21 AUG 2014 Company Report

BUY

Target Price: Rs 1,140

CMP	: Rs 850
Potential Upside	: 34%
Relative to Sector	: Outperformer

MARKET DATA

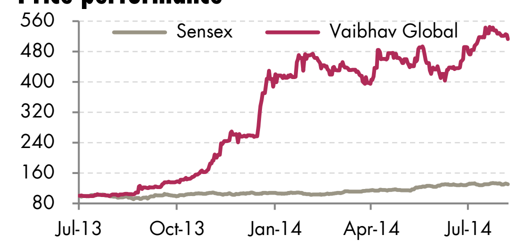
No. of Shares	: 32 mn
Market Cap	: Rs 27 bn
Free Float	: 21%
Avg. daily vol (6mth)	: 36,077 shares
52-w High / Low	: Rs 910 / Rs 169
Bloomberg	: VGM IB Equity
Promoter holding	: 67%
FII / DII	: 16% /0%

Vaibhav Global

RETAIL

Catch it young!

Price performance



Key drivers

	FY14	FY15E	FY16E
TV volume (% YoY)	23%	15%	20%
Web volume (% YoY)	74%	35%	45%
Consol rev (% YoY)	31%	18%	23%
EBITDA margin (%)	11%	10%	11%

Company financials (Consolidated)

Y/E Mar	Sales (Rs mn)	EBITDA (Rs mn)	Adj PAT (Rs mn)	EPS (Rs.)	Chg YOY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/E (x)	Net D/E (x)
FY13	8,929	639	781	24	(2)	35	37	20	44.5	0.5
FY14	12,983	1,422	1,525	47	95	18	78	47	19.5	0.1
FY15E	15,192	1,531	1,090	34	(29)	25	37	41	17.7	(0.1)
FY16E	18,210	2,017	1,377	42	25	20	32	41	13.0	(0.3)

Source: Company, Axis Capital; Note: FY14 had forex gain of Rs 198 mn, excluding which PAT would have been Rs 1,328 mn

Nivedan Reddy VP - Telecom
nivedan.reddy@axiscap.in 91 22 4325 1128

Contents

The potential of Vaibhav Global (VGL) – a TV shopping and e-commerce retailer of fashion jewelry in the US and UK – lies in simple business economics…profitability led by significant volume ramp up and operating leverage

- **Customer base can ramp up ~10x**: A combination of product development competency (VGL has 65,000 SKUs of fashion jewelry and creates 100 new SKUs every day) and attractive price point (~USD 20, making it non-discretionary purchase) are necessary and sufficient conditions for significant ramp up in customer base
  - **Icing on the cake – no significant competition** who are primarily focused on deep discount fashion jewelry
- **Significant operating leverage as 35% of cost is fixed:** Increasing penetration will trigger operating leverage (expect an average improvement of 100 bps/ year from FY15 onwards)

Vision 2020: We estimate VGL to post **20%/ 30% revenue/ PAT CAGR with sustainable RoE of ~30%**. Initiate coverage with **BUY** and **TP of Rs 1,140** (27x FY16E EPS of Rs 42); implies 34% upside from CMP of Rs 850

Volume drivers: VGL operates in the ~USD 20 bn US & UK fashion jewelry and accessories market and has just 1% market share currently. We expect significant increase in penetration given:

- **A combination of impulse and non-discretionary purchases create the volume push:** 250 employees across geographies monitor fashion trends and contribute to VGL's product development. New products (aligned to global demand patterns) at attractive price points make VGL's fashion jewelry a 'value for money' proposition which generates impulse and repeat buying
- **Competition insignificant, unlikely to emerge strong:** VGL's niche is in retailing fashion jewelry products at low price points, a segment not targeted by other well-established international TV shopping players such as QVC and HSN (who sell only branded fine jewelry at average price points of USD 100+). Also, VGL's extensive experience in jewelry manufacturing (Jaipur, India) and sourcing (from micro markets in China, Thailand and Indonesia) enables it to sell quality products at low price points – a key advantage which is tough to be replicated. Hence, we believe it will be difficult for a challenger to beat VGL in its own game

Note: Vaibhav Global restructured its business in 2009 through Corporate Debt Restructuring (CDR) cell. It has since gained significant business traction and came out of CDR in 2013 by paying full recompense (no financial loss to banks). Refer page 39-42 for history

…Investment summary

- **Profitability to soar with volume ramp up**
  - VGL generates 87% revenue from B2C segment (70% through TV shopping and 17% through internet), the primary growth driver which is expected to witness 20%+ revenue CAGR over the long run. Growth in B2B segment (wholesale distribution to various retail chains in US and UK, contributes 13% of revenue currently) will be relatively muted
  - **Significant operating leverage as 35% of costs are fixed:** Cost of TV carriage and web marketing (17% of revenue currently) is fixed and is the main source of operating leverage. Employee cost (17% of revenue currently) and SG&A (16% of revenue currently) will peak out in next 2-3 years (investment phase of VGL) and will then contribute to operating leverage
  - **Tax incidence to impact PAT in short term:** VGL will start to pay taxes in US & India subsidiaries from FY15 as the benefit from carried forward losses have almost been exhausted in FY14. VGL's tax incidence (25%/ 28% tax in FY15/16 vs. almost nil in FY14) will lead to adjusted PAT being flat over FY14-16
  - **Over the long run,** strong volume growth coupled with stable price point should lead to 20% revenue CAGR, which will translate to a much higher 30% PAT CAGR. Expect RoE to sustain at 30%

- **Initiate coverage with BUY and TP of Rs 1,140 (27x FY16E EPS of Rs 42)**
  - We base our target multiple at 10% discount to VGL's long term earnings CAGR (~30%). We also derive comfort from high return ratios (RoE/ RoCE expected to sustain at 30%/ 40% respectively)

- **Additional upsides if VGL can accelerate customer engagement**
  - Higher than expected growth in active customers → long term revenue CAGR can better our base case of 20%
  - Launch of mobile apps across platforms → higher volumes as 15-35 age group can be better targeted
  - Increasing catalogue sales on e-commerce platform → higher average realization and better margin (visible in Q1FY15)
  - Start of dividend payout → Likely in FY15, will improve return ratios

- **Key risks:** a) Products fail to attract customers and volume growth slows down; b) INR appreciation and/or higher raw material (gemstone) prices will dent margin

Multiple growth drivers set to play out

- **Huge opportunity canvas as most growth drivers still at nascent stage**
  - We believe VGL has multiple growth drivers and most of them are at a nascent stage, given its **relatively recent entry into TV shopping industry**. VGL has 7 years history in this segment vs.30+ years for well-established players (QVC, HSN)
  - **Market share gain on the cards:** VGL operates in the ~USD 20 bn US & UK fashion jewelry and accessories market and has just 1% market share currently. As the below mentioned drivers play out, we believe VGL's market share gains in fashion jewelry segment will be meaningful, given
    - Niche focus on fashion jewelry and expertise across the value chain, and
    - No significant organized competitor focused on this space

# Driver 1 – Household reach *(Number of households reached as % of total households)*	♦ VGL's reach in the US & UK (total 140 mn households) is 67% vs. 80%+ for peers (90% for QVC, the largest TV shopping network). We expect VGL's penetration to reach 90%+ over the next 5 years, which increases addressable market by ~35%
# Driver 2 – Active customer base *(Number of households shopping at least once a year)*	♦ VGL's active customer base stands at ~394K (just 0.4% of households reached) vs. 4.0%/ 3.2% for QVC/ HSN. VGL's customer base has been posting 30% CAGR over the last 4 years ♦ Assuming active customer penetration reaches even 2% over the next 5 years, this can potentially result in USD 1 bn revenue for VGL by FY19 (5x the current revenue of USD 215 mn)
# Driver 3 – Repeat purchase *(Frequency of purchase by an active customer)*	♦ This is a function of increasing customer retention rate (thus driving higher customer lifetime value). Retention rates for VGL have been trending higher and stood at 48% at the end of FY14

- As these drivers play out, we believe **Gross Revenue Per Minute (GRPM) will witness a solid ramp up**. <u>Akin to the key metric of "revenue per sq ft" in the retail industry, the focus of TV shopping industry is on generating higher GRPM</u>

GRPM ramp up will drive operating leverage, resulting in strong earnings momentum (~30% CAGR) over the long run

Significant potential for GRPM to ramp up

VGL's GRPM is 1/20th that of peers, due to low penetration currently

VGL's focus remains on these key drivers, enabling it to bridge the GRPM differential with peers

VGL intends to keep the ticket size low, in line with its focus on deep discount fashion jewelry

GRPM (Gross revenue per minute) = **Penetration** × **Purchase velocity** (Repeat purchase) × **Ticket size**

GRPM — VGL: USD 400 | Peers: USD 7,800

Penetration = **Household penetration** (Households reached as % of total households) × **Customer penetration** (Households shopping from VGL as % of households reached)

- Household penetration — VGL: 67% | Peers: 87%
- Customer penetration — VGL: 0.4% | Peers: 3.6%

Purchase velocity → **Number of products purchased by a customer in a year** — Function of stickiness (Customer retention & customer lifetime)

- VGL: 24x | Peers: 20x

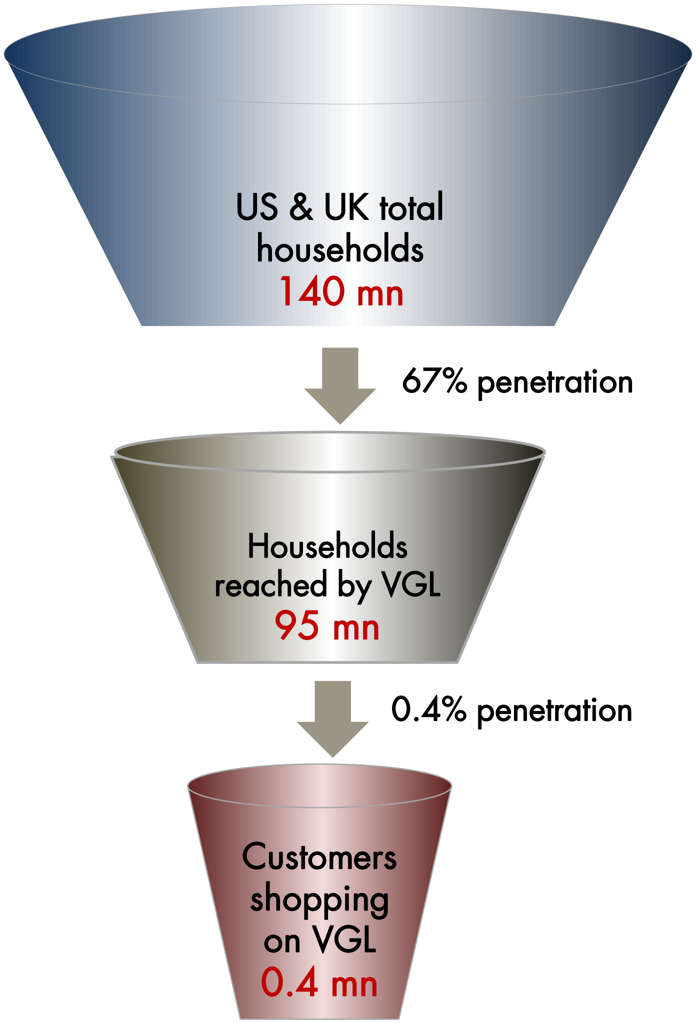
Sensitivity analysis on Target Price

- Assuming the above mentioned GRPM is achieved in 2020 from USD 400 in FY14, we calculate the current TP based on the following assumptions
- Target multiple at 20x FY20E EPS (due to matured business) vs. current target multiple of 27x FY16 EPS
- Target price discounted back to Mar'15 at 12% cost of equity

TP (Rs/sh)		GRPM in 2020 (USD)				
		1,000	1,250	1,500	1,750	2,000
FY14-20 rev CAGR		16%	20%	24%	27%	30%
2020 Net Profit margin	8%	845	1,056	1,267	1,478	1,689
	10%	1,056	1,320	1,584	1,848	2,111
	12%	1,267	1,584	1,900	2,217	2,534
	14%	1,478	1,848	2,217	2,587	2,956
	16%	1,689	2,111	2,534	2,956	3,378

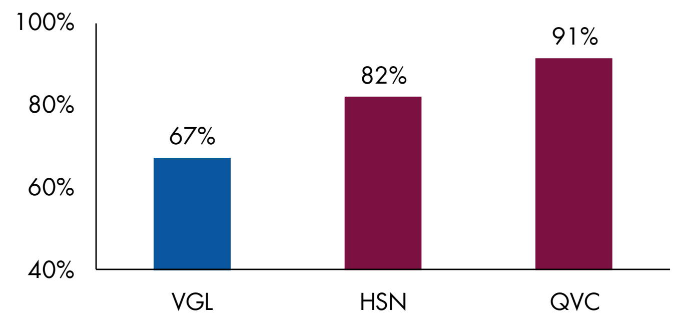
Note: Metrics for Vaibhav Global include both US & UK (as separate geographic metrics are unavailable) while that for Peers (QVC, HSN) includes metrics only for US geography. At the macro level, we believe the metrics are comparable

