

7 March 2013

Lovable Lingerie

Growth bountiful; Buy

Our interaction with the Lovable Lingerie management leaves us assured of its FY14 growth prospects. Its recent price hikes as well as the excise duty removal would help it expand realizations and margins. With its expanded distribution network and no further increase in competition, Lovable is expected to report a 19% earnings CAGR over FY13-15. We retain a Buy, with a target of ₹366.

Price hikes and removal of excise duty to drive realizations up. Its product prices have been hiked after 18 months. In Dec'12 the Lovable range was hiked 6%; in Jan'13 Daisy Dee was hiked 7%. The removal of excise duty on ready made garments, we believe, would help expand its FY14 net realization 2.5-3%. (Earlier, excise duty was 12% on the MRP, with 70% abatement minus cenvat credit.) After the margin drop in FY11-13, we expect the EBITDA margin in FY14 to expand. This would arise from the national launch of Daisy Dee in FY12 and FY13 and from stable prices of cotton, the major raw material.

Expansion of distribution network on track. After the change in its distribution structure, the number of Lovable retail outlets has increased, from 1,800 to 3,500. Daisy Dee has been successfully launched nationally and its retail outlets have increased from 7,000 to 10,000. The company believes there is significant room to widen the reach of both the brands.

No rise in competitive pressure. In the past 12 months, no major change has been seen in the competition scenario. Marks & Spencer is focussing on metropolises. La Senza and Enamor are focusing on retail. Hanes and Fruit of the Loom have not yet launched lingerie in India. This has helped Lovable maintain a 25%+ market share in premium lingerie.

Our take. We retain our Buy rating on the stock, with target price of ₹366 at a target PE of 20x FY14e earnings. Since listing, it has traded at a mean PE of 24x. We believe the EBITDA margin expansion, improved return ratios and 19% earnings CAGR over FY13-15e would help expand valuation multiples.

Risks: Higher raw material prices and keener competition.

Key financials (YE Mar)	FY11	FY12	FY13e	FY14e	FY15e
Sales (₹m)	1,040	1,329	1,712	2,205	2,775
Net profit (₹m)	141	217	255	306	361
EPS (₹)	8.4	12.9	15.2	18.3	21.6
Growth (%)	(3.3)	53.7	17.8	20.0	18.0
PE (x)	30.1	19.6	16.6	13.8	11.7
P BV (x)	3.0	2.6	2.3	2.0	1.8
RoE (%)	16.8	14.3	14.9	15.7	16.2
RoCE (%)	21.6	14.1	15.1	17.8	19.5
Dividend Yield (%)	0.6	0.8	0.9	1.2	1.6
Net Gearing (%)	(75.5)	(59.3)	(50.1)	(40.2)	(33.0)

Source: Company, Anand Rathi Research

Rating: **Buy**

Target Price: ₹366

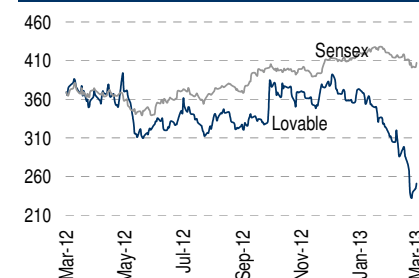
Share Price: ₹253

Key data	LLL IN / LOVA.BO
52-week high / low	₹405 / ₹220
Sensex / Nifty	19253 / 5819
3-m average volume	US\$1.2m
Market cap	₹4bn / US\$78m
Shares outstanding	17m

Shareholding pattern (%)	Dec '12	Sep '12	Jun '12
Promoters	67.0	67.0	67.0
- of which, Pledged	-	-	-
Free Float	33.0	33.0	33.0
- Foreign Institutions	10.1	10.2	10.5
- Domestic Institutions	3.9	3.9	3.4
- Public	19.0	18.9	19.1

Estimates revision (%)	FY13e	FY14e	FY15e
Sales	0.0	0.0	2.2
EBITDA	(1.4)	3.3	1.6
EPS	(3.7)	(2.5)	(4.1)

