

# Nitin Khandkar Institutional Research

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## INDIA RESEARCH - SMALL CAP - APPAREL

### Lovable Lingerie Ltd. - IPO Analysis

March 8, 2011

[Note: Please read important Disclaimer / Analyst Certification on the last page of this report]

#### Issue Highlights

Price Band	:	₹195 - 205 per Share
IPO subscription dates	:	March 8 - 11, 2011 (till March 10 for QIBs)
BRLM	:	Anand Rathi Advisors Ltd.
Grading	:	3/5 (CARE)
Post-listing Market Cap (at cap price)	:	₹3.44bn (\$77mn)
Free Float Market Cap (at cap price)	:	₹0.93bn (\$21mn)
Rating	:	<b>Subscribe</b>

IPO of 4.55mn Equity Shares of ₹10 each, aggregating to ₹932.8mn (\$20.7mn) at the cap price

#### Issue Breakup

Particulars	No. of Shares	No. of Shares	% of Issue
<b>QIBs</b>		<b>2,275,000</b>	<b>50%</b>
- Anchor Investors	682,500		
(Domestic MFs : 227,500)			
(Others : 455,000)			
- QIBs excl. MFs	1,512,875		
- MFs	307,125		
<b>Non-Institutional Investors</b>		<b>682,500</b>	<b>15%</b>
<b>Retail Investors</b>		<b>1,592,500</b>	<b>35%</b>
<b>Total</b>		<b>4,550,000</b>	<b>100%</b>

#### Executive Summary

- Lovable Lingerie Ltd. (LLL) is one of the leading players in the women's branded innerwear market in India.
- Its business model is based on ownership of innerwear brands such as Lovable, Daisy Dee and College Style and their respective sub-brands, backed by integrated, diversified manufacturing operations, with aggregate capacity of 6.75mn pieces p.a. and a wide distribution network spanning different formats.
- Its core promoter is well entrenched in the business, and was earlier associated with Maxwell Industries Ltd., another leading player in the same segment.

Nitin Khandkar Institutional Research also distributed via Capital IQ and TheMarkets.com Award Winner - "India's Best Market Analyst 2009 - IPO Category", in a previous assignment

- Importance of the lingerie market within the overall apparel market in India can be highlighted by the fact that it constituted 9.4% of the overall apparel market and 31.9% of the women's apparel market, in volume terms, in CY2009. In value terms, the lingerie market constituted 5.1% of the total Indian apparel market and 15.8% of the overall women apparel market in CY2009.
- The organized sector of the innerwear market in India holds tremendous potential, since its share is barely one-third of the overall innerwear market in India. However presence of competing brands such as Triumph, Enamor, Amante, Jockey, Juliet, Softline, etc. makes the market extremely competitive.
- With presence in both the premium and mid-market segments, LLL seems to have attempted to hedge the business risks. Its premium brand Lovable is amongst the top three preferred brands in women's innerwear in India, while its Daisy Dee brand is a mid-market brand. According to the management, Lovable accounts for ~50% of revenues, indicating equal focus on the premium and mid-market segments.
- A Sequoia Capital group company has taken a pre-IPO stake in LLL at a valuation of ₹200 per share, in February, 2011.
- We however note that though the company was set up as early as 1987, it commenced commercial operations only in 1995, with a small capacity of 70,000 pieces p.a. Scale-up of capacity has taken place only post 2004, as the capacity was aggressively raised first to 2.6mn, then to 5mn, 6mn and then to 6.75mn.
- The company's volume growth which was robust at 30% and 23% in FY07 and FY08 respectively, tapered off to 12% and 8% in FY09 and FY10 respectively. This leads us to believe that the branded innerwear industry may be susceptible to economic downturns. In time of economic recession, even urban consumers may "down-trade" or buy lower value products. Such industries also do exceedingly well in consumerism boom times. Having said that, the company's presence in the mid-market segment may partly insulate it from demand crunch during times of economic downturns.
- The company's average sales realization increased from ₹83 in FY06 to ₹120 in the 9 months to December 2010. We believe this indicates both the purchasing power of the consumers and the company's pricing power, vis-à-vis unbranded players.
- We note that the company has managed to avoid over-dependence on a few clients; its top 10 customers together accounted for just ~19% of revenues for the period of 9 months ended December 31, 2010.
- Under the ongoing expansion project, the company intends to set up an addition manufacturing unit, further increasing the capacity to 9.25mn pieces p.a.
- Its proposed JV with Lifestyle Galleries of London Ltd., U.K. will not only help it gets access to the London Calling brand, but also enable launch of new products.
- The valuation of the IPO makes LLL slightly expensive compared to peer Maxwell Industries (see peer comparison on page 9). However given LLL's presence in the premium segment, its expansion plans, proposed JV with Lifestyle Galleries of London, the valuation premium seems justified. Successful rollout out the expansion project, increase in utilization of existing plant and pricing power would be key to future profitability. We recommend subscribing to the IPO, mainly with a view to participating in the medium term growth of the company.