Penetration at nascent stage



Source: Company, Axis Capital

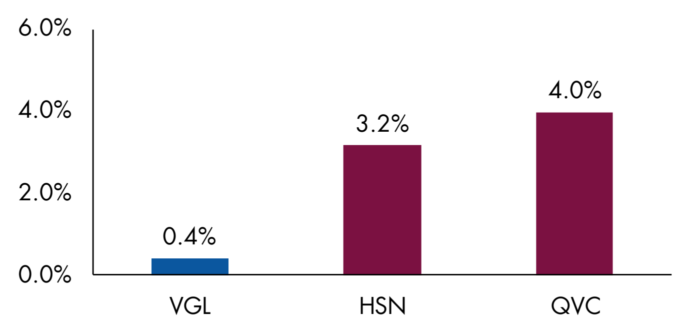
VGL's household reach is the lowest…



Source: Companies

We believe VGL will plug the gap and reach 90%+ penetration in the next 4-5 years by increasing channel reach through affiliate agreements (implies 35% increase in addressable market)

…and customer penetration is nascent



Source: Companies

Key drivers for ramp-up in customer penetration

1. VGL's thrust on deep value proposition and fast fashion (products mapped to global trends) is key to new customer acquisition
2. Launch of lifestyle products and mobile apps will attract younger audience
3. Increasing retention rate of existing customers led by superior products, value for money proposition, and customer service
4. Increasing household reach (likely over next 5 years)

Peer comparison

Comparison of VGL across metrics with peers in the US & UK

	Units	VGL (US & UK)	QVC Global	HSN US	ShopHQ US
Financials					
Revenue	(USD bn)	0.2	8.6	2.3	0.6
Gross profit margin	(%)	61%	37%	35%	36%
Employee + SG&A	(% of revenue)	50%	16%	24%	33%
EBITDA margin	(%)	11%	21%	11%	3%
Operating metrics					
Households reached	(mn)	95	195	96	87
Revenue per household	(USD)	2.3	44.0	24.0	7.0
Units shipped	(mn)	9	169	47	9
Average price point	(USD)	23	51	58	81
Internet/ Mobile Sales	(%)	17%	37%	37%	46%
FY16 Valuation					
P/E	(x)	20	20	15	14
EV/Sales	(x)	1.5	2.2	0.8	0.3
RoE	(%)	32%	10%	30%	20%
FY15-17 EPS CAGR	(%)	28%	21%	12%	NA

Revenue per household is a derived metric, depending on the extent of household penetration and customer penetration. As these two inch up, expect VGL's revenue/ household gap with other players to be bridged

VGL's 61% gross margin is highest in the industry, led by vertical integration (no other competitor has own manufacturing) and selling own brands

Employee, TV carriage and SG&A together comprise 50% of VGL's revenue, the highest among peers. Over time, this will come down as carriage costs (17% of revenue, fixed in nature) will get apportioned over a larger base, thus driving operating leverage

Low price point is a distinct competitive advantage for VGL, as its target segment will be differentiated from peers. We believe it will be relatively difficult for other players to replicate VGL's low cost "deep-value" proposition without manufacturing capabilities & supply chain expertise in micro markets

Source: Company, Axis Capital

Low competitive intensity due to niche focus

- **VGL's niche focus on fashion jewelry lends higher revenue visibility** as there is hardly any overlap with product segments of key competitors – QVC, HSN and ShopHQ (their product mix is highly diversified). *Refer page 36*
- Outlined below are the key differentiators of VGL

	Vaibhav Global	Competitors (QVC, HSN, ShopHQ)
Product mix	Mainstay is jewelry (90% of revenue)	Diverse product profile (jewelry is only 10-12% of revenue)
Ticket size	Focus is on retailing **'fashion jewelry'** (hardly any gold products) at low price points (average price of USD 20)	Retailing branded **'precious jewelry'** (average price likely USD 100+)
Target demographic	Age group 35-65; potential to attract relatively younger users after mobile investments are complete	Age group 35-65; new customers are relatively younger, as these networks already invested in multiple channels including mobile platforms
Internet (e-commerce)	17% of revenue	35-45% of revenue
Return rates	♦ VGL does not accept returns in the US for products with ticket size of < USD 200 ♦ As per management, return rate in US are low at ~5%, while that in UK is ~25%	**20% on average** This will be higher if only jewelry segment is considered
Brands & sourcing	♦ **In-house brands**. VGL does not intend to sell third party brands – this will help it to maintain 60% gross margin ♦ Sourcing is an equal mix from its manufacturing unit in Jaipur and from micro markets of China, Thailand and Bali	**Third party brands** and in a few cases proprietary products

This differentiates the target customer segment of VGL to that serviced by competitors. VGL's target segment includes most households as the products serve "impulse purchase" category, **which is non-discretionary in nature due to low ticket size**

QVC and HSN retail branded jewelry with ticket size of USD 100+, largely catering to discretionary demand (thus targets households with above-average financial means)

USD 5-7 mn investment in technology platform underway to upgrade its website to become mobile ready (implementing Hybris platform from SAP). This will give a fillip to growth of e-commerce vertical

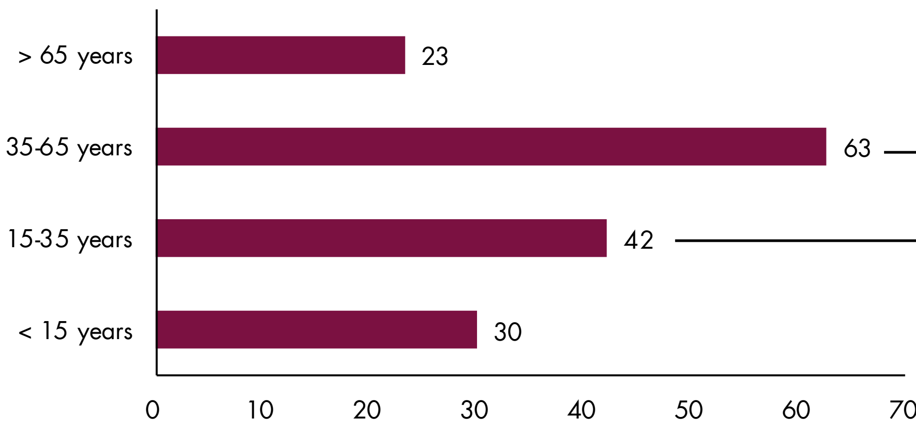
Low return rates help VGL manage its opex pyramid efficiently

Source: Axis Capital

Scalable business with high revenue visibility

- **Customer profile ensures sticky revenue:** TV shopping in developed markets has highly engaged and loyal customer base. Key attributes of the customer profile which enable TV shopping networks to realize consistently growing customer base and higher repeat purchase are:
  - **The typical TV shopping customer is aged** 35-65 years in the developed markets, and the gender mix is highly skewed towards the fairer sex
  - **Customer loyalty** builds from the highly engaging TV shopping experience, that use **"story telling"** as the **key sales pitch**. Over time, this results in higher customer loyalty, which in turn increases retention rate and repeat purchase. Note, an average viewer watches a show 6-7 times before starting to buy a product
  - **Interconnected platforms serving new age groups:** While TV is the major revenue driver, most networks have also invested heavily in their own e-commerce sites, which supplement TV sales. The same content/ products aired on TV are also made available through e-commerce platforms, as relatively young users shop online

US: Female population distribution by age group



Source: US Census Bureau

This user group comprises significant portion of TV shopping network's customer base. Empirical evidence has shown that this group's shopping preferences (including TV shopping) have remained largely consistent over time

TV shopping networks are also significantly investing in e-commerce websites/ mobile apps which can effectively tap into this age group. In VGL's context, its focus on fresh fashion (rolls out ~100 new SKUs everyday) and low price points may be well received through this medium. Note, VGL's technology rejig (implementation of SAP platform) will have been completed by September 2014

Business model high on operating leverage

	Cost as % of revenue	Nature of cost	Comments
TV carriage + Web marketing cost	17%	Fixed	This is the key source of operating leverage for VGL. Increase in per household revenue and increasing share of web revenue will drive operating leverage
Employee expenses	16%	Partially fixed	VGL is in expansion mode and we estimate employee expenses as % of revenue to remain flattish in the short run, however, this will transform to a source of operating leverage over the long run
SG&A	17%	Partially fixed	VGL can eliminate some discretionary spends here, but not a material source of operating leverage
Mfg expenses	6%	Variable	Generally tracking revenue, hence not a source of operating leverage. Only higher realizations and lower discounts (e.g. higher catalogue sales in internet platform) will drive operating leverage – however we do not build for this as VGL is focused on deep value fashion jewelry which does not allow elbowroom to increase prices
Cost of goods sold	33%		

Expect consistent improvement in EBITDA margin going forward

Source: Axis Capital

High operating leverage, FCF generation, return ratios

Operating leverage	♦ 35% of VGL's costs are fixed. The immediate source of operating leverage is fixed carriage cost i.e. increasing household and customer penetration will drive higher revenue per household while carriage cost per household is fixed ♦ While employee count may rise in the short term, it will be a source of operating leverage in the medium to long run
Low capex	♦ Expect Capex/ Sales to be <2% going forward ♦ Incremental capex required only for technology (Hybris platform from SAP being implemented) and maintenance
Low working capital	♦ Expect net working capital at ~10% of sales going forward ♦ Note, receivables are negligible as B2B has become insignificant (just 13% of revenue) and B2C (87% of revenue) has negative working capital as ALL purchases are through credit cards
High FCF	♦ Due to low capital intensity of business, we expect VGL to generate significant FCF going forward ♦ FCF conversion (FCF/ post tax-EBITDA) will be ~70% going forward
High return ratios	♦ Due to higher asset turns (rising GRPM) and operating leverage, we expect steady state RoE/ RoCE of 30%/ 40% ♦ RoE upside from likely start of dividend payout from FY15

Initiate coverage with TP of Rs 1,140 (33% upside from CMP)

- **We expect volume-led 20% revenue and EBITDA CAGR over FY14-16; PAT to be impacted by tax incidence**
  - Revenue growth will majorly be led by 25% CAGR in volume growth, offset by 2% CAGR decline in pricing and 3% appreciation in INR (assumed in FY16)
  - EBITDA CAGR of 20% over FY14-16 will be in line with revenue CAGR due to
    - Continuing investments in employees and SG&A as VGL continues to invest in ramping up operations in US/ UK. This will offset benefit of operating leverage from fixed carriage costs
    - No benefit of INR depreciation going forward (which partly helped drive operating leverage earlier)
  - PAT to likely remain flattish over FY14-16 due to tax incidence
    - VGL will start to pay taxes in US & India subsidiaries from FY15 as the benefit from carry forward losses have almost been exhausted in FY14. We expect VGL to pay 25%/ 28% tax in FY15/16 respectively (2% in FY14)
    - Apart from tax incidence, flattish EBITDA margin over FY14-16 (due to investment in opex – mainly S&M spends) also contributes to PAT being muted

- **Despite short term impact, expect healthy long term revenue/ PAT CAGR of 20%/ 30% respectively**
  - We believe post the investment phase of FY14-16 (especially in HR and SG&A), there will be a steady uptick in EBITDA margin (average 100 bps/year from FY15), as operating leverage will play out
  - Expect earnings CAGR in the long run at ~30%, driven by operating leverage
  - Steady state RoE/ RoCE will stablilize at 30%/ 40% respectively, in our view

- **Initiate coverage with TP of Rs 1,140** (27x FY16E earnings) **and BUY rating** (34% upside from CMP of Rs 850)
  - <u>We base our target multiple at 10% discount to long term earnings CAGR of VGL (approx. 30% CAGR)</u>
  - We also take comfort from high return ratios. Even as RoE/ RoCE get impacted by cash accumulation on books (due to high FCF), core RoIC will be 45%+ for VGL going forward

Business model

Revenue model...