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Net sales	1,040	1,329	1,712	2,205	2,775
Sales growth (%)	19.6	27.8	28.8	28.8	25.8
- Op. expenses	845	1,099	1,421	1,808	2,271
EBIDTA	195	231	291	397	503
EBITDA margins (%)	18.8	17.4	17.0	18.0	18.1
- Interest	5	6	5	5	5
- Depreciation	14	15	27	43	60
+ Other income	9	67	85	82	78
- Tax	44	61	90	125	155
Effective tax rate (%)	23.9	21.9	26.0	29.0	30.0
Reported PAT	141	217	255	306	361
Adjusted PAT	-	-	-	-	-
PAT growth (%)	-	-	-	-	-
FDEPS (₹/share)	141	217	255	306	361
Adj. FDEPS growth (%)	8.4	12.9	15.2	18.3	21.6
DPS (₹/share)	(3.3)	53.7	17.8	20.0	18.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Share capital	168	168	168	168	168
Reserves & surplus	1,244	1,422	1,638	1,900	2,202
Shareholders' fund	1,412	1,590	1,806	2,068	2,370
Minority interests	-	-	-	-	-
Debt	-	45	45	45	45
Def tax Liability	9	10	10	10	10
Capital employed	1,422	1,646	1,862	2,124	2,426
Fixed assets	129	234	471	703	943
Investments	931	1,018	918	818	768
Of which liquid	931	1,018	918	818	768
Working capital	218	323	380	483	597
Cash	143	33	93	120	119
Capital deployed	1,422	1,646	1,862	2,124	2,426
Net Debt	(1,065)	(994)	(955)	(882)	(831)
W C turn (%)	21.0	24.3	22.2	21.9	21.5
Book value (Rs/Sh)	84.9	95.5	108.4	124.1	142.1

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
PAT	141	217	255	306	361
+Non-cash Items	14	15	27	43	60
Cash profit	143	186	282	349	421
- Incr./Decr. in WC	(146)	(132)	(57)	(103)	(114)
Operating cash-flow	(3)	53	225	246	307
- Capex	15	158	225	275	300
Free cash-flow	(18)	(105)	(0)	(29)	7
- Dividend	9	29	39	44	59
+ Equity raised	1,057	-	-	-	-
+ Debt raised	(3)	34	-	-	-
- Investments	911	14	(100)	(100)	(50)
- Misc. items	-	-	-	-	-
Net cash-flow	116	(113)	61	27	(1)
+ Opening cash	26	142	33	93	120
Closing cash	142	29	93	120	119

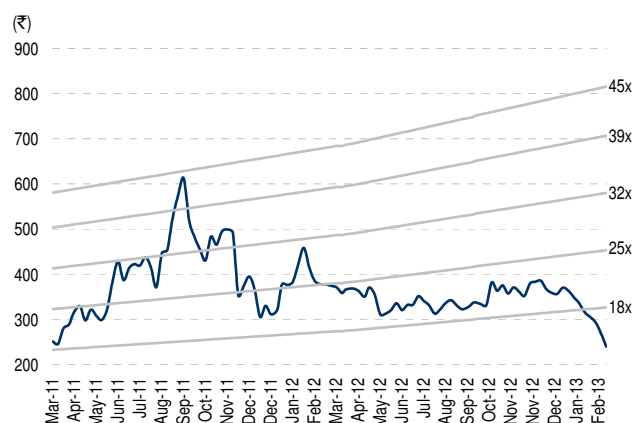
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹253

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
P/E (x)	30.1	19.6	16.6	13.8	11.7
P/B (x)	3.0	2.6	2.3	2.0	1.8
EV/Sales (x)	3.2	2.5	1.9	1.5	1.2
EV/EBITDA (x)	16.8	14.3	11.3	8.3	6.5
RoAE (%)	16.8	14.3	14.9	15.7	16.2
RoACE (%)	21.6	14.1	15.1	17.8	19.5
Dividend yield (%)	0.6	0.8	0.9	1.2	1.6
Dividend payout (%)	17.8	15.5	14.8	16.4	18.5
RM to sales (%)	44.2	40.3	40.5	39.9	40.0
Ad spend to sales (%)	3.1	2.1	2.2	2.0	2.0
EBITDA growth (%)	20.9	18.2	26.0	36.4	26.8
EPS growth (%)	(3.3)	53.7	17.8	20.0	18.0
PAT margin (%)	13.5	16.3	14.9	13.9	13.0
Volume growth (%)	-	-	-	-	-
Realization growth (%)	-	-	-	-	-