### Shareholding Pattern

Shareholder Categories	Pre-IPO		Post-IPO	
	No. of Shares	% Holding	No. of Shares	% Holding
Promoters	11,250,000	91.8%	11,250,000	67.0%
FII (Pre-IPO) #	1,000,000	8.2%	1,000,000	6.0%
Anchor Investors (excl. Domestic MFs)	0	0.0%	455,000	2.7%
QIBs excl. Mutual Funds	0	0.0%	1,512,875	9.0%
Mutual Funds (incl. Domestic MFs)	0	0.0%	307,125	1.8%
Non-Institutional Investors	0	0.0%	682,500	4.1%
Public	0	0.0%	1,592,500	9.5%
<b>Total</b>	<b>12,250,000</b>	<b>100.0%</b>	<b>16,800,000</b>	<b>100.0%</b>

# Sequoia Capital, @ ₹200 per share

### Company Background

Lovable Lingerie Ltd. (LLL) was originally incorporated as Hybo Knit Pvt. Ltd. in September, 1987. Its name was changed to Lovable Lingerie Pvt. Ltd. in November, 1995. In December, 1995, LLL obtained license for use of the brands viz., 'Lovable' and 'Celebrity' from Lovable World Trading Company (LWTC), USA. LLL commenced commercial operations by setting up a manufacturing unit in Bengaluru with an installed capacity of 70,000 pieces p.a.

Subsequently, in December, 2000, LLL acquired 'Lovable' and 'Celebrity' from LWTC on an exclusive basis for the territories of India, Nepal, Sikkim and Bhutan.

LLL acquired license for the brand 'Vanity Fair' from Vanity Fair, Inc. effective July 2002. However it discontinued manufacture of products under the 'Vanity Fair' brand in 2007.

In March 2009, LLL acquired the trademark 'College Style' from Levitus Trading Limited, Hong Kong.

### Relationship with Maxwell Industries Ltd.

LLL acquired the brand 'Daisy Dee' from Maxwell Industries Ltd. in March, 2004. The company approved a scheme of amalgamation with Maxwell Industries Ltd. in 2006. However in 2007, LLL withdrew the scheme of amalgamation with Maxwell Industries Ltd.