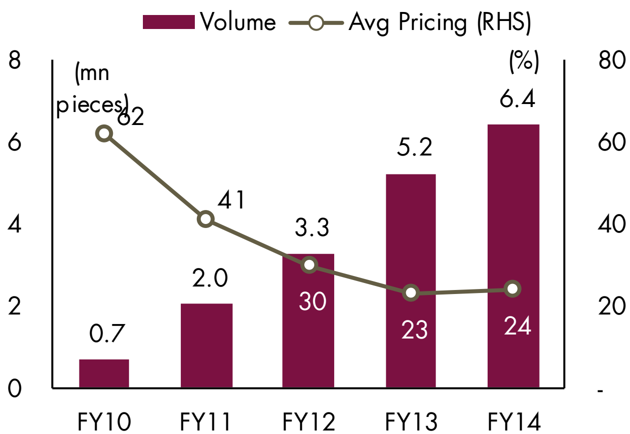
Revenue model

B2C
(87% of revenue)

- **24*7 TV shopping**
  (70% of revenue)
  Live shows on all major cable, satellite and DTH platforms
- **Internet sales**
  (17% of revenue)
  Catalogue sales, rising auction and Live TV streaming on Web

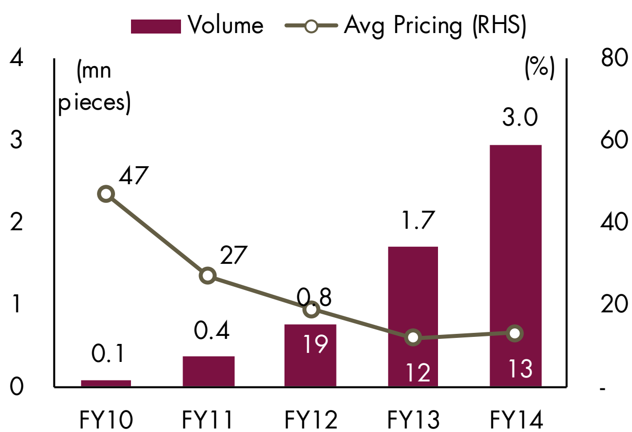
B2B
(13% of revenue)
B2B sale comprises wholesale distribution to various retail chains in the US and UK as well as sale of rough stones to various parties

TV channel: Volume and pricing trends



Source: Company

Internet channel: Volume and pricing trends

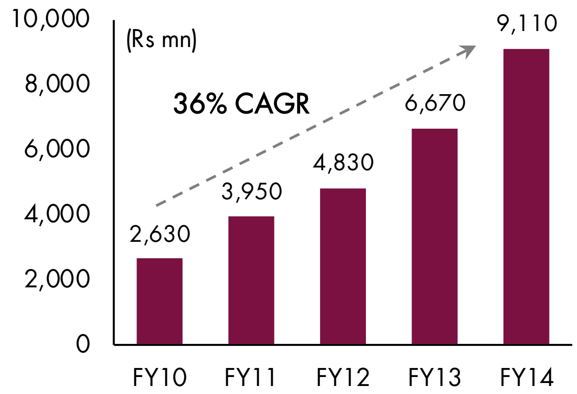


Source: Company

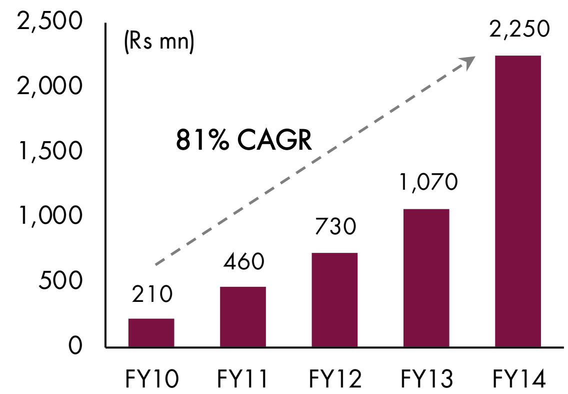
- Post the recession (FY08-09), VGL changed its business model to B2C retail through digital commerce (TV/ e-commerce platforms)
- With its focus on discount segment, the average selling prices through both TV/ e-commerce are ~1/3rd the prices 5 years back. However, volumes have increased ~10x in the same period

...Revenue model

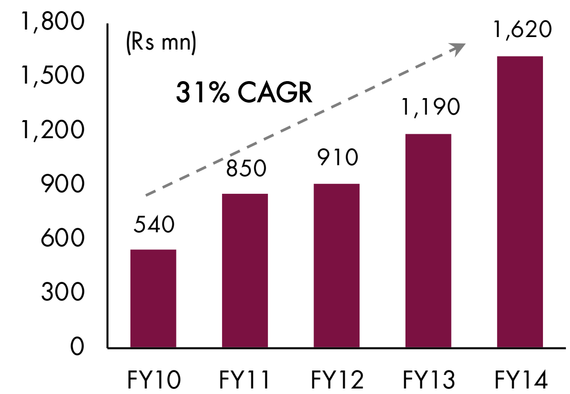
TV shopping revenue



Internet revenue

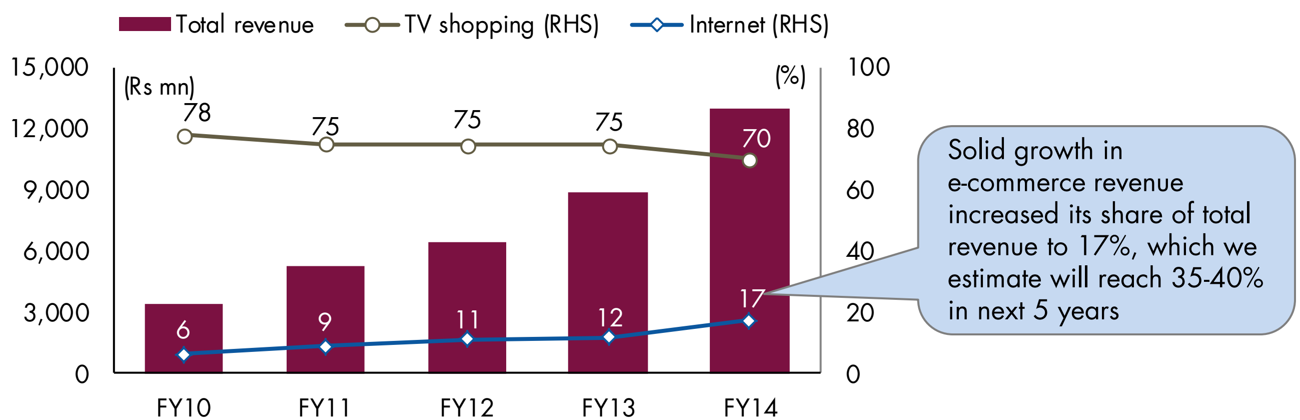


B2B revenue



Source: Company

Consolidated revenue: Internet remains the fastest growing segment, now comprises ~1/6th of revenue



Internet channel must be viewed as complementary to TV channel. Products which remain unsold on TV get listed on internet channel and are often sold at discount, this mitigates inventory risk for VGL. Further, internet channel needs no marketing cost (as majority are TV shopping customers)

Source: Company

Extensive product range

Fine & Fashion Jewelry

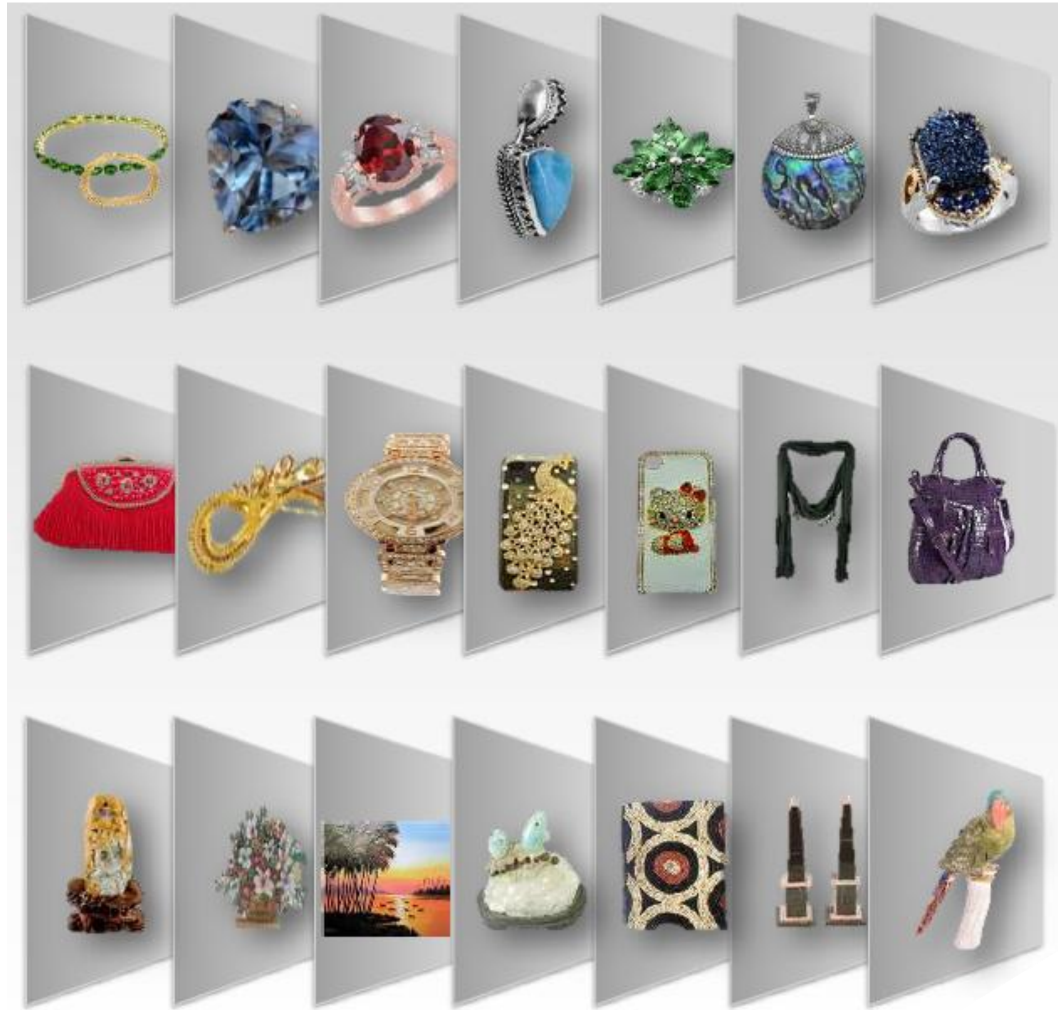
Product catalogue includes bracelets, bangles, earrings, studded jewelry etc

Fashion Accessories

Product catalogue includes watches, bags, phone protective shells etc

Other Lifestyle Products

Product catalogue includes office and home décor, etc



Portfolio of 65,000 designs augmented with recent launch of lifestyle accessories

Integrated global operations

Sourcing markets

India

- Corporate HQ – Jaipur, Rajasthan. ISO 9001:2008 manufacturing facilities
- Production capacity of 5-6 mn pieces p.a. VGL intends to build new plant at SEZ Jaipur, with capacity of 1.2 mn pieces p.a
- Over 2,200 people in corporate, manufacturing, design, sales & marketing, customer service, logistics and support functions

Asia

- China is the hub for sourcing fashion and lifestyle accessories, accessed from multiple locations
- Sourcing capacity from China at 10-12 mn pieces p.a.
- Outsourcing operations expanding to Hong Kong, Indonesia and Thailand
- ~120 people in purchase/ procurement and ancillary functions across Asia

Consumption markets

USA

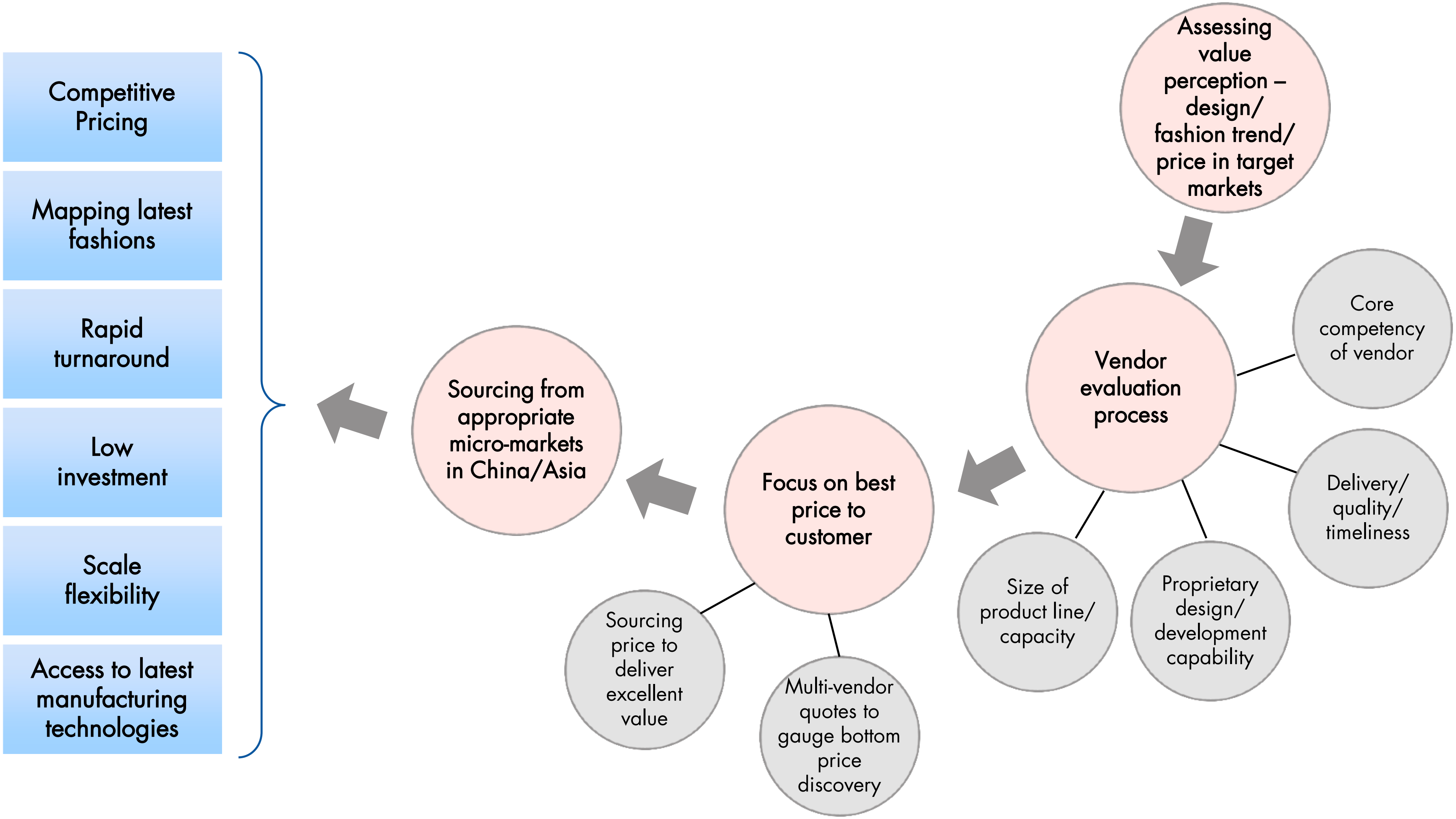
- USA HQ – Austin, Texas
- Liquidation Channel (US-based TV channel) and e-commerce
- Reaching 68 million (FTE) households.
- Over 650 people in sales & marketing, customer service, logistics, TV production, ecommerce and support functions

