Vaibhav Global Limited

Investor/Analyst Conference Call Transcript
July 30, 2014

Karl Kolah: Good morning everyone and thank you for joining us on Vaibhav Global's Q1 FY15 results earning call. Today we have with us Mr. Sunil Agrawal – Chairman and Managing Director of Vaibhav Global and Mr. Hemant Sultania – Group CFO.

We will begin this call with brief opening remarks from the management, following which we will open the forum for questions.

Before we get started, I would like to point out that some statements made or discussed on the call today maybe forward looking in