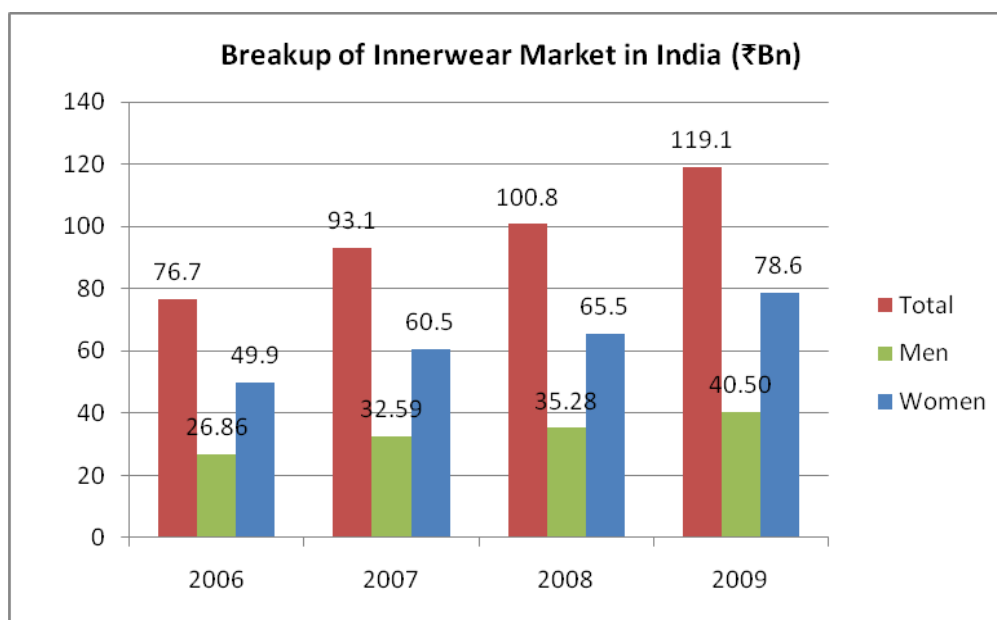
### Promoters

The company has been promoted by the Reddy family. L. Vinay Reddy, CMD, has over 2 decades of experience in the innerwear industry. There are three independent directors on the board of the company.

### Industry Overview

#### Innerwear Industry

As per a report by CARE, the overall innerwear market (excl. kids) in India was worth ₹119.1bn in CY2009. It has grown at 15.8% CAGR over the last four years, due to the rising disposable incomes, growing consumer class and entry of international brands.

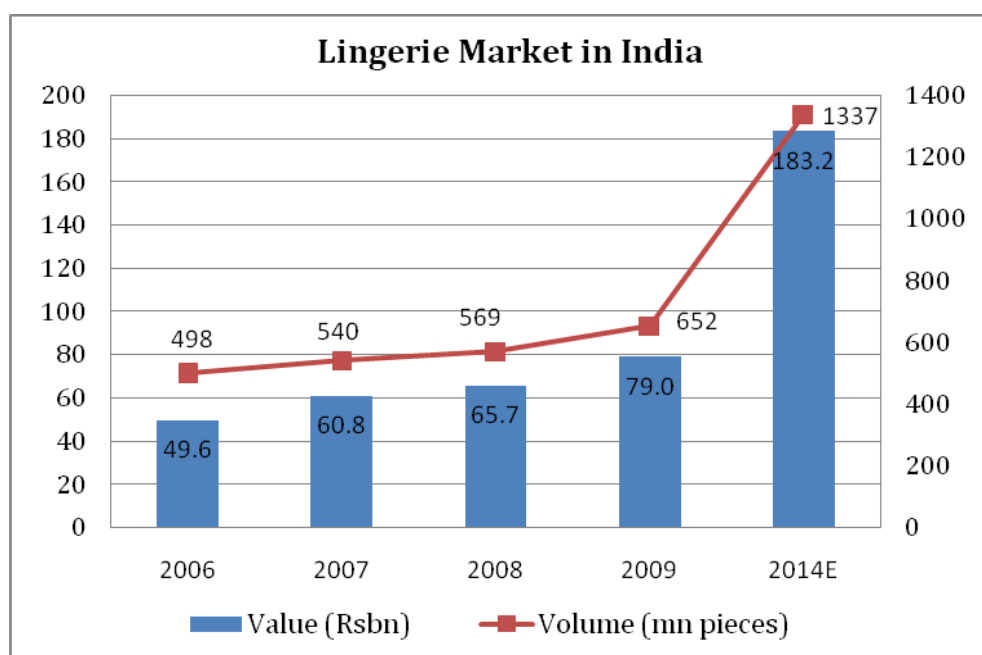


The breakup of the market between men’s and women’s innerwear is 48:52 in volume terms, and 34:66 in value terms. Women’s innerwear market has a larger value share and a smaller volume share due to higher Average Selling Prices (ASP) of the former vis-à-vis men’s innerwear.

**Lingerie market in India**

The lingerie industry in India grew at 16.8% CAGR over the period 2006-09, and was worth ₹78.97bn in CY2009. Its growth can be attributed to the rising disposable income and growing preference for lifestyle products. The lingerie market constituted 5.1% of the total Indian apparel market and 15.8% of the overall women apparel market during 2009.

The lingerie industry grew at 9.4% CAGR over the last four years in volume terms. Lingerie sales grew from 498mn pieces in 2006 to 652mn pieces in 2009. Lingerie constitutes 9.4% of the overall apparel market and 31.9% of the women’s apparel market, in volume terms.



Average selling price of lingerie grew from ₹100 in 2006 to ₹121 in 2009, at 6.7% CAGR.

### High potential of organized sector

With two-third of the lingerie market being controlled by unbranded and unorganized regional players, the potential of the organized, branded players is tremendous. The advent of international brands in the Indian market place has brought about some realignment in the fragmented lingerie market.

