% subsidiary – Carlton Travel Goods Ltd. The international business (Carlton + V.I.P.) is expected to register revenues of Rs800-850mn compared to Rs400mn recorded last year. Carlton is expected to generate a profit of Rs15mn in FY07. Newer markets are being opened up, and this should immensely benefit the brand's penetration.

**Further VRS write-off's**
Over the last four years, V.I.P. has spent almost Rs450mn on VRS. In August 2006, it had offered VRS to 225 employees at its Nashik plant. The management plans to write-off the VRS cost of ~Rs100mn this year. One more round of VRS will be offered at the Nashik plant next year (in April 2007). The management plans to reduce the employee strength at this plant by 250 people by May-June 2007. Thus the current workforce of 770 employees at the Nashik plant will come down to 500. The number of people at the office level would also be reduced to ~100 from nearly 130-140 at present. This will further help in controlling costs, as employee costs currently constitute 10-11% of sales.

**Haridwar plant**
The start up cost for the Haridwar plant was ~Rs15-16mn. This plant is eligible for excise duty (for 10 years) and income tax concession (for 5 years). The company plans to reduce production at the Nashik plant and produce more at this plant, to avail the fiscal benefits. The Haridwar plant (only for the domestic market) has now stabilized, and the Nashik plant will cater to the export markets.

**Moderna – cosy and comfortable**
The management is content with the Rs250-300mn of annual revenues being generated by the furniture division under the brand name Moderna. Being manufactured at Sinnar (Maharashtra), the plant is paying for itself by breaking even and taking care of costs. The management feels that any pressure on it to enhance volumes will lead to losses, and they are unwilling to pump in money to aggressively market the brand in an increasingly commoditized market.

**Enhancing Brand Imagery**
Since starting the exercise to convert itself from a manufacturing driven organization to an organization driven by marketing/sales/brands, V.I.P. has been constantly on the move to evolve itself. It has pruned down its list of dealers/distributors and has gone in for a new brand image. With the retailing scenario changing dramatically over the past few years, V.I.P. plans to increase it presence mainly through owned stores in malls (for premium luggage) and super markets (for mass luggage). The company's strategy primarily is to increase its visibility and enhance brand recognition and recall. V.I.P. at present has ~115 own stores (35 opened so far in 2006-07), which it plans to take to ~200 by the end of March 2007. Christened 'V.I.P. Lounge', these stores house the V.I.P., Footloose and Delsey brands.

V.I.P. intends to finally prune down the list of own stores/MBOs to ~800 from 2,000+ at one point of time. This will help them in keeping a tight control on inventory as well as focused attention to customers, besides ensuring that only the most committed retailers stock the luggage. It has also upped its campaign against copyright infringements aggressively. MBOs (multi-brand outlets) would stock just Alfa, while customers seeking the other brands would have to necessarily come to the exclusive stores. This has been done to ensure better pricing and creating premium imagery. Carlton is made available in India through exclusive Carlton Lounge – seven have opened so far, and ~20 are expected to open by March 2008. And to keep up with the design cues across the globe, V.I.P. has invested in design centres in Hong Kong and London, besides the existing one at Nashik.

**Breaking new ground**

V.I.P. is already a licencee of Delsey, which is one of the premium luggage brands from France, and also globally. Even as the licencee agreement with Delsey comes up for renewal in April 2007, V.I.P. has signed an outsourcing agreement with Delsey, to manufacture 200,000 pieces per year for them. The first shipment will start from February 2007. The management is optimistic of generating ~Rs150-200mn per year of additional revenues from next year, and EBIDTA margins of ~20%.

V.I.P. is also negotiating a marketing arrangement with Switzerland-based Victorinox, which is more into the luxury segment, and is famous for their Swiss knives. This will help it get into a higher price segment as compared to Carlton or Delsey. The management is looking towards this tie-up to have a positive rub-off effect on V.I.P. and allied brands. Besides these, V.I.P. also plans to get into gents accessories, and will also be introducing new ranges under the Footloose brand to cater to yuppies and the youth.