UK

- UK HQ – Hampton, Middlesex
- The Jewellery Channel (UK-based TV channel) and e-commerce
- Reaching 25 mn households
- Over 100 people in sales & marketing, customer service, logistics, TV production, ecommerce and support functions

Seamless value delivery from complete vertical integration

Sourcing: One of the key advantages of VGL vs peers



Product development aligned with demand patterns

Collections

Valentine's Day & Spring Product Line
Process begins – September
Product in warehouse – January

Mothers' Day
Process begins – December
Product in warehouse – April

Summer Product Line
Process begins – December
Product in warehouse – May

Fall Product Line
Process begins – March
Product in warehouse – August

Holiday Season
Process begins – June
Product in warehouse – October

Process

1
- Buyer discussions
- Evaluation/feedback of last year's hits/misses
- Product development strategies – by category

2
- Discussions/directions with global design teams

3
- Product development reviews
- Final approval to sketches/ designs/ styles/concepts

4
- Live sample evaluation
- Buyer reviews

5
- Products finalized by buyers
- Orders placed

6
- Product in warehouse

TV shopping snapshot

Live TV shopping (The Jewelry Channel, UK)

Live TV shopping (The Jewelry Channel, UK)

- VGL runs 24*7 TV shopping networks in both US (Liquidation Channel) & UK (The Jewellery Channel)
- VGL reaches approx 70 mn households in the US (60% penetration) and 25 mn households in the UK (100% penetration)
- All content is LIVE and the same is available across other platforms such as Internet, mobile etc
- LIVE programming helps enhance user experience and drive higher user engagement, resulting in improving retention ratio and higher revenue per household

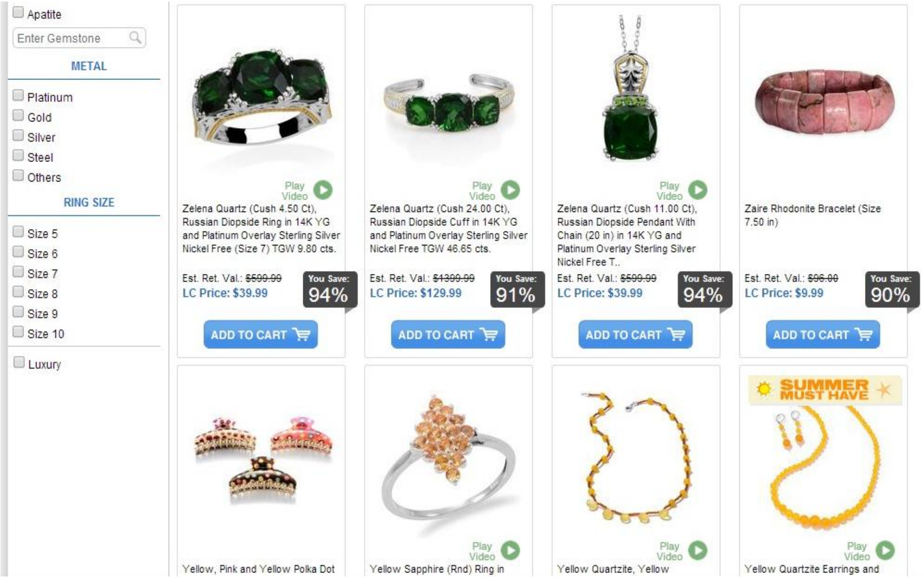
Key TV shopping stats for VGL: US & UK

Total no. of households	(mn)	141
No. of households reached	(mn)	95
Penetration	(%)	67%
No. of pieces sold/ day	('000)	18
Avg price	(USD)	24

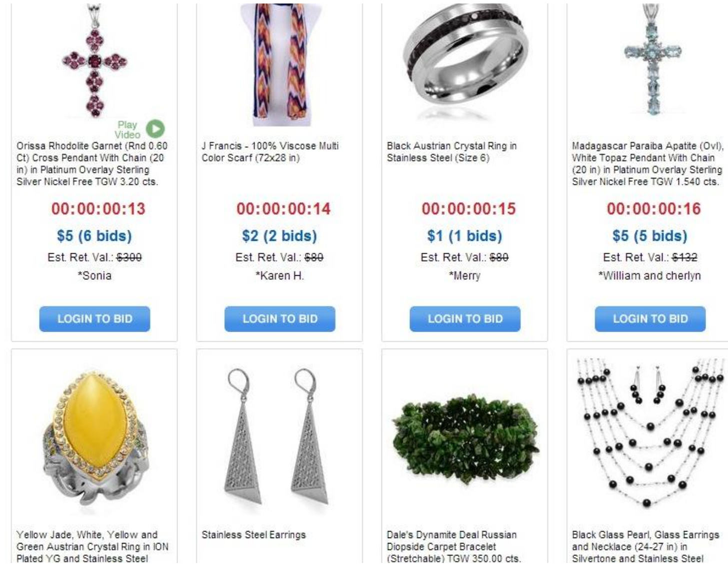
Source: Company

Internet shopping snapshot

Internet: Catalogue shopping (liquidationchannel.com, US)



Internet: Rising auctions (liquidationchannel.com, US)



- VGL also retails jewelry on internet platforms at highly discounted prices (http://www.liquidationchannel.com/) in the US & (http://www.thejewellerychannel.tv/) in the UK
- The two ways of retailing
  - **Catalogue sales**: Fixed price (including the discount)
  - **Rising auctions**: Starting from the base price, the auctions rise by an increment of 1 USD/ GBP depending on user demand for the product
- Apart from driving incremental volumes, internet sales will also clear out VGL's inventory, thus reducing inventory risk

Key internet stats for VGL: US & UK		
No. of pieces sold/ day	('000)	8
Avg price	(USD)	13

Source: Company

SWOT

Strength

- **In-house brands:** Success in building own brands, such as ILIANA, Rhapsody, J Francis, FH, Karis and Elanza
- **Global cost competitiveness** backed by broad-based manufacturing infrastructure and end-to-end vertical integration
- **Strong product design and development:** Has a team of over 250 employees worldwide for trend-spotting and product development
- Large number of Gems and Jewelry institutions in India that supply trained manpower to VGL
- Rich industry experience & knowledge of Promoters

Weaknesses

- Concentration on US and UK market → volumes will be sensitive to macro economic changes
- Exposure to foreign exchange and raw material price fluctuations (VGL depends on international markets for raw material)
- Technology of production is less advanced as compared to Japan and European countries

Opportunities

- Large potential of per household revenue increment (currently at USD 2/ household for VGL vs. USD 30-50 for peers)
- Potential to acquire another 40 mn homes
- Increased branding will improve direct sale to end customers either through 24 hour jewelry TV channels or through web-based electronic media
- Potential to replicate discount model in other countries

Threats

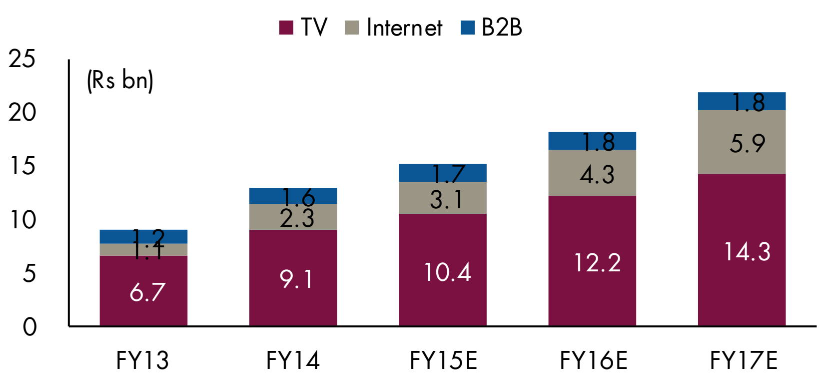
- Rising gemstone prices
- Attrition of show hosts
- Global economic slowdown
- Competition from Indian as well as international companies, if they replicate VGL's low cost model

Financials

Expect healthy revenue growth over the long run

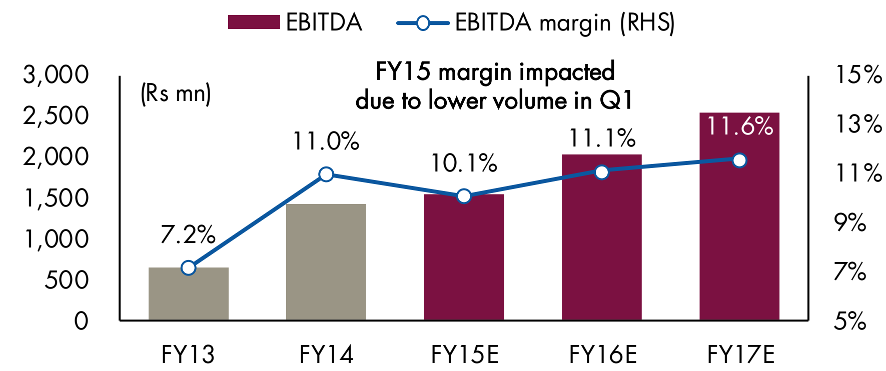
- **Expect 20% CAGR in revenue over the long run**
  - FY15 revenue growth (17% YoY) will be impacted by lower volume in Q1, which was due to transition of outsourcing center in the US, inventory compression, and upgradation of AMS (software which manages TV business)
  - However, expect growth to bounce back to 20% FY16 onwards, which will also set in operating leverage
  - We expect web sales (35% CAGR) to outpace TV sales (16% CAGR) over the long run. E-commerce is expected to account for 1/3rd of consolidated revenue over next 5 years (17% currently)
- **Operating leverage to drive consistent margin expansion**
  - With 35% of total costs being fixed in nature, revenue growth will drive operating leverage
  - We estimate ~100 bps margin expansion/ year from FY15, as VGL will continue to invest in household reach (increases carriage costs), HR pyramid and branding in the medium term

20% revenue CAGR over the long run



Source: Axis Capital

Consistent improvement in EBITDA margin

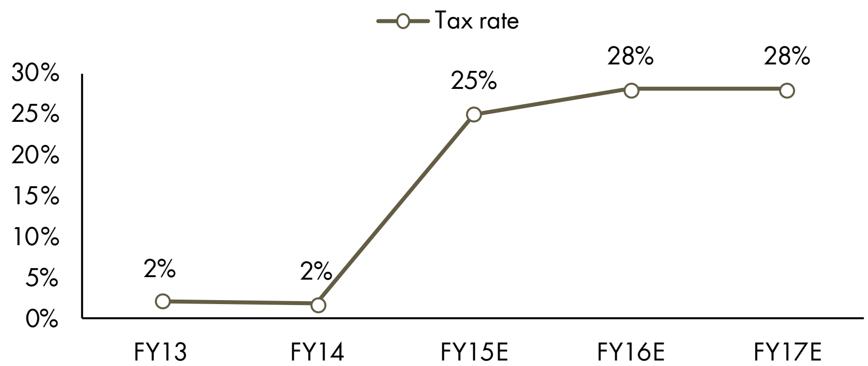


Source: Axis Capital

Tax incidence set to dent PAT in the short term

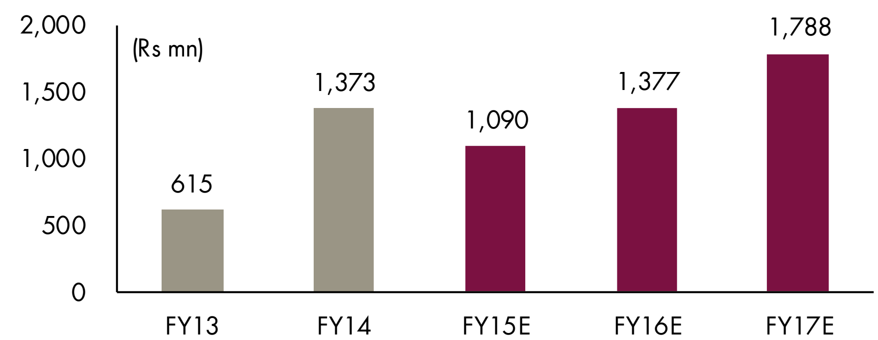
- **PAT to likely remain flat over FY14-16 due to tax incidence**
  - VGL will start to pay taxes in US & India subsidiaries from FY15 as the benefit from carry forward losses have almost been exhausted in FY14. We expect VGL to pay 25%/ 28% tax in FY15/16 respectively (2% in FY14)
  - Apart from tax incidence, flattish EBITDA margin over FY14-16 (due to investment in opex – mainly S&M spends) also contributes to PAT being muted
- **Post FY15, expect robust 30% earnings CAGR**
  - Post tax incidence from FY15, operating leverage will drive healthy growth in PAT
  - While our assumptions peg the net profit margin at 8-9% currently, we believe VGL can potentially surprise on the upside if (a) volume growth is better than estimates, and (b) better cost control results in lower than expected investments in SG&A