### Segment-wise lingerie market

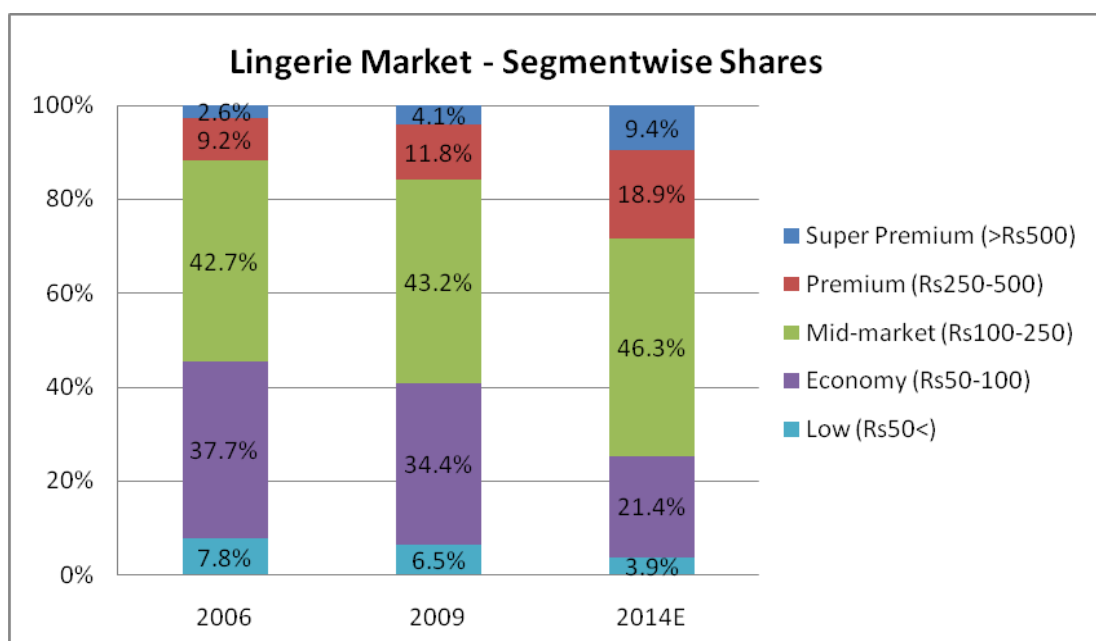
The price-point based segments of the lingerie market in India are super-premium, premium, mid-market, economy and low-market segment. The mid-market and economy segments account for a 75% market share in both value and volume terms. However, the super-premium and premium segments are relatively smaller but fast-growing segments.

In volume terms, the economy segment accounts for the highest share in the lingerie market. The volume-wise share of different segments has remained more or less stable over the last four years.

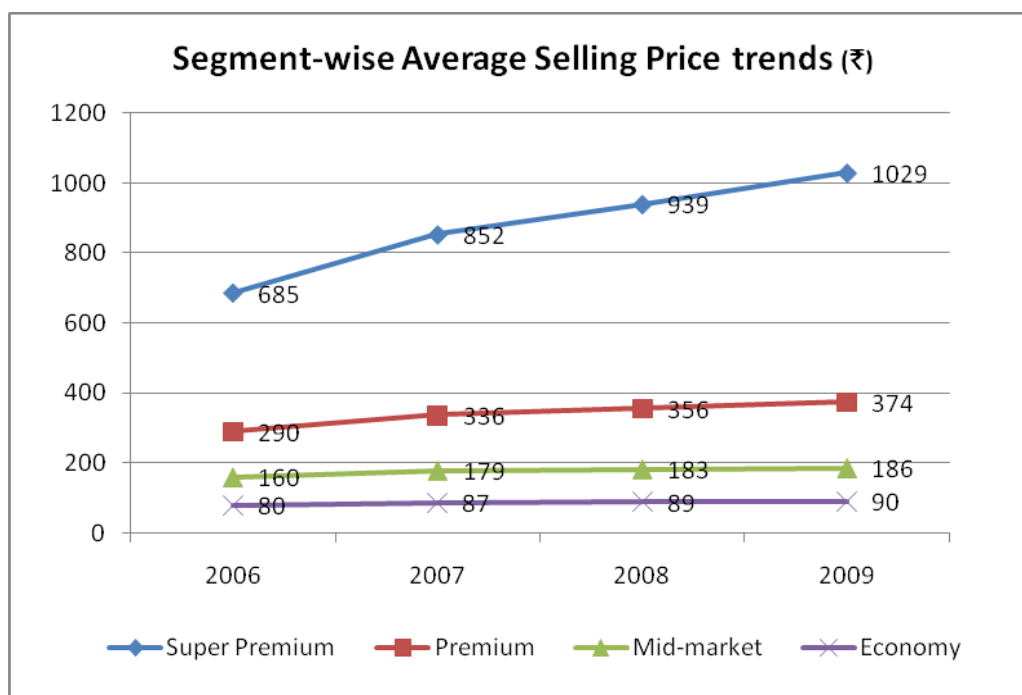
The super-premium segment was the fastest growing in volume terms (18.9% CAGR), followed by the premium segment (16.6% CAGR). This can be attributed to the surge in international brands entering India, rising income levels, changing demographics, growing brand awareness and the consumer's willingness to spend on lifestyle products.