**Aristocrat – likely merger with V.I.P.**

Aristocrat Luggage (formerly Universal Luggage Manufacturing Company Ltd.) is a group company generating revenues of ~Rs1bn. It operates in both segments of the industry – hard and soft – with price points in the hard luggage segment ranging from Rs1,200 to Rs3,500 per piece, i.e. from the upper end of the Alfa range to almost the mid-range of V.I.P. The management feels that the merger of Aristocrat with itself will result in overheads savings of ~Rs120mn in a year, besides brand rationalization and operational efficiencies. The brand teams of Aristocrat and Alfa would be made into one, and the pruned list would be able to service the requirements of the mass market efficiently. The sales channel for the two brands would remain the same – MBOs.

The financial merger is likely to begin from April 2007 while the physical merger will start from July 2007. V.I.P. plans to position Aristocrat and Alfa brands at the lower end of the market whereas V.I.P., Delsey and Carlton brands will be placed in the mass premium and premium segments. One of the two – Alfa and Aristocrat – would either be discarded or made into a sub brand. Aristocrat has recently shut down its plant at Satara (Maharashtra) and has also moved on to same location at Haridwar, to avail of the fiscal benefits on offer. The merged entity would emerge as a powerhouse in the organized as well as unorganized luggage industry in India, straddling the entire spectrum of products across various price points.

**Financials to improve**

The management expects the merged V.I.P.-Blow Plast topline at Rs5.8-6.2bn in FY07 and Rs6.8-7bn in FY08 – excluding Aristocrat. It expects to maintain the growth rate at CAGR 10-15% in the future, and EBIDTA of 30-35%. The bottomline would come in at around Rs160-170mn for FY07 and Rs220-230mn in FY08. The company expects to receive Rs300-400mn as extraordinary income from the promoters due to the sale of DGP Hinoday to M&M. The money from the sale is expected to be received by promoters in early January. The management plans to use this cash for cleaning up of its balance sheet. V.I.P. has a high debt of Rs968mn on its books, and this infusion shall be utilized to reduce the company's gearing.

**Outlook**

Post merger V.I.P. will have five brands in its stable – Alfa (or Aristocrat), V.I.P., Footloose, Delsey and Carlton. On top of this, would be the likely deal signing with Victorinox. Over the past 2-3 years, V.I.P. has been registering a sluggish growth in topline and bottomline mainly due to slow growth in the core hard luggage segment accompanied by firm raw material prices and cheaper imports. However, the increasing focus towards soft luggage segment and price hikes taken across products will contribute to the topline as well as bottomline growth. Transfer of major part of production from Nashik plant to Haridwar plant will also reduce income tax and excise burden.

During FY06, V.I.P. recorded 8% yoy increase in consolidated revenues at Rs3.2bn while net profit rose by 40% yoy to Rs43.3mn. The lower revenue growth was mainly on account of the sluggish hard luggage segment. The company was not able to take a price hike on its sales to the government's CSD segment. Net profit growth could have been even higher but for the ~Rs35mn loss suffered by Carlton during the year. Margins were also under pressure due to the rising polypropylene prices, which form ~60% of V.I.P.'s revenues.

Break even of the Carlton brand and higher exports, improved sales from soft luggage, increase in the aggression in the retail push and penetration, and the likely merger of Aristocrat will fuel growth going forward. Be that as it may, one should wait till for the company to actually start delivering concrete results and successfully implement its plans. At the current market price of Rs90, V.I.P. is trading at 13.9x FY07E EPS of Rs6.5 per share of the merged entity. Meanwhile, Aristocrat is trading at 4.3x FY07E EPS of ~Rs8 at the CMP of Rs34. **The downside looks limited at these levels.**