Tax rate set to increase going forward…



Source: Axis Capital

…impacting PAT in the medium term

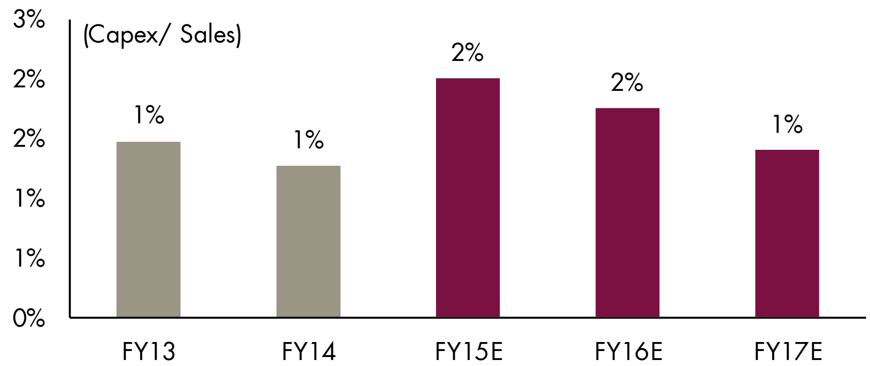


Note, VGL has outstanding loan of USD 20 mn to subsidiaries, which were booked at USD INR of Rs 40. VGL will benefit from exchange gain (~50% INR depreciation since) when these loans are repaid

Source: Axis Capital

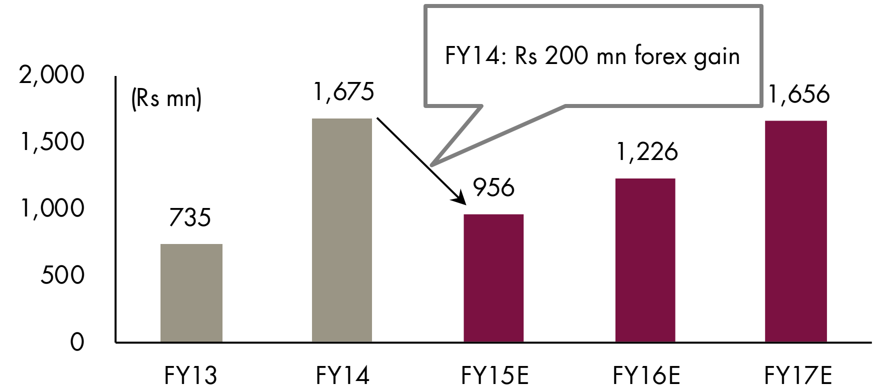
Operating leverage, low capex to drive robust FCF generation

Low capex model…



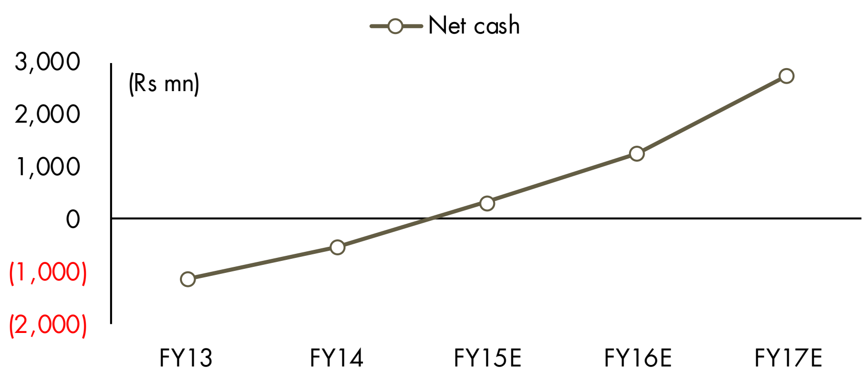
Source: Axis Capital

…will drive significant increase in FCFs



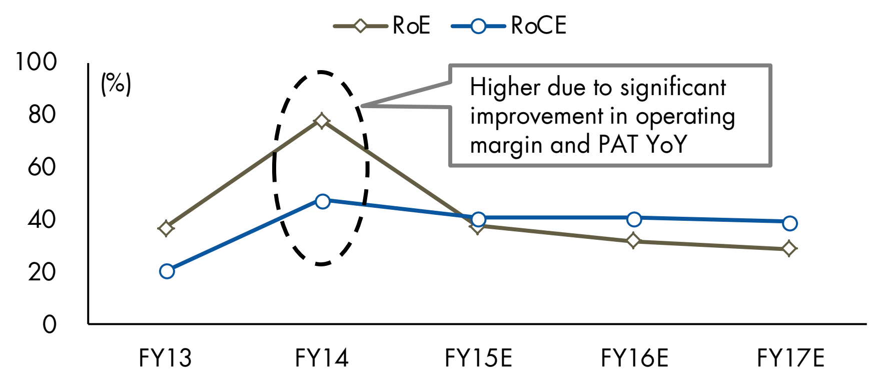
Source: Axis Capita; Note: In calculating above FCF, we haven't considered impact of W.Cap

VGL will be net cash company by FY15



Source: Axis Capital

Long term RoE/ RoCE will settle at 30%/ 40% respectively



Source: Axis Capital

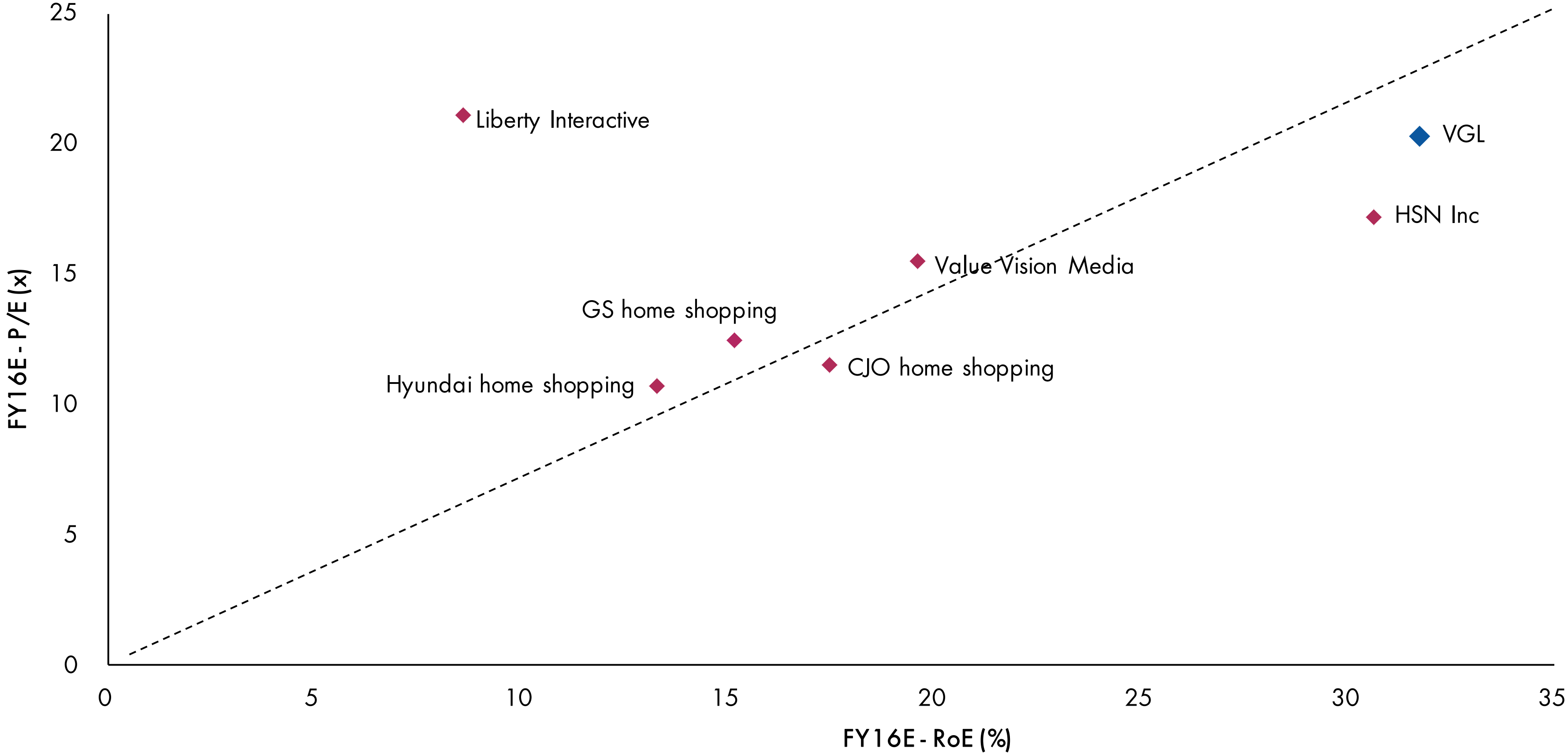
Valuation: Peer comparison

Global peer comparison

Listed company	Liberty Interactive	HSN Inc	Value Vision Media	*Average*	GS home shopping	CJO home shopping	Hyundai home shopping	*Average*	VGL
	US home shopping cos				Korean home shopping cos				
Home shopping brand	QVC	HSN	ShopHQ		GS	CJO	Hyundai		
Country - listed	US	US	US		Korea	Korea	Korea		India
M.Cap (USD bn)	13.9	3.2	0.2		1.8	2.1	1.9		0.5
CAGR % (FY14-16E)									
Revenue	(2)	4	9	*4*	8	15		*12*	20
EBITDA	(2)	6	54	*20*	9	11		*10*	19
Adj PAT*	11	1		*6*	12	22		*17*	0
RoE (%)									
FY15E	7	30	13	*16*	16	18	14	*16*	37
FY16E	9	31	20	*20*	15	17	13	*15*	32
RoCE (%)									
FY15E	3	12		*8*	11	6	11	*9*	41
FY16E	4	11		*7*	11	6	11	*9*	41
P/E (x)									
FY15E	25	20	57	*34*	14	14	12	*13*	25
FY16E	21	17	16	*18*	12	12	11	*12*	20
FCF Yield (x)									
FY15E	5	5	(5)	*2*	5	5	8	*6*	2
FY16E	7	5	3	*5*	7	7	9	*8*	3

Source: Bloomberg, Axis Capital
Note:
1. Liberty Interactive comprises QVC, its proportionate shareholding in HSN and a host of other e-commerce websites. Hence, it is strictly not comparable to VGL
* Adjusted PAT of VGL is flat over FY14-16 due to tax incidence from FY15 (VGL will pay 25%/ 28% tax in FY15/ FY16 vs. nil in FY14)

VGL placed favorably



Source: Bloomberg, Axis Capital

Note: Liberty Interactive comprises QVC, its proportionate shareholding in HSN and a host of other e-commerce websites. Hence, it is strictly not comparable to VGL

Company financials

Company financials (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY13	FY14	FY15E	FY16E
Net sales	8,929	12,983	15,192	18,210
Other operating income	-	-	-	-
Total operating income	**8,929**	**12,983**	**15,192**	**18,210**
Cost of goods sold	(3,023)	(4,305)	(5,059)	(6,064)
Total operating expenses	(5,267)	(7,255)	(8,602)	(10,130)
EBITDA	**639**	**1,422**	**1,531**	**2,017**
EBITDA margin (%)	*7.2*	*11.0*	*10.1*	*11.1*
Depreciation	(73)	(75)	(91)	(106)
EBIT	**566**	**1,347**	**1,440**	**1,910**
Net interest	(145)	(145)	(79)	(61)
Other income	166	153	92	64
Profit before tax	**798**	**1,553**	**1,453**	**1,913**
Total taxation	(17)	(28)	(363)	(536)
Tax rate (%)	*2.1*	*1.8*	*25.0*	*28.0*
Profit after tax	781	1,525	1,090	1,377
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	781	1,525	1,090	1,377
Adj. PAT margin (%)	*8.7*	*11.7*	*7.2*	*7.6*
Net non-recurring items	(1,637)	-	-	-
Reported net profit	(856)	1,525	1,090	1,377

We depict the adjusted PAT (excluding forex gains/ losses) and USD revenue growth for like to like comparison

Balance sheet (Rs mn)