The key brands in the premium and super-premium category are Marks & Spencer, Triumph, Enamor, Lovable and La Senza. The key brands in the economy and mid-segment are Groversons, Bodycare, Bodyline, Daisy Dee and Teenager.

In value terms, the mid-market segment is the largest followed by economy and super-premium and premium segments. The mid-market and economy segments, dominated by unbranded regional players, account for ~78% market share by value. These categories hold immense potential.



As depicted in the chart above, the share of super premium and premium segments is likely to move up from ~16% in 2009 to ~28% in 2014E. The share of the economy and low segments is likely to decline from ~41% in 2009 to ~25% in 2014E.



Lovable is amongst the top three preferred brands in women’s innerwear in India, as per Images Business of Fashion Magazine, October 2009 issue.

**Demand drivers for the organized lingerie market**

1. Growing brand-conscious consumer class
2. Rising income levels and focus on lifestyle products
3. Rising percentage of working women
4. Growing urbanization
5. Growing organized retail

**Business Overview**

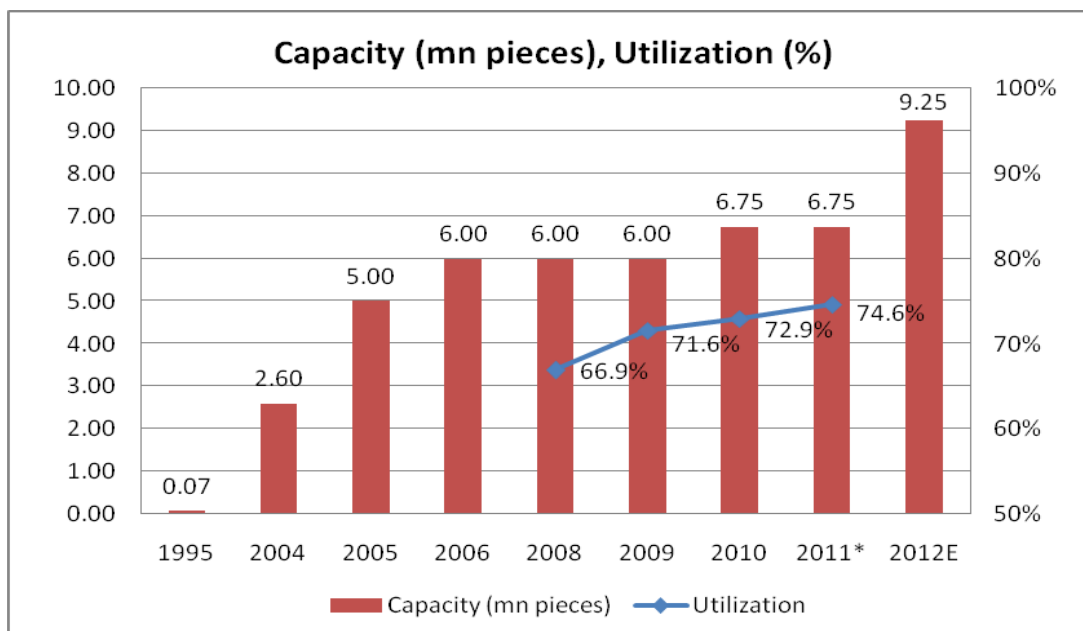
**Brands**

- Lovable (premium women’s innerwear brand)
- Daisy Dee (mid-segment market brand)
- College Style (young segment)

**Manufacturing locations**

Location	Capacity (mn pieces p.a.)
Bengaluru	6.00
Roorkee	0.75
<b>Total</b>	<b>6.75</b>

**Scale-up of Manufacturing Capacity and Utilization data**



\* for 9 months ended December 31, 2010

Management expects new manufacturing facility at Bengaluru to commence commercial production in January 2012.