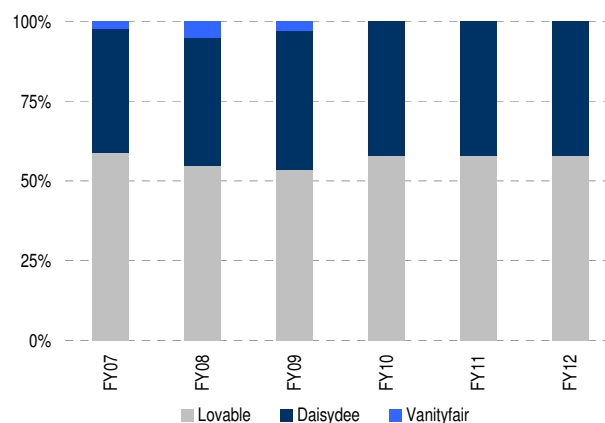
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up



Source: Company

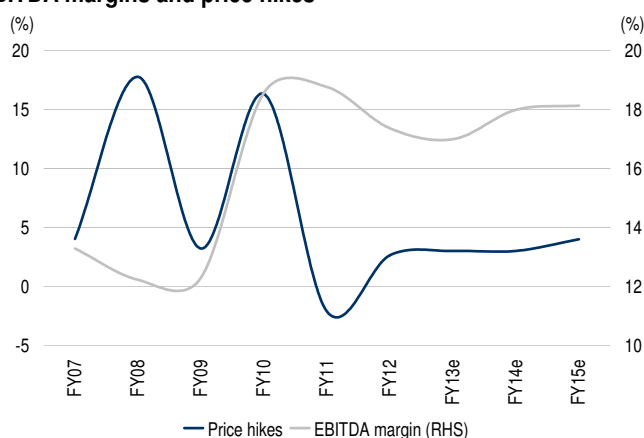
Key highlights

Price hikes in Dec'12 and Jan'13 to drive margins up

After 18 months the company had hiked prices. Despite the increase in costs, in order to maintain healthy volume growth it had not hiked prices. It has now hiked prices of Lovable by 6% (in Dec'12) and those of Daisy Dee by 7% (in Jan'13). The company expects no major change in cotton prices, the major raw material. Also, having completed its national launch of Daisy Dee, it does not see any sharp increase in ad-spend in FY14.

We expect that the price hikes and stable raw material prices would help expand margins. The EBITDA margin has come down from 18.8% in FY11 to 16.6% in 9MFY13. By FY15, we expect the company will be able to raise it back to 18%.

Fig 7 – EBITDA margins and price hikes



Source: Company, Anand Rathi Research

Removal of excise duty to increase net realizations

The Union Budget 2013-14 proposed the removal of excise duty on readymade garments. Earlier, readymade-garment manufacturers were required to pay 12% excise duty on the MRP, with abatement of 70%, and were permitted to utilise cenvat credit. We believe the effective excise duty was ~2.5-3%. On the removal of the excise duty, net realizations would go up without the need to resort to price hikes.

Fig 8 – Calculation of excise duty reduction

Particulars	Amt (₹)
Assumed MRP (₹)	100.0
Less: Distributor margin	10.0
Less: Retailer margin	30.0
Net Selling price (a)	60.0
Assumed MRP (₹)	100.0
Abatement @ 70%	70.0
Assumed cost	30.0
Excise @ 12%	3.6
Less: Assumed Cenvat	1.6
Net Saving from excise (b)	2.0
Increase in realization (%) (b/a)	3.3

Source: Company

Expansion of distribution network on track

Earlier, the company directly marketed its Lovable range to retailers; Daisy Dee was a South India brand. In FY11 Lovable and Daisy Dee were sold through respectively 1,800 and 7,000 retail outlets. However, the company has now established a strong network of 52 distributors for the Lovable brand. This is available at 3,500 retail outlets. Daisy Dee has 120 distributors and now is an all-India brand, sold through 10,000 retail outlets.

The company believes vast potential exists to expand the reach of both its brands within the next 2-3 years.

