Luggage

Manthan

How will VIP IN turn profitable?

Plagued by intense competition, excessive discounting and inventory write down, VIP IN has been seeding losses since the past two years. Given stiff competition, we believe GM is unlikely to circle back to the 50% mark. Thus, VIP IN's path to profitability revolves around fixing inefficiencies in the cost structure. In today's edition, we analyze the opex bill of VIP IN. We have specifically highlighted cost heads that have witnessed inflation in the past and then shared our view on possibility of mean reversion.

We specifically discuss select cost heads that are either critical in nature or offer scope of improvement.

Professional fee: The professional fee has averaged at 1.8% of sales over the last 3 years (0.5% of sales from FY19 to FY23) as VIP IN hired services of consulting firms (example: BCG Group) to fix supply chain issues. Given inventory optimization exercise is over, and new management has taken over, professional fee expense is set to decline going ahead.

A&P expense: Given stiff competition, A&P spends have averaged at 7.6% of sales in the last 3 years. Amid rising prevalence of D2C brands, we expect competitive environment to remain stiff and hence A&P spends will likely mimic the trend witnessed in last 3 years.

Freight & Octroi: Freight expense has averaged at 9.5% of sales over the last 3 years as volumes have increased. Luggage is a voluminous product and increasing volumes due to discounting is likely to result in higher freight cost. VIP IN has manufacturing units located at Nashik and Bangladesh. Thus, it can cover Western and Eastern belt (not fully optimal though) of India in a cost-effective manner. However, we believe freight cost to Northern and Southern regions could be higher.

Human resource procurement: Human resource procurement cost has averaged at 4.5% of sales over the last 3 years. As growth is driven by volumes, requirement of outsourced labour will continue to remain high leaving limited scope for sharp improvement.

Miscellaneous expense: Over the last 3 years, VIP IN's miscellaneous expense has averaged at 2.4% of sales. VIP IN does not classify the exact nature of these expenses but given change of guard at top-level (due diligence cost) and litigation issue (legal fees) pertaining to Carlton brand, miscellaneous expenses could have been high over the last 3 years. We believe there is a significant scope of reduction in this cost head.

Job work expense: Given growth is volume driven, outsourcing requirement would continue to remain high. Over the last 3 years, job work expense has averaged at 2.0% of sales, and we do not foresee a scope of sharp improvement.

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Exhibit 1: **Breakdown of expenses**

Particulars (INR mn)	FY21	FY22	FY23	FY24	FY25	FY26	Critical cost head?	Is there a scope of reduction?
Consumption of stores and spare parts	23	83	95	110	35	73	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.4%*	*0.6%*	*0.5%*	*0.5%*	*0.2%*	*0.4%*		
Power and fuel	76	143	185	219	185	201	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*1.2%*	*1.1%*	*0.9%*	*1.0%*	*0.8%*	*1.1%*		
Rent	59	32	89	156	202	105	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*1.0%*	*0.2%*	*0.4%*	*0.7%*	*0.9%*	*0.6%*		
Repairs and Maintenance- Buildings	6	2	3	2	13	4	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.1%*	*0.0%*	*0.0%*	*0.0%*	*0.1%*	*0.0%*		
Repairs and Maintenance- P&M	1	2	2	4	3	3	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Repairs and Maintenance- Others	99	113	147	202	230	210	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*1.6%*	*0.9%*	*0.7%*	*0.9%*	*1.1%*	*1.1%*		
Insurance	48	60	83	44	30	32	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.8%*	*0.5%*	*0.4%*	*0.2%*	*0.1%*	*0.2%*		
Rates and taxes	26	19	35	63	23	40	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.4%*	*0.1%*	*0.2%*	*0.3%*	*0.1%*	*0.2%*		
Travelling expense	41	84	188	222	200	199	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.7%*	*0.7%*	*0.9%*	*1.0%*	*0.9%*	*1.1%*		
Director's fee	1	3	3	4	3	5	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Payment to auditors	5	6	8	8	9	9	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.1%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.1%*		
Expenditure towards CSR activities	35	16	9	14	25	12	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.6%*	*0.1%*	*0.0%*	*0.1%*	*0.1%*	*0.1%*		
Professional fee	**48**	**56**	**89**	**380**	**387**	**340**	**No**	**Yes**
As a % of sales	***0.8%***	***0.4%***	***0.4%***	***1.7%***	***1.8%***	***1.8%***		
Communication expense	20	21	30	31	34	34	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.3%*	*0.2%*	*0.1%*	*0.1%*	*0.2%*	*0.2%*		
Advertisement expense	**208**	**355**	**1,125**	**1,848**	**1,383**	**1,531**	**Yes**	**No**
As a % of sales	***3.4%***	***2.8%***	***5.4%***	***8.2%***	***6.3%***	***8.2%***		
Freight and Octroi	**460**	**1,046**	**1,418**	**2,087**	**1,907**	**1,919**	**Yes**	**There is some scope of reduction**
As a % of sales	***7.4%***	***8.1%***	***6.8%***	***9.3%***	***8.8%***	***10.3%***		
Commission on sales	2	2	49	1	(0)	0	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.2%*	*0.0%*	*0.0%*	*0.0%*		