**Joint Venture with Lifestyle Galleries of London**

LLL entered into an agreement with Lifestyle Galleries of London Ltd., U.K. in July, 2010, to establish a joint venture company in India by the name of ‘Lovable Lifestyles Private Limited’ for manufacturing, marketing etc. of product lines of LGL in the categories of personality grooming/style, lifestyle enhancement and beauty, including but not limited to, women’s intimate apparels as well as men’s undergarments under the ‘London Calling’ brand in India.

Under the JVA, LLL will acquire a 90% stake in Lovable Lifestyles for a total cash consideration of ₹250mn, while LGL shall acquire the remaining 10% stake in Lovable Lifestyles.

LGL has agreed to license its know-how and trademark to Lovable Lifestyles and assign in perpetuity the ‘London Calling’ brand to Lovable Lifestyles. Complete product lines that are developed in the United Kingdom by LGL would also be made available to Lovable Lifestyle.

The JV will provide avenues for diversification to other lifestyle products using the existing customer base of LLL. The higher end life style products and accessories which will be manufactured in India and exported to overseas markets, will help create access to overseas markets and increase revenues.

**Strengths**

- Strong brands (Lovable, Daisy Dee and sub-brands)
- Integrated operations and economies of scale
- Strong distribution network (103 distributors, 1425 retail outlets for Lovable brand and 7500 retail outlets for Daisy Dee brand, across large format stores, multi-brand outlets and hosiery /innerwear stores)
- Wide product range and diversified customer base
- Product design and development capabilities

### Strategy

- Promotion of existing brands Lovable, Daisy Dee and College Style
- Expansion of product range
- Modernization and upgrading of manufacturing facilities
- Expanding the retail space
- Exploring inorganic growth opportunities

### Concerns

- Focus on super-premium/premium segments may not pay off in times of economic recessions
- Dependence on organized retail chains such as Shoppers Stop, Westside, Lifestyle can pose a risk if any of these has to scale down operations
- Business model prone to risks of raw material availability, prices and quality
- Labour intensive nature of operations
- Poor brand loyalty
- Competition

### Highlights of Expansion Project

Particulars	Amount (`Cr)	% of Total
Setting up of manufacturing facility at Bengaluru	22.85	23.5%
Investment in Joint Venture with Lifestyle Galleries of London	25.00	25.7%
Brand-building expenses	18.00	18.5%
Brand Development expenses for College Style brand	6.00	6.2%
Setting up of Exclusive Brand Outlets (EBOs)	14.12	14.5%
Setting up of retail store modules for shop-in-shop	3.61	3.7%
Upgradation of design studios	7.60	7.8%
<b>Identifiable Total Expenditure</b>	<b>97.18</b>	<b>100.0%</b>

### Means of Finance

Particulars	Amount (`Cr)
Initial Public Offer	93.28
Pre-IPO Placement	20.00
Term loan	16.33
Internal Accruals	N.A.
<b>Total</b>	<b>129.61</b>

### Earnings Estimates and Valuations

(`Cr)

Particulars	FY11E	FY12E
Sales	108.31	135.39
EBITDA	20.15	25.05
PAT	14.47	15.94
EBITDA margin	18.6%	18.5%
Fully-diluted EPS (`)	8.61	9.49
P/e multiple (at cap price)	23.8x	21.6x
EV/EBITDA	17.4x	14.0x

Source: Nitin Khandkar Institutional Research



## Lovable Lingerie Ltd. - IPO Analysis

Since the new unit at Bengaluru will likely commence commercial production only in January 2012, its full contribution could come only in FY13. In the meantime, we expect the company's existing facilities to improve the level of utilization of capacity.

We believe investors may consider earnings for FY12 only, since the new unit will get commissioned towards the end of FY12.