Fig 9 – Expansion of distribution network

No of outlets	FY11		FY13	
	Lovable	Daisy Dee	Lovable	Daisy Dee
Distributors	-	80	52	120
Retail points	1,800	7,000	3,500	10,000

Source: Company

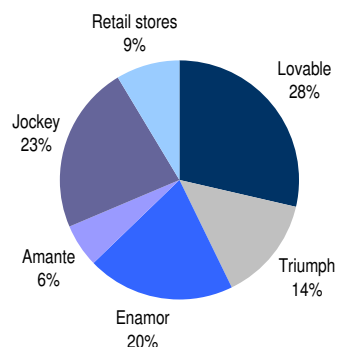
Entry in new segments

The company is planning to enter new segments. It has launched home wear and plans to enter sportswear (track pants). These segments are growing at over 40%, though on smaller bases. It has also launched Lovable Brassieres at prices between ₹250 and ₹350 to widen its distribution reach.

No major increase in competitive pressures

The company has not yet seen any significant increase in competitive pressure. Players such as Marks & Spencer are focussing only on metros. Those brands focused on a retail strategy such as Enamor and La Senza are still in investment mode. Others such as Triumph have a smaller scale than Lovable. Hanes and Fruit of the Loom have not yet introduced brassieres in India. This allows Lovable to maintain a market share of ~28% in the premium lingerie (MRP >₹350) market.

Fig 10 – Market shares in premium lingerie segment



Source: Company

Change in Estimates and Valuation

Change in estimates

Due to delayed price hikes, aggressive spending on the national rollout of Daisy Dee and higher income taxes, we lower FY13 PAT estimates 3.7%. With the expected fall in interest rates and investment yields, we reduce FY14 earnings estimates 2.5%.

Fig 11 – Change in estimates

₹m	FY13e			FY14e		
	Old	Revised	Change (%)	Old	Revised	Change (%)
Revenues	1,712	1,712	(0.0)	2,205	2,204	(0.0)
PAT	265	255	(3.7)	314	306	(2.5)

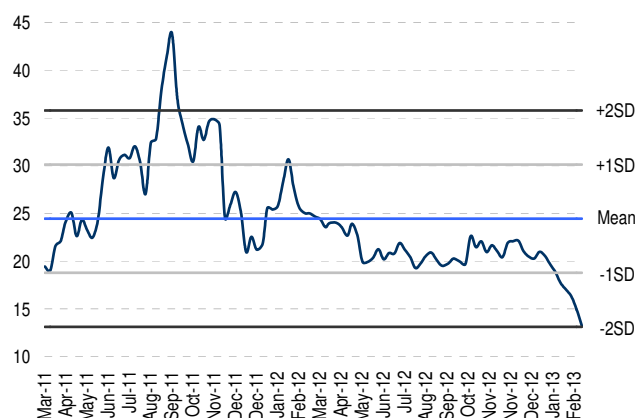
Source: Anand Rathi Research

Valuation

We retain our Buy rating on Lovable and value it at ₹366 (earlier ₹490). Our price is based on a target PE of 20x FY14e earnings. Since listing, the stock has traded at an average PE of 24x. At present, it trades at close to the mean PE minus 2 standard deviations.

The increase in the EBITDA margin is expected to lead to a 19% earnings CAGR over FY13-15. We also expect better return ratios and, hence, valuation ratios to expand after the 35% correction in the past three months.

Fig 12 – Mean PE and Standard deviations



Source: Company

Fig 13 – Relative Valuation

Company	Price (₹)	M.Cap (\$m)	RoE (%)	RoCE (%)	CAGR FY13-15e (%)	EPS CAGR (%)	PE FY14e
			FY14e	FY14e	Revenues	PAT	
Lovable	253	78	16	18	27	19	14
Page Inds	3,385	693	61	47	24	27	26

Source: Company, Anand Rathi Research

Key risks

- Higher raw material prices
- Increase in competitive pressure
- Delay in expansion of distribution network.