Y/E March	FY13	FY14	FY15E	FY16E
Paid-up capital	761	322	323	326
Reserves & surplus	831	2,008	3,202	4,819
Net worth	1,591	2,329	3,525	5,145
Borrowing	1,432	964	700	300
Other non-current liabilities	13	13	15	18
Total liabilities	**4,010**	**4,663**	**5,420**	**6,827**
Gross fixed assets	1,200	1,270	1,574	1,893
Less: Depreciation	(624)	(609)	(700)	(806)
Net fixed assets	577	661	874	1,087
Add: Capital WIP	0	-	-	-
Total fixed assets	577	661	874	1,087
Total Investment	1	30	860	1,373
Inventory	2,091	1,962	2,079	2,492
Debtors	356	543	670	711
Cash & bank	459	721	187	222
Loans & advances	408	459	546	721
Current liabilities	974	1,357	1,180	1,364
Net current assets	2,341	2,329	2,305	2,784
Other non-current assets	118	287	200	220
Total assets	**4,010**	**4,663**	**5,420**	**6,827**

	FY13	FY14	FY15	FY16
Adjusted PAT (INR mn)	571	1,328	1,090	1,377
% YoY		133%	-18%	26%
Revenue (USD mn)	164	215	253	311
% YoY		31%	18%	23%

Company financials (Consolidated)

Cash flow (Rs mn)

Y/E March	FY13	FY14	FY15E	FY16E
Profit before tax	798	1,553	1,453	1,913
Depreciation & Amortisation	(73)	(75)	(91)	(106)
Chg in working capital	*22*	*274*	*(510)*	*(444)*
Cash flow from operations	1,021	2,019	750	1,101
Capital expenditure	*(264)*	*(70)*	*(304)*	*(319)*
Cash flow from investing	(234)	(268)	(1,048)	(851)
Equity raised/ (repaid)	*(206)*	*(787)*	*106*	*243*
Debt raised/ (repaid)	*(167)*	*(468)*	*(264)*	*(400)*
Dividend paid	-	-	-	-
Cash flow from financing	(519)	(1,400)	(235)	(215)
Net chg in cash	268	351	(533)	35

Valuation ratios

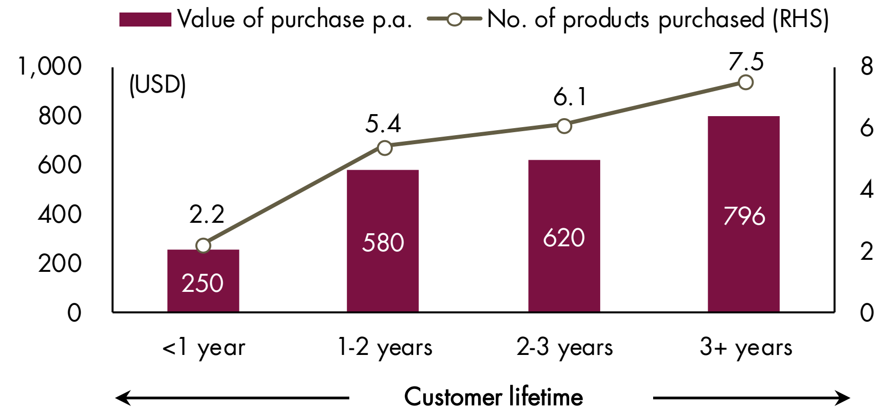
Y/E March	FY13	FY14	FY15E	FY16E
PE (x)	34.9	17.9	25.2	20.1
EV/ EBITDA (x)	44.5	19.5	17.7	13.0
EV/ Net sales (x)	3.2	2.1	1.8	1.4
PB (x)	17.1	11.7	7.8	5.4
Dividend yield (%)	-	-	-	-
Free cash flow yield (%)	0.0	0.1	0.0	0.0

Key ratios

Y/E March	FY13	FY14	FY15E	FY16E
OPERATIONAL				
FDEPS (Rs)	24.4	47.4	33.7	42.2
CEPS (Rs)	(24.4)	49.7	36.6	45.5
DPS (Rs)	-	-	-	-
Dividend payout ratio (%)	-	-	-	-
GROWTH				
Net sales (%)	38.1	45.4	17.0	19.9
EBITDA (%)	(13.6)	122.6	7.6	31.7
Adj net profit (%)	(0.6)	95.3	(28.5)	26.4
FDEPS (%)	(1.7)	94.6	(28.8)	25.2
PERFORMANCE				
RoE (%)	36.8	77.8	37.2	31.8
RoCE (%)	20.1	47.3	40.6	40.7
EFFICIENCY				
Asset turnover (x)	2.7	5.1	5.3	5.1
Sales/ total assets (x)	2.0	3.0	3.0	3.0
Working capital/ sales (x)	0.2	0.1	0.1	0.1
Receivable days	14.5	15.3	16.1	14.3
Inventory days	252	166	150	150
Payable days	45	50	50	50
FINANCIAL STABILITY				
Total debt/ equity (x)	0.7	0.5	0.2	0.1
Net debt/ equity (x)	0.5	0.1	(0.1)	(0.3)
Current ratio (x)	3.4	2.7	3.0	3.0
Interest cover (x)	3.9	9.3	18.3	31.3

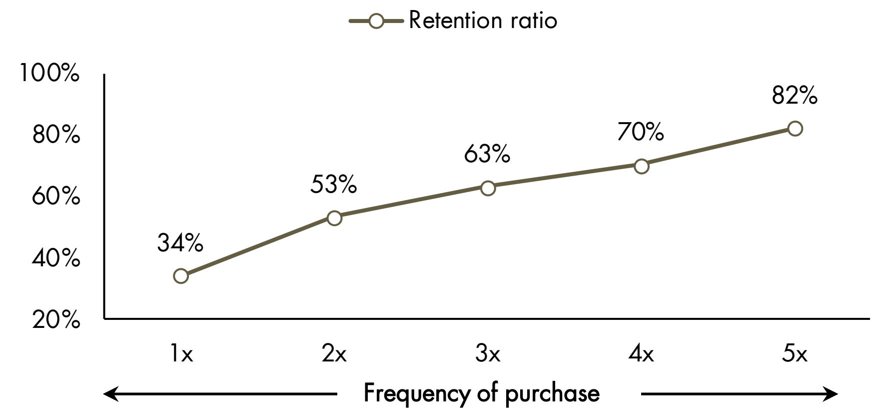
Appendix 1:
Snippets from peers

Increasing lifetime increases customer value



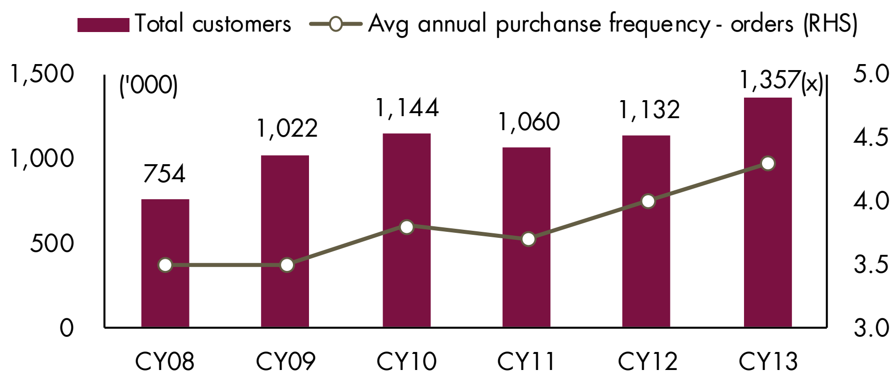
Source: ShopHQ

Higher frequency of purchases increases retention ratio



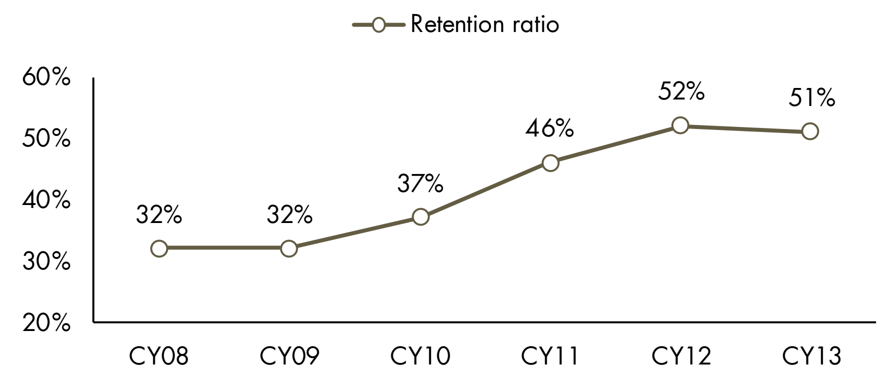
Source: ShopHQ

ShopHQ: Increasing customers and order frequency



Source: ShopHQ

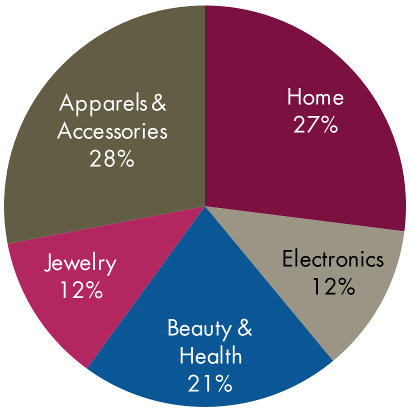
ShopHQ: Increasing customer retention



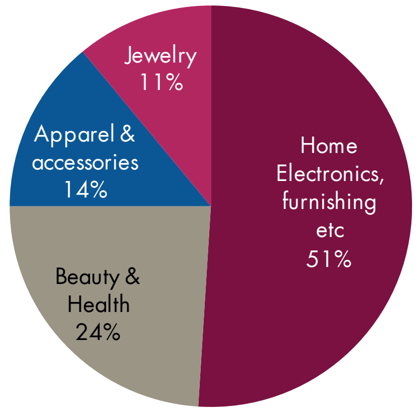
Source: ShopHQ

Most TV shopping networks have diverse product mix

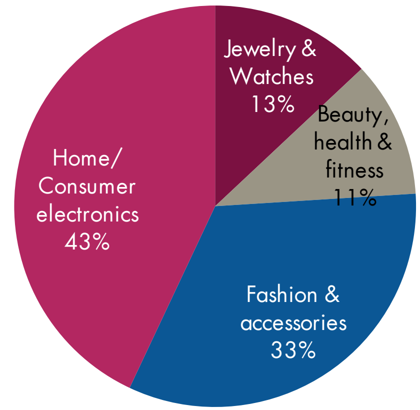
QVC: Revenue mix



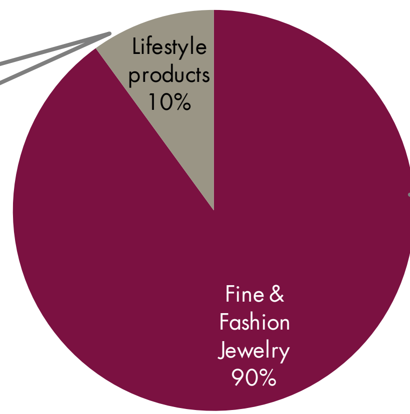
HSN: Revenue mix



Shop HQ: Revenue mix



VGL: Revenue mix



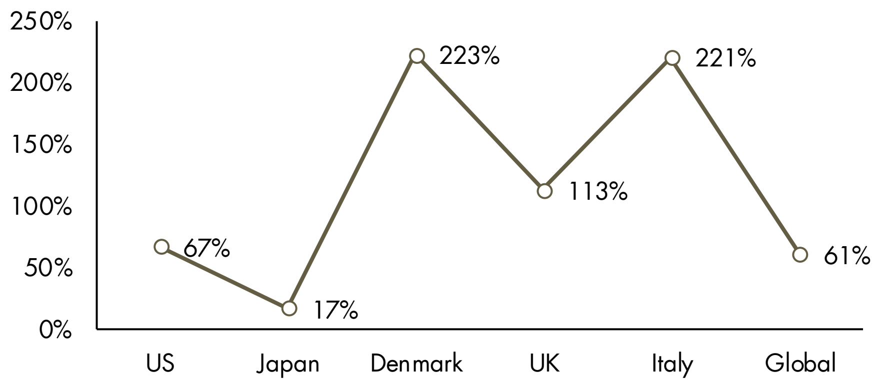
VGL estimates the mix of lifestyle products over the next 5 years to improve to 30%+

Unlike its peers, VGL's primary focus is on fashion jewelry and we expect this to be the flagship segment over the long run even as the company has launched lifestyle products

Source: Companies

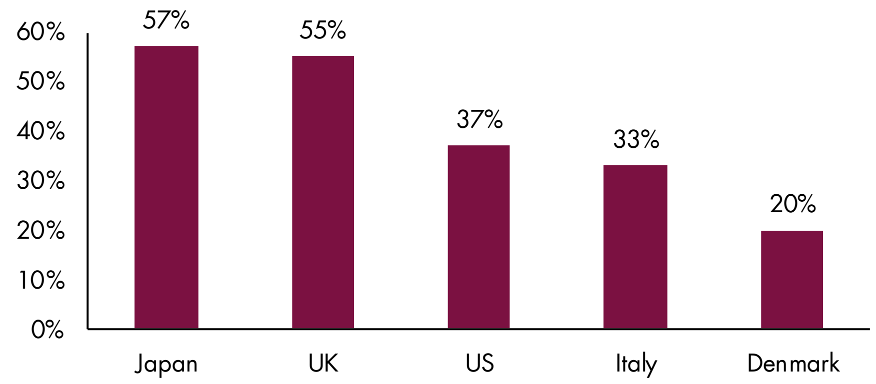
Mobile becoming a complementary medium to TV shopping