### Peer Comparison

We compared LLL with Maxwell Industries Ltd., which has men's innerwear brands Frenchie, Frenchie X, VIP and Leader and women's innerwear brand Feelings. We chose not to compare LLL with Page Industries, on account of the latter's higher revenue size and presence mainly in the premium segment.

Particulars	Lovable Lingerie	Maxwell Industries
Price (Rs)	205	18
Face value (Rs)	10	2
52-wk High / Low	-	30 / 14
Paid-up Equity Capital	16.80	12.62
No. of shares outstanding (Cr)	1.68	6.31
Market Capitalization	344	114
Sales FY10	86.95	211.39
PAT FY10	10.55	6.53
EPS (Rs) FY10	6.28	1.04
Sales FY11	108.31	225.00
PAT FY11	14.47	5.20
EPS (Rs) FY11	8.61	0.82
Book value (Rs)	81.46	13.67
<i>P/e (x)</i>	23.8	21.8
<i>P/s (x)</i>	3.2	0.5
<i>P/b (x)</i>	2.5	1.3
Debt	0.34	74.04
EV	343	185
EBITDA	16.66	23.37
EV/EBITDA (x)	20.6	7.9
EBITDA margin	19.2%	11.1%
Debt-Equity ratio (x)	-	0.77
ROE	10.6%	6.0%
ROCE	13.8%	9.7%

While both companies have strong brands, it would be somewhat difficult to choose between the two.

While Maxwell Industries has a higher revenue size, it has slimmer EBITDA margins by virtue of higher share of mid-market products in its revenues. Maxwell's balance sheet is highly leveraged too. Maxwell's profitability has been under pressure for the 9 months ended December 31, 2010. LLL's return ratios are superior to those of Maxwell Industries.

### Recommendation: **Subscribe**

On the basis of forward valuations, LLL seems slightly more expensive vis-à-vis Maxwell Industries. However given the aggressive expansion plans and outlook for the lingerie market in general, we believe investors may **subscribe** to this IPO.

**Caveats**

LLL will have to not only display smooth execution of the expansion project and JV with Lifestyle Galleries of London, but would also need to improve utilization of existing plants. In the market which is getting increasingly competitive, LLL will have to strive to protect its margins too.

**Annexure**

**Profit & Loss Statements**

(₹Cr)

Particulars, for period ending	31.3.07	31.3.08	31.3.09	31.3.10	31.12.10
<b>Income</b>					
Sales of Manufactured Products	41.54	60.06	69.24	86.95	88.06
Sales of Traded Products	0.00	0.00	0.00	0.00	0.00
<b>Net Sales</b>	<b>41.54</b>	<b>60.06</b>	<b>69.24</b>	<b>86.95</b>	<b>88.06</b>
<b>Expenditure</b>					
Materials Consumed	18.31	24.34	28.60	40.42	38.48
Wages and Staff Costs	6.48	8.09	9.09	9.29	8.81
Other Manufacturing Expenses	1.82	2.17	2.70	2.78	3.39
Administrative Expenses	1.50	2.55	3.34	2.80	2.41
Selling and Distribution Expenses	7.92	15.57	17.00	15.52	18.29
<b>Total</b>	<b>36.02</b>	<b>52.72</b>	<b>60.73</b>	<b>70.80</b>	<b>71.39</b>
<b>EBITDA</b>	<b>5.52</b>	<b>7.34</b>	<b>8.51</b>	<b>16.15</b>	<b>16.66</b>
Other Income	0.04	0.12	0.11	0.10	0.85
Financial Charges	0.25	0.64	1.37	0.93	0.44
<b>Profit Before Depreciation &amp; Tax</b>	<b>5.31</b>	<b>6.82</b>	<b>7.26</b>	<b>15.32</b>	<b>17.07</b>
Depreciation	0.21	0.28	0.39	1.31	1.02
<b>Profit Before Taxation</b>	<b>5.09</b>	<b>6.54</b>	<b>6.87</b>	<b>14.01</b>	<b>16.05</b>
Provision for Taxation	1.81	2.27	1.13	3.04	3.25
Provision for Deferred Tax	-0.06	-0.01	-0.37	0.42	0.19
Provision for FBT	0.04	0.11	0.08	0.00	0.00
Add/Less Adjustments of Prior Year	0.02	0.22	0.00	0.77	0.00
<b>Total</b>	<b>1.80</b>	<b>2.61</b>	<b>0.85</b>	<b>4.22</b>	<b>3.44</b>
<b>PAT before Extraordinary Items</b>	<b>3.29</b>	<b>3.94</b>	<b>6.02</b>	<b>9.79</b>	<b>12.61</b>
Extraordinary Items	0.00	0.00	-2.54	0.00	0.00
Excess Provision for Gratuity	0.00	0.00	0.00	0.25	0.00
Material adj. for Restatement	-0.11	0.22	-0.62	0.51	0.00
<b>Net Profit after Adjustments</b>	<b>3.18</b>	<b>4.16</b>	<b>2.87</b>	<b>10.55</b>	<b>12.61</b>
EBITDA margin	13.3%	12.2%	12.3%	18.6%	18.9%
EPS (₹)	63.70	27.73	19.11	14.07	13.72
Book value (₹)	141.21	79.90	97.84	32.48	32.86