Financials

Fig 14 – Income statement (₹m)

Year-end: March	FY11	FY12	FY13e	FY14e	FY15e
Gross Sales	1,040	1,410	1,815	2,206	2,776
Less: Excise Duty	-	80	102	-	-
Less: Sales Tax	0	1	1	1	1
Net Sales	1,040	1,329	1,712	2,205	2,775
Growth (%)	19.6	27.8	28.8	28.8	25.8
Expenditure					
Cost of Goods Sold	459	536	692	879	1,110
Staff Cost	116	155	199	257	323
Other Manufacturing exps	33	80	103	132	166
Admin expenses	33	28	38	44	55
Selling & Distri exps	203	300	389	496	616
EBITDA	195	231	291	397	503
EBITDA Margin (%)	18.8	17.4	17.0	18.0	18.1
EBITDA Growth (%)	43.9	53.7	17.8	20.0	18.0
Depreciation	14	15	27	43	60
EBIT	181	216	264	354	443
Interest Expense	5	6	5	5	5
Other Income	9	67	85	82	78
Profit Before Tax	185	277	345	431	516
Income Taxes	44	61	90	125	155
Income Tax rate (%)	23.9	21.9	26.0	29.0	30.0
Profit After Tax	141	217	255	306	361
Share of Profit From Associates	-	-	-	-	-
Prof. Dividends/Minority Interest	-	-	-	-	-
Profit Before X/O	141	217	255	306	361
PAT Margin (%)	13.5	16.3	14.9	13.9	13.0
PAT Growth (%)	43.9	53.7	17.8	20.0	18.0
Extraordinary Items	-	-	-	-	-
Profit for Shareholders	141	217	255	306	361
Number of shares (m)					
	17	17	17	17	17
Earnings Per Share Bef X/O (₹)	8.4	12.9	15.2	18.3	21.6
Earnings Per Share Aft X/O (₹)	8.4	12.9	15.2	18.3	21.6

Source: Company, Anand Rathi Research

Fig 15 – Balance sheet (₹m)

Year-end: March	FY11	FY12	FY13e	FY14e	FY15e
Sources of Funds					
Share Capital	168	168	168	168	168
Reserves and Surplus	1,244	1,422	1,638	1,900	2,202
Deferred Tax Liability/Misc. Exps	9	10	10	10	10
Net Worth	1,422	1,600	1,816	2,078	2,381
Net Worth Net of Rev. Reserve	1,422	1,600	1,816	2,078	2,381
Prof. Capital/Minority Interest	-	-	-	-	-
Secured Loans	-	34	34	34	34
Unsecured Loans	-	11	11	11	11
Total Loans	-	45	45	45	45
Total	1,422	1,646	1,862	2,124	2,426
Application of Funds					
Fixed Assets					
Gross Block	191	310	573	848	1,148
Less: Depreciation	61	76	102	145	205
Net Block	129	234	471	703	943
Capital WIP	-	38	-	-	-
Gross Block-Brand value	191	310	573	848	1,148
Goodwill	-	-	-	-	-
Liquid Investments	931	961	861	761	711
Other Investments	-	56	56	56	56
Current Assets	510	565	751	956	1,159
Inventories	224	336	428	551	694
Sundry Debtors	106	155	188	243	305
Cash & Bank Balances	143	33	93	120	119
Loans & Advances	37	42	42	42	42
Current Liabilities	148	209	278	353	444
Liabilities	119	156	205	265	333
Provisions	29	54	73	88	111
Net Current Assets	362	356	473	603	715
Total	1,422	1,646	1,862	2,124	2,426

Source: Company, Anand Rathi Research

Fig 16 – Cash flow statement (₹m)

Year-end: March	FY11	FY12	FY13e	FY14e	FY15e
OCF before W/C changes	143	186	282	349	421
W/c Changes	(146)	(132)	(57)	(103)	(114)
OCF After W/C Changes	(3)	53	225	246	307
Cash Flow from Investing	-	-	-	-	-
Capital Expenditure	(15)	(158)	(225)	(275)	(300)
Disposal	0	0	-	-	-
Investments	(911)	(14)	100	100	50
Acquisitions	-	-	-	-	-
Net Cash used in Investing	(926)	(172)	(125)	(175)	(250)
Cash Flow from Financing	-	-	-	-	-
Changes in Share Capital	1,057	-	-	-	-
Changes in Loans	(3)	34	-	-	-
Dividends & Tax thereon	(9)	(29)	(39)	(44)	(59)
Net Cash used in Financing	1,045	5	(39)	(44)	(59)
ExtraOrdinary Items	-	-	-	-	-
Changes in Cash & Equivalents	116	(113)	61	27	(1)
Opening Cash & Equivalents	26	142	33	93	120
Closing Cash & Equivalents	142	29	93	120	119
Free Cash Flow	(18)	(105)	(0)	(29)	7