Particulars (INR mn)	FY21	FY22	FY23	FY24	FY25	FY26	Critical cost head?	Is there a scope of reduction?
Bank charges	10	17	29	40	57	37	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.2%*	*0.1%*	*0.1%*	*0.2%*	*0.3%*	*0.2%*		
Human resource procurement	**285**	**421**	**630**	**826**	**984**	**1,006**	**Yes**	**Limited scope of sharp improvement**
As a % of sales	***4.6%***	***3.3%***	***3.0%***	***3.7%***	***4.5%***	***5.4%***		
Allowance for doubtful debt	106	165	230	40	35	108	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*1.7%*	*1.3%*	*1.1%*	*0.2%*	*0.2%*	*0.6%*		
Bad debts	0	0	-	3	3	1	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Provision for doubtful debt	(0)	(0)	-	(3)	(3)	(1)	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Net loss on FX transactions	(2)	25	115	55	123	53	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.2%*	*0.6%*	*0.2%*	*0.6%*	*0.3%*		
Obsolescene of fixed assets	11	-	-	1	0	-	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.2%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Net loss on sale of fixed asset	-	6	4	-	-	-	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Miscellaneous expense	**122**	**179**	**242**	**404**	**512**	**559**	**No**	**Yes**
As a % of sales	***2.0%***	***1.4%***	***1.2%***	***1.8%***	***2.3%***	***3.0%***		
Job work expense	**85**	**234**	**300**	**374**	**422**	**422**	**Yes**	**Limited scope of sharp improvement**
As a % of sales	***1.4%***	***1.8%***	***1.4%***	***1.7%***	***1.9%***	***2.3%***		
Electricity expense	24	24	34	45	62	62	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.4%*	*0.2%*	*0.2%*	*0.2%*	*0.3%*	*0.3%*		
Net loss on fair value changes on investments	1	-	2	-	-	-	No	Limited scope. Even if cost gets optimized a bit, savings could be minimal.
As a % of sales	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Total expenses	**1,801**	**3,114**	**5,141**	**7,180**	**6,862**	**6,963**		
As a % of sales	***29.1%***	***24.1%***	***24.7%***	***32.0%***	***31.5%***	***37.5%***		

Source: Company, PL

In the following table, we have compared some of these critical cost heads of VIP IN and SII IN. We have also included employee cost and rent (depreciation on RoU asset and interest cost on lease liabilities used as proxy) for the purpose of our analysis to get a better idea of the cost structure of both entities.

Exhibit 2: VIP IN versus SII IN - Comparison of Sales, GM and critical cost heads