Mobile commerce growth for multi category retail



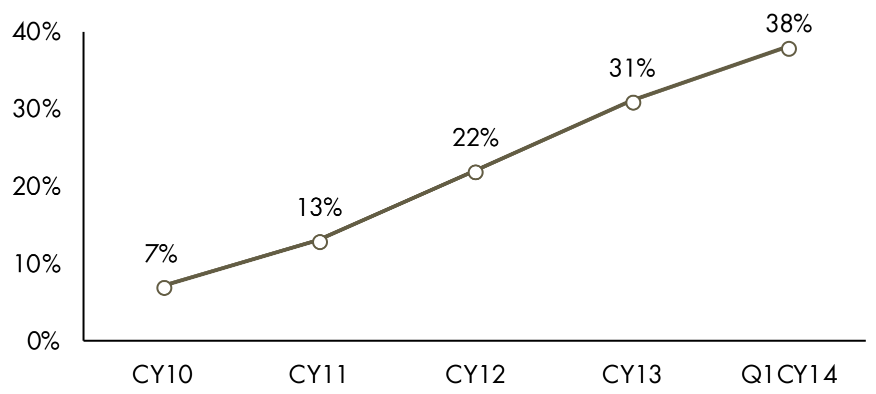
Source: QVC

Mobile share of e-Commerce



Source: QVC

Trends in mobile e-commerce for QVC



Source: QVC

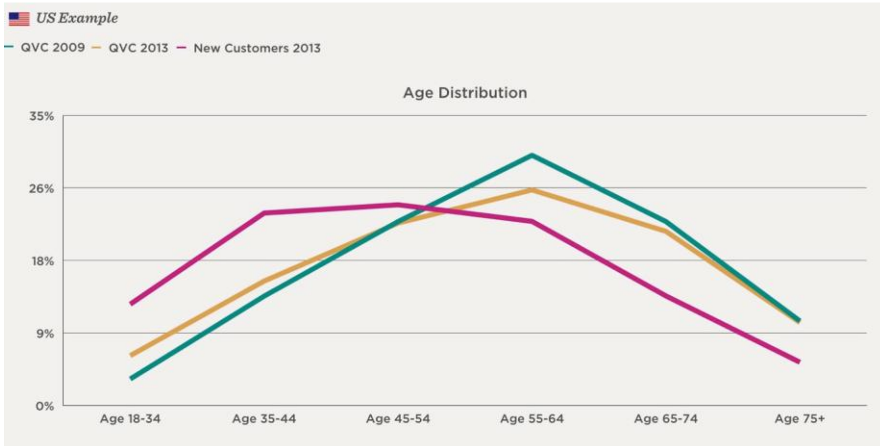
Mobile increases monetization potential for off-air products

Off-air products (%)	Existing customers	New customers
PC web	59	70
Mobile	50	66
Tablet	47	59
Mobile apps	27	42
Phone	18	12

Source: QVC

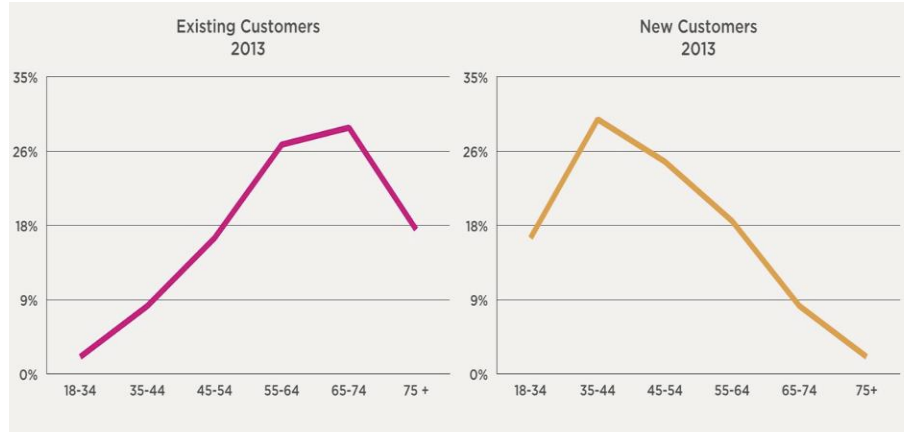
New customers are younger, prefer shopping through mobile

New customers for online/ TV shopping are relatively younger



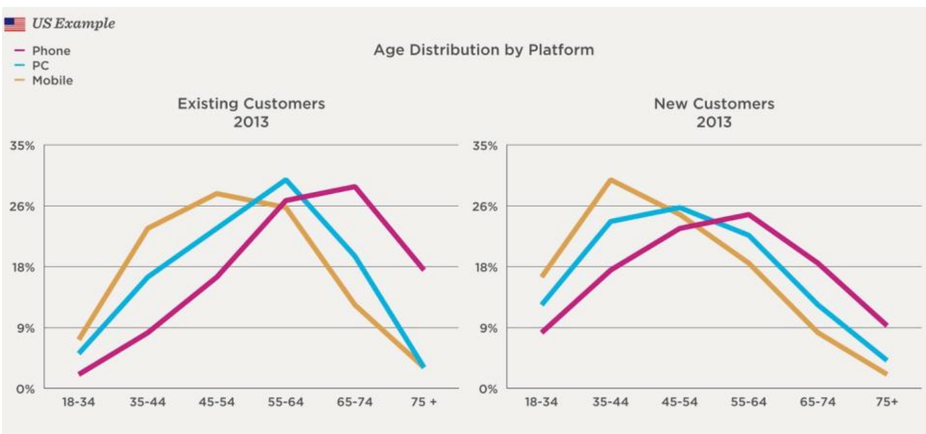
Source: QVC

Age profile of new customers is 20 years younger vs. existing



Source: QVC

New customers prefer shopping through mobile

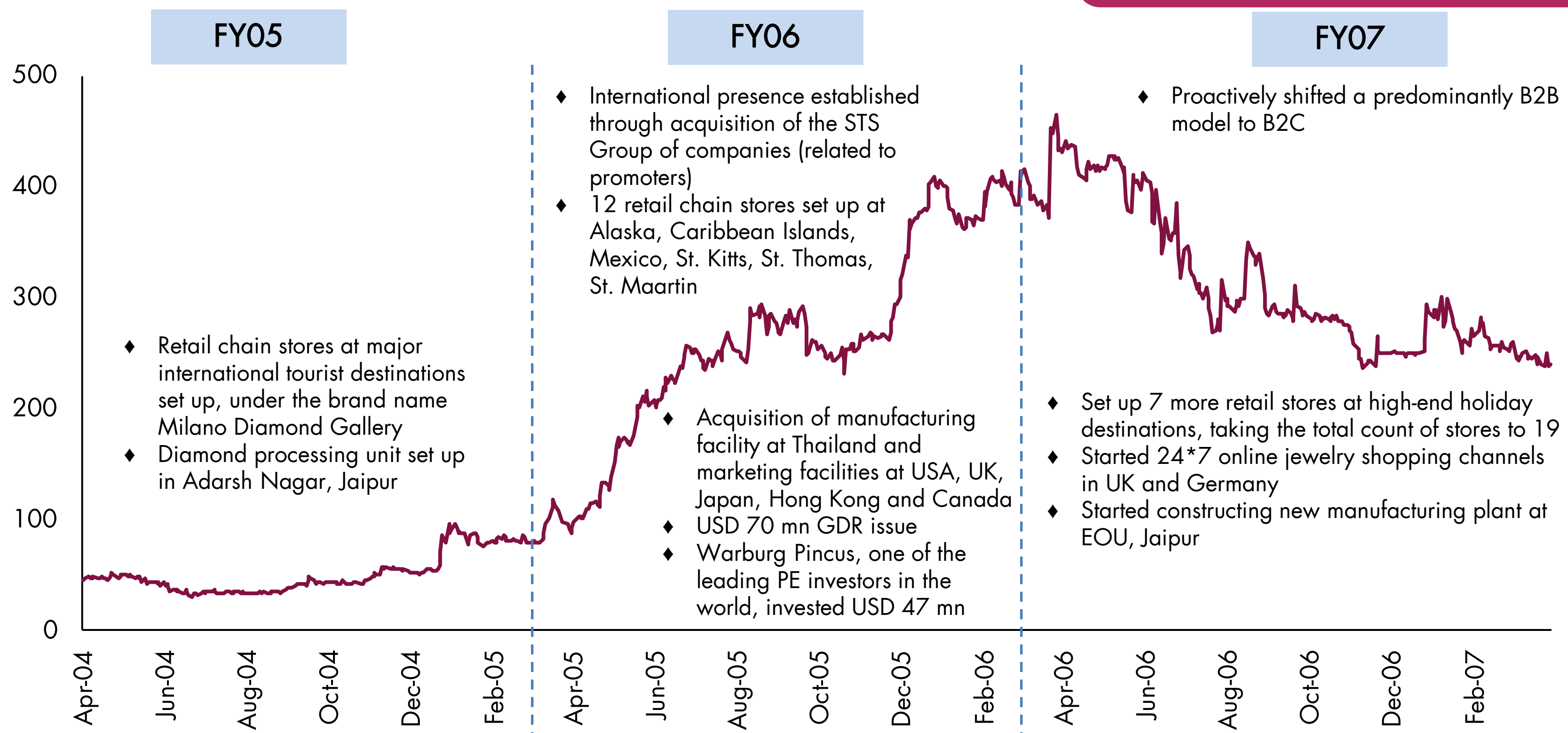


Source: QVC

These trends make it imperative for VGL to invest in mobile technologies (making its websites mobile ready) and launch mobile apps. This will enable VG to better target the 15-35 age group, while majority customers are now in the 35-65 age group

Appendix 2:
Company background

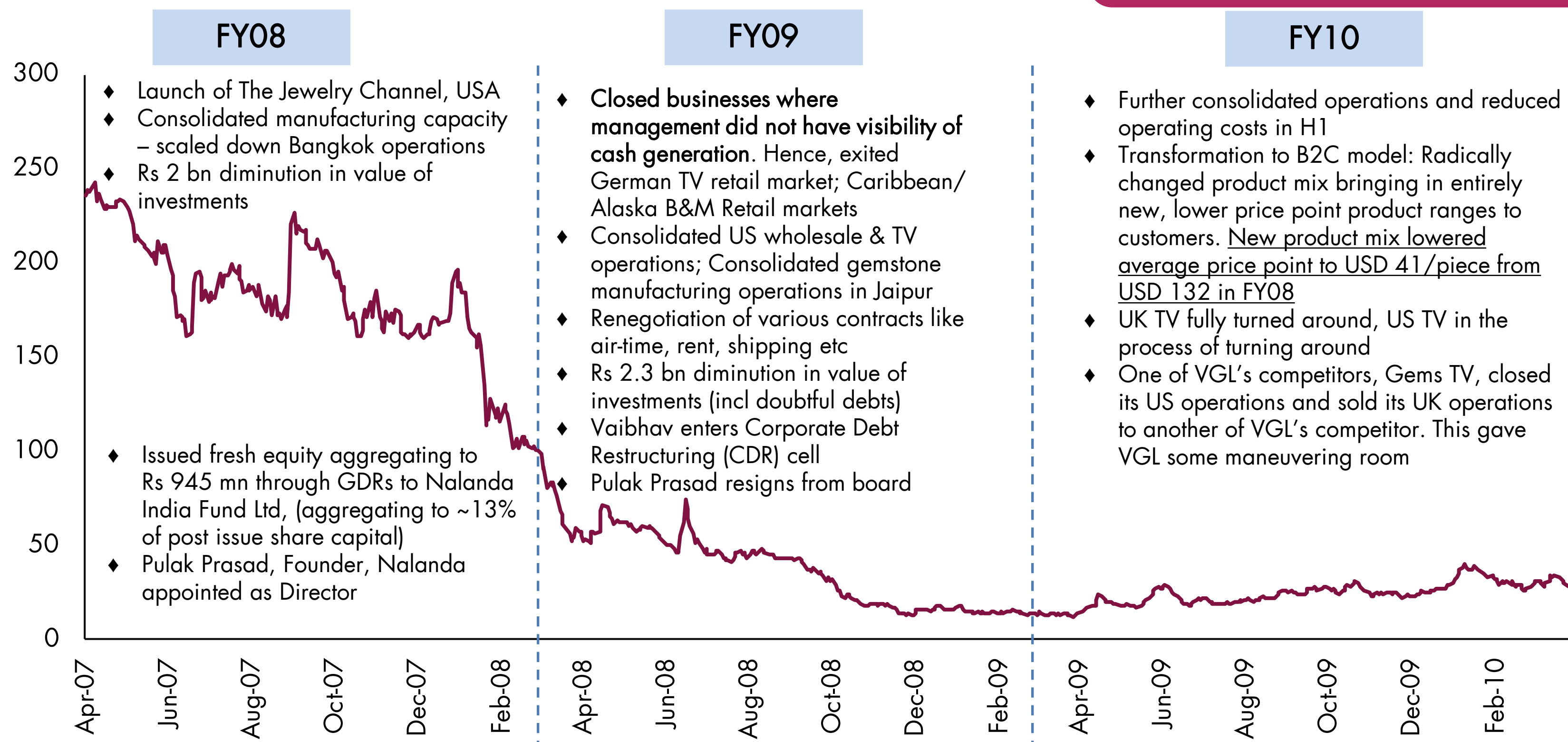
FY05-07: Major acquisition and launch of high-end retail stores