Source: Company, Anand Rathi Research

Fig 17 – Ratio analysis

Year-end: March	FY11	FY12	FY13e	FY14e	FY15e
Profitability ratios (%)					
EBITDA Margin	18.8	17.4	17.0	18.0	18.1
EBITDA+Other Income Margin	19.7	22.4	22.0	21.7	20.9
EBIT Margin	17.4	16.2	15.4	16.1	16.0
PBT Margin	17.8	20.8	20.1	19.6	18.6
PAT Margin	13.5	16.3	14.9	13.9	13.0
Income Tax Rate	23.9	21.9	26.0	29.0	30.0
Excise Duty Rate	-	6.0	6.0	-	-
RoE	16.8	14.3	14.9	15.7	16.2
RoCE	21.6	14.1	15.1	17.8	19.5
Major Costs as % of Net Sales					
Cost of Goods Sold	44.2	40.3	40.5	39.9	40.0
Staff Cost	11.2	11.7	11.7	11.7	11.7
Other Manufacturing expts	3.2	6.0	6.0	6.0	6.0
Admin expenses	3.1	2.1	2.2	2.0	2.0
Selling & Distri expts	19.6	22.6	22.7	22.5	22.2
Per share data (₹)					
Earnings Per Share	8.4	12.9	15.2	18.3	21.6
Growth (%)	(3.3)	53.7	17.8	20.0	18.0
Book Value per Share	84.9	95.5	108.4	124.1	142.1
Growth (%)	278.3	12.6	13.5	14.4	14.6
Dividend Per Share	1.5	2.0	2.3	3.0	4.0
Growth (%)	125.0	33.3	12.5	33.3	33.3
Sales Per Share	62.1	79.4	102.2	131.6	165.6
Growth (%)	(19.6)	27.8	28.8	28.8	25.8
Other ratios (%)					
Net debt/Equity	(75.5)	(59.3)	(50.1)	(40.2)	(33.0)
FCF/EPS	(12.8)	(48.3)	(0.1)	(9.5)	2.0
OCF/Sales	(0.3)	4.0	13.1	11.2	11.1
Div Payout Ratio	17.8	15.5	14.8	16.4	18.5

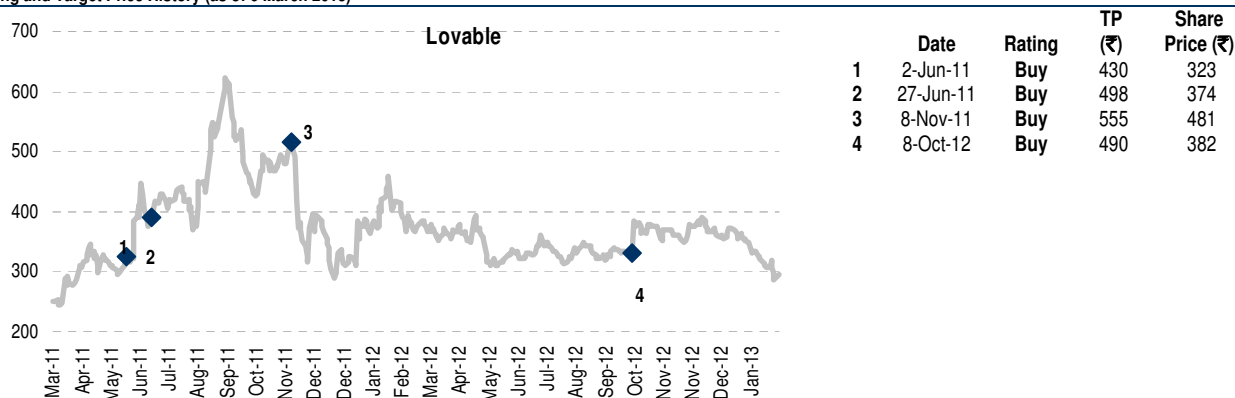
Source: Company, Anand Rathi Research

Appendix

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	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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	Buy	Hold	Sell
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% who are investment banking clients	4%	2%	0%

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