Particulars (Rs mn)	Company	FY21	FY22	FY23	FY24	FY25	FY26	FY27E	FY28E
Sales	VIP IN	6,186	12,895	20,823	22,450	21,784	18,581	19,615	22,042
	SII IN	3,280	7,057	12,120	15,504	17,716	20,470	23,445	26,801
GM	VIP IN	40.8%	50.0%	51.1%	52.6%	45.6%	36.2%	42.5%	46.0%
	SII IN	41.9%	37.0%	42.5%	47.2%	45.7%	47.1%	46.2%	46.8%
A&P spends	VIP IN	3.4%	2.8%	5.4%	8.2%	6.3%	8.2%	8.0%	7.5%
	SII IN	2.8%	2.6%	3.7%	5.0%	7.4%	7.8%	8.1%	8.2%
Freight & Octroi	VIP IN	7.4%	8.1%	6.8%	9.3%	8.8%	10.3%	9.5%	8.0%
	SII IN	7.5%	6.1%	5.7%	6.7%	7.3%	7.4%	6.7%	6.5%
Human resource procurement	VIP IN	4.6%	3.3%	3.0%	3.7%	4.5%	5.4%	Explicit forecast not in place	
	SII IN	4.8%	4.1%	4.5%	5.6%	5.6%	5.7%	Explicit forecast not in place	
Job work expense	VIP IN	1.4%	1.8%	1.4%	1.7%	1.9%	2.3%	Explicit forecast not in place	
	SII IN	1.3%	1.7%	1.1%	1.7%	1.7%	2.0%	Explicit forecast not in place	
Employee cost	VIP IN	22.2%	14.6%	11.3%	12.0%	10.3%	11.7%	11.7%	11.3%
	SII IN	18.3%	9.6%	7.1%	6.3%	6.7%	7.0%	6.7%	6.2%
Depreciation on RoU assets (proxy for rent)	VIP IN	8.4%	3.6%	2.3%	2.8%	3.4%	4.3%	4.3%	4.1%
	SII IN	3.2%	1.7%	1.7%	2.1%	1.9%	1.6%	1.5%	1.4%
Interest expense on lease liability (proxy for rent)	VIP IN	2.6%	1.2%	0.7%	1.0%	1.2%	1.5%	1.4%	1.3%
	SII IN	0.8%	0.4%	0.3%	0.5%	0.4%	0.4%	0.4%	0.4%

Source: Company, PL

As can be seen, VIP IN's GM profile has deteriorated over the years due to stiff competition and discounting. However, A&P expenses of both companies have increased in response to stiff competition. SII IN's freight cost is lower than VIP IN as it has plants in Halol (Western belt) and Jaipur (Northern belt). Further, SII IN's employee cost structure is lean and even the rental expense is considerably lower than VIP IN.

What is the path to profitability for VIP IN?

While there will be a reduction in professional fee and miscellaneous expense going ahead, VIP IN will either have to improve GM profile or find ways to re-align the cost structure to drive profitability. Given intense competition, reducing A&P spends (discretionary cost and can be easily reduced) or improving the GM profile by taking a price hike appears challenging. Further, while there is a stark variation in employee cost between VIP IN and SII IN, the employee cost of VIP IN had declined 16.5% YoY to INR2,253mn in FY25 (retrenchment in Bangladesh) and 3.2% YoY to INR2,180mn in FY26. Thus, further cost re-alignment from current level looks difficult. Nonetheless, on the opex front, realignment possibility exists in rent and freight (to a certain extent). On the other hand, if VIP IN is able to increase the share of captive manufacturing, then GM profile can improve materially. We expect VIP IN to report sales CAGR of 9% over the next 2 years with GM of 42.5%/46.0% and adjusted loss of INR1,871mn/INR69mn in FY27E/FY28E respectively. We have a SELL on the stock with a TP of INR246 (EV multiple of 1.75x on FY28E sales).

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (INR)	Share Price (INR)
1	Apeejay Surrendra Park Hotels	Buy	156	116
2	Chalet Hotels	BUY	991	805
3	Delhivery	HOLD	503	473
4	DOMS Industries	Buy	2703	2253
5	Flair Writing Industries	BUY	409	248
6	Imagicaaworld Entertainment	BUY	62	47
7	Indian Railway Catering and Tourism Corporation	BUY	706	507
8	InterGlobe Aviation	Hold	4520	5024
9	Lemon Tree Hotels	BUY	143	108
10	Mahindra Logistics	Buy	507	391
11	Nazara Technologies	BUY	378	353
12	PVR Inox	BUY	1307	1064
13	Safari Industries (India)	Buy	1953	1505
14	Samhi Hotels	BUY	201	174
15	TCI Express	HOLD	576	580
16	V.I.P. Industries	SELL	246	308
17	Zee Entertainment Enterprises	BUY	116	94

PL's Recommendation Nomenclature (Absolute Performance)

BUY	:	> 15%
Accumulate	:	5% to 15%
Hold	:	+5% to -5%
Reduce	:	-5% to -15%
Sell	:	< -15%
Not Rated (NR)	:	No specific call on the stock
Under Review (UR)	:	Rating likely to change shortly

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