**Legend**

₹ = Indian Rupees (INR)

Crore = 10 million

## Balance Sheets

(₹Cr)

Particulars, as at	31.3.07	31.3.08	31.3.09	31.3.10	31.12.10
<b>Sources of Funds</b>					
Paid-up Equity Share Capital	0.50	1.50	1.50	7.50	11.25
Reserves & Surplus	6.56	10.49	13.18	16.86	25.71
<b>Net Worth</b>	<b>7.06</b>	<b>11.99</b>	<b>14.68</b>	<b>24.36</b>	<b>36.96</b>
11% Cumm.Redeemable Pref. Shares	0.50	0.00	0.00	0.00	0.00
Secured Loans	3.28	5.54	3.71	0.29	0.34
Unsecured Loans	3.00	1.50	2.68	0.04	0.00
<b>Total Debt</b>	<b>6.28</b>	<b>7.04</b>	<b>6.39</b>	<b>0.33</b>	<b>0.34</b>
Deferred Tax Liability	0.00	0.00	0.46	0.88	1.07
<b>Total Liabilities</b>	<b>13.84</b>	<b>19.03</b>	<b>21.53</b>	<b>25.57</b>	<b>38.37</b>
<b>Applications of Funds</b>					
<b>Fixed Assets</b>					
Gross Block	5.93	6.67	16.67	17.54	18.34
Less: Depreciation	2.80	3.08	3.48	4.75	5.77
<b>Net Block</b>	<b>3.13</b>	<b>3.58</b>	<b>13.19</b>	<b>12.79</b>	<b>12.57</b>
Investments	0.00	1.00	1.00	1.98	0.01
<b>Current Assets, Loans &amp; Advances</b>					
Inventories	13.17	16.61	13.53	13.07	14.19
Receivables	5.45	6.09	8.71	13.64	17.63
Cash & Bank Balance	1.56	2.03	2.03	2.70	2.23
Loans & Advances	1.67	4.74	9.10	2.32	2.95
Deferred Tax Asset	0.04	0.04	0.00	0.00	0.00
<b>Total</b>	<b>21.89</b>	<b>29.52</b>	<b>33.36</b>	<b>31.72</b>	<b>36.99</b>
<b>Current Liabilities &amp; Provisions</b>					
Current Liabilities	8.60	14.12	25.33	18.61	10.37
Provision for Taxes	2.22	0.28	0.16	1.18	0.55
Provision for Gratuity	0.36	0.53	0.38	0.38	0.32
Other Provisions	0.00	0.15	0.15	0.75	0.00
<b>Total</b>	<b>11.18</b>	<b>15.08</b>	<b>26.03</b>	<b>20.92</b>	<b>11.24</b>
<b>Net Current Assets</b>	<b>10.71</b>	<b>14.44</b>	<b>7.34</b>	<b>10.80</b>	<b>25.75</b>
Misc. Exp. non written off	0.00	0.00	0.00	0.00	0.05
<b>Total Assets</b>	<b>13.84</b>	<b>19.03</b>	<b>21.53</b>	<b>25.57</b>	<b>38.37</b>

## Key Ratios

Current ratio (x)	2.0	2.0	1.3	1.5	3.3
Fixed Assets Turn (x)	13.3	16.8	5.2	6.8	7.0
Debtors collection period (days)	47	37	45	56	72
Debt-equity ratio (x)	0.890	0.588	0.436	0.014	0.009
ROE	45.1%	34.7%	19.5%	43.3%	34.1%
ROCE	38.3%	37.1%	37.7%	58.0%	40.8%

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