## Financial Highlights

***VIP Industries Ltd.***

| Period to | 09/06 | 09/05 | Growth | 09/06 | 09/05 | Growth |
|---|---|---|---|---|---|---|
| **(Rs mn)** | **(3)** | **(3)** | **(%)** | **(6)** | **(6)** | **(%)** |
| Net Sales | 763 | 651 | 17.1 | 1,802 | 1,596 | 12.9 |
| Expenditure | (717) | (602) | 19.0 | (1,670) | (1,424) | 17.3 |
| Operating Profit | 46 | 49 | (6.3) | 132 | 172 | (23.4) |
| Other Income | 19 | 24 | (21.9) | 38 | 40 | (5.2) |
| Interest | (17) | (15) | 13.0 | (36) | (30) | 18.7 |
| Depreciation | (25) | (30) | (15.1) | (50) | (61) | (17.7) |
| PBT | 23 | 28 | (20.2) | 84 | 121 | (30.7) |
| Tax | (4) | (5) | (32.7) | (8) | (33) | (76.8) |
| PAT | 19 | 23 | (17.4) | 76 | 88 | (13.3) |
| Exceptional Items | (18) | (15) | 21.6 | (34) | (28) | 22.1 |
| Adjusted PAT | 1 | 8 | (87.8) | 43 | 60 | (29.4) |
| OPM (%) | 6.0 | 7.5 | - | 7.3 | 10.8 | - |
| Equity Capital | 156 | 154 | - | 156 | 154 | - |
| EPS (Rs) | 0.3 | 2.1 | - | 2.7 | 3.9 | - |
| P/E (x), CMP – Rs90 | - | - | | 32.6 | - | |

### *Blow Plast Ltd.*

| Period to | 09/06 | 09/05 | Growth | 09/06 | 09/05 | Growth |
|---|---|---|---|---|---|---|
| **(Rs mn)** | **(3)** | **(3)** | **(%)** | **(6)** | **(6)** | **(%)** |
| Net Sales | 427 | 365 | 17.3 | 1,332 | 1,239 | 7.5 |
| Expenditure | (433) | (373) | 16.0 | (1,262) | (1,158) | 9.0 |
| Operating Profit | (5) | (9) | (38.8) | 70 | 81 | (14.3) |
| Other Income | 16 | 17 | (7.2) | 16 | 17 | (7.5) |
| Interest | (1) | 1 | - | (3) | 0 | - |
| Depreciation | (7) | (3) | 160.0 | (14) | (5) | 185.7 |
| PBT | 3 | 6 | (58.7) | 69 | 94 | (26.2) |
| Tax | (1) | 4 | - | (22) | (26) | (16.7) |
| PAT | 2 | 10 | (83.7) | 47 | 68 | (29.9) |
| Exceptional Items | 0 | (10) | - | (0) | (11) | - |
| Adjusted PAT | 2 | (0) | - | 47 | 57 | (17.3) |
| OPM (%) | (1.2) | (2.3) | - | 5.2 | 6.6 | - |
| Equity Capital | 168 | 160 | - | 168 | 160 | - |
| EPS (Rs) | 0.4 | - | - | 5.6 | 7.1 | - |
| P/E (x), CMP – Rs92 | - | | | 16.5 | | |

### *Aristocrat Luggage Ltd.*

| Period to | 09/06 | 09/05 | Growth | 09/06 | 09/05 | Growth |
|---|---|---|---|---|---|---|
| **(Rs mn)** | **(3)** | **(3)** | **(%)** | **(6)** | **(6)** | **(%)** |
| Net sales | 131 | 107 | 21.9 | 385 | 271 | 42.2 |
| Expenditure | (120) | (98) | 22.9 | (344) | (247) | 39.1 |
| Operating profit | 11 | 9 | 11.8 | 41 | 24 | 75.5 |
| Other income | 1 | 0 | - | 1 | 0 | - |
| Interest | (6) | (4) | 52.5 | (12) | (9) | 37.8 |
| Depreciation | (3) | (3) | (1.7) | (4) | (5) | (22.3) |
| PBT | 2 | 3 | (6.9) | 26 | 10 | 172.5 |
| Tax | (1) | (0) | - | (7) | (1) | 688.8 |
| PAT | 1 | 2 | (40.4) | 19 | 9 | 122.4 |
| Exceptional items | (1) | (2) | (47.1) | (2) | (4) | (57.2) |
| Adjusted PAT | 0 | 1 | - | 18 | 5 | 290.8 |
| OPM (%) | 8.1 | 8.8 | - | 10.7 | 8.7 | - |
| Equity capital | 56 | 56 | - | 56 | 56 | - |
| EPS (Rs) | 0.3 | 0.4 | - | 6.3 | 1.6 | - |
| P/E (x), CMP – Rs34 | - | | | 5.5 | | |