(Rs mn)	FY05	FY06	FY07
Revenue	1,677	2,975	5,192
EBITDA	165	434	(208)
PAT	147	357	(237)
Gross Fixed Assets	184	567	877
Goodwill	0	2,532	2,551
Equity	636	6,497	6,221
Net Debt	221	(841)	610

Source: Company

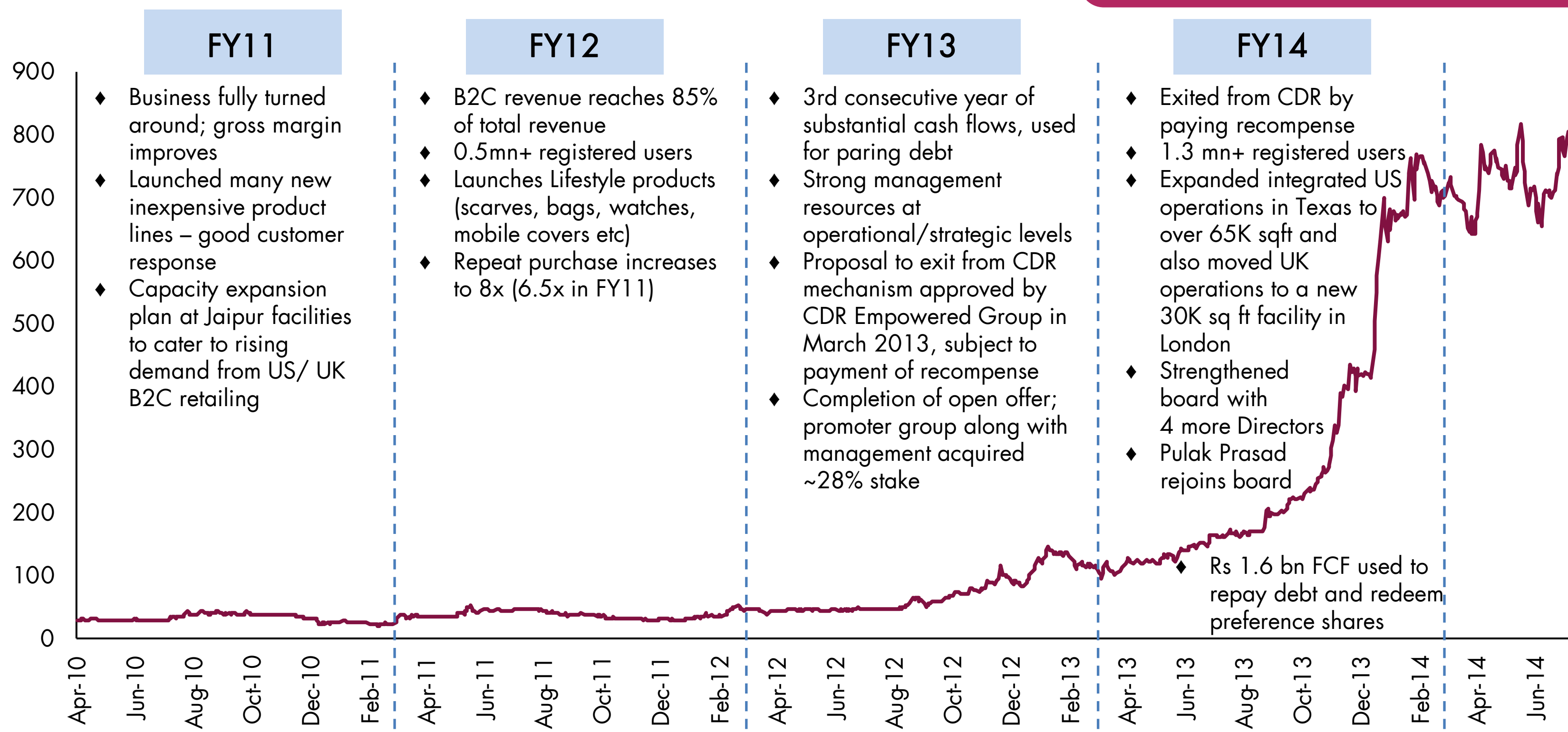
FY08-10: Impacted by recession, transformed to B2C model



(Rs mn)	FY08	FY09	FY10
Revenue	7,608	5,948	3,382
EBITDA	(1,707)	(1,034)	(277)
PAT	(1,849)	(1,536)	(575)
Gross Fixed Assets	1,041	787	553
Goodwill	1,844	1,798	1,852
Equity	4,627	2,169	1,857
Net Debt	1,603	1,781	1,756

Source: Company

FY11-14: Hit the sweet spot of US/ UK digital commerce



(Rs mn)	FY11	FY12	FY13	FY14
Revenue	5,255	6,465	8,929	12,983
EBITDA	590	740	639	1,422
PAT	424	786	781	1,525
Gross Fixed Assets	594	709	847	904
Goodwill	1,856	1,864	353	366
Equity	2,051	2,653	1,591	2,330
Net Debt	1,643	1,459	1,150	523

Source: Company

Board of Directors

Name	Designation	Background
Sunil Agrawal	Chairman & Managing Director	Commerce graduate with an MBA from Columbia University, New York (USA). A first generation entrepreneur, he established Vaibhav in 1980 and has immense knowledge of gemstones and jewelry. He represented the company at all major international trade shows and jewelry fairs. He is credited with the pioneering commercialization of popular gemstones like Tanzanite
Rahimullah	Whole Time Director	Began his career in his emerald trading and export business, and has gained considerable experience and knowledge in this field. Travelled extensively in Africa, Europe and the Far East to source rough stones. He has 40 years of industry experience
Nirmal Kumar Bardiya	Director	One of the renowned jewelers of Jaipur with vast experience in the manufacture of colored gemstones. He is associated with the Company since 2001. He is specialized in high volume gemstones and beads, and is one of the leading global players in this segment. Mr. Bardiya is the President of Jewellers Association, Jaipur & also working committee member of GJEPC, Mumbai
Mitha Lal Mehta	Director	Retired IAS officer. He is a gold medalist in M.Sc (Physics) from the University of Rajasthan and a P.G. Diploma Holder in urbanization from the University of London. He served in various senior government positions culminating in his becoming Chief Secretary of Rajasthan in 1994
Surendra Singh Bhandari	Director	Mr. S.S. Bhandari, B. Com., FCA, is a Practicing CA since 1970. He is Founder Partner of M/s. S. Bhandari & Co., Chartered Accountants, Jaipur and is one of the leading consultants to various companies. Mr. Bhandari is presently on the Board of Directors of Bank of Baroda
Sheela Agrawal	Director	She is the mother of Mr. Sunil Agrawal, Chairman. She is also an active social worker
Pulak Prasad	Director	Founder of Nalanda Capital. Prior to Nalanda, Pulak was with the global PE firm Warburg Pincus for more than 8 years where he was MD and co-head of India. Before Warburg Pincus, Pulak spent 6 years at McKinsey in India, South Africa and the US
Vikram Kaushik	Director	His experience spans 40 years and recently he has been MD & CEO of "Tata Sky Ltd" from 2004 to 2010. He is currently holding directorship in Sistema Shyam Teleservices Ltd from July 2011 and India Capital Growth Fund from June 2012
Mahendra Kumar Doogar	Director	A CA with rich experience of about 38 years in Corporate Finance, Taxation, Statutory and Internal Audit etc. He is presently on the Board of various companies and has been a member of Corporate Governance Committee constituted by SEBI under the Chairmanship of Mr. Narayan Murti
Peter Duncan Whitford	Director	Has extensive international experience of almost 34 years in various fields including consumer products, marketing etc. He has been Group CEO & Chairman of The Wet Sea Inc., President Worldwide of The Walt Disney Company Inc etc

Key management

Name	Designation	Background and responsibilities
Hemant Sultania	Group CFO	Joined VGL in December, 2013 as Group CFO. He is CA, CS and CWA and has 17 years of experience in strategic financial planning, budgeting, project evaluation, taxation etc. Prior to VGL, he worked as CFO with Dr. Lal Path labs, Vice President with Bata India Ltd and Senior Tax Manager at Ernst & Young India
Gerald Tempton	President, Liquidation Channel USA	Joined VGL Group in 2009 as President of Liquidation Channel, USA. He has over 25 years of experience, working with MNCs such as Gordon Jewelry Corp, Limited Brands, GAP Inc, The Walt Disney company, The United Colors of Benetton etc. He holds a Bachelor of Applied Arts and Sciences Degree, with emphasis on Business Administration/Management & Human Performance Technology from Texas State University
Colin Wagstaffe	Managing Director, The Jewellery Channel UK	Joined VGL Group in April 2013 as MD of The Jewellery Channel UK. Prior to VGL, he was at Signet Jewelers (the largest specialty retail jeweler by sales in the US and UK) for 6 years as Director of Marketing for the UK division. Colin also held a number of leadership marketing roles in major UK businesses
Charlie Curnow	Chief Information Officer, Group	Joined VGL Group in October 2013 as CIO. Prior to VGL, he held leadership positions with many Fortune 500 companies. Most recently, he was SVP and CIO of Academic Partnership and prior to that, he held similar IT leadership positions at A.H. Belo Corporation, Bear Stearns, Blockbuster, Coca-Cola, Computer Sciences, Dell, and General Electric
Pushpendra Singh	Vice President, HR Asia	Has total 17 years of experience in HR. He was previously employed with companies like NTPC, Kalpataru and Reliance Communications. He has successfully implemented many Talent Acquisition, Talent Retention and Talent Management initiatives in his career

Board of Directors: Changes in composition over time

Name	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Sunil Agrawal	✓	✓	✓	✓	✓	✓	✓	✓	✓
Nirmal Kumar Bardiya	✓	✓	✓	✓	✓	✓	✓	✓	✓
Rahimullah	✓	✓	✓	✓	✓	✓	✓	✓	✓
M.L. Mehta	✓	✓	✓	✓	✓	✓	✓	✓	✓
S.S. Bhandari	✓	✓	✓	✓	✓	✓	✓	✓	✓
Ms Sheela Agrawal				✓	✓	✓	✓	✓	✓
Pulak Chandan Prasad			✓						✓
Vikram Kaushik									✓
Mahendra Kumar Doogar									✓
Peter Duncan Whitford									✓
Anandi Lal Roongta	✓	✓	✓	✓	✓	✓	✓		
Suresh Punjabi	✓	✓	✓	✓					
Sanjeev Agrawal	✓	✓	✓						
Ikramullah	✓	✓	✓						
Santosh Madan								✓	

Source: Company

Management/ Auditors: Changes in composition over time

MD	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Rahimullah	✓	✓	✓	✓	✓	✓	✓	✓	
Sunil Agrawal									✓

CFO	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Pramod Akhramka	✓	✓	✓	✓	✓				
Atul Agarwal							✓		
Anshuman Khandelwal*						✓		✓	
Hemant Sultania									✓

Note: * Anshuman was Senior Manager Finance Accounts as at FY13

Auditors	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
M/s Haribhakti & Company	✓	✓	✓	✓	✓	✓	✓	✓	✓
M/s B. Khosla & Co	✓	✓	✓	✓	✓	✓	✓	✓	✓

Source: Company

Axis Capital Limited

Axis House, C2, Wadia International Centre, P.B Marg, Worli, Mumbai 400 025, India.
Tel:- Board +91-22 4325 2525; **Dealing** +91-22 2438 8861 - 69;
Fax:- Research +91-22 4325 1100; **Dealing** +91-22 4325 3500

CONFLICT OF INTEREST DISCLOSURE

We, at Axis Capital, are committed to providing the most honest and transparent advice to our clients. However, given the nature of the capital markets, from time to time we are faced with situations that could give rise to potential conflict of interest. In order to provide complete transparency to our clients, before we make any recommendations, we are committed to making a disclosure of our interest and any potential conflict IN ADVANCE so that the interests of our clients are safe- guarded at all times. In light of this policy, we have instituted what we believe to be the most comprehensive disclosure policy among leading investment banks/brokerages in the world so that our clients may make an informed judgment about our recommendations. The following disclosures are intended to keep you informed before you make any decision- in addition, we will be happy to provide information in response to specific queries that our clients may seek from us.

Disclosure of interest statement (As of Aug 11, 2014)

1. Analyst ownership of the stock	No
2. Investment Banking mandate	No

We are committed to providing completely independent and transparent recommendations to help our clients reach a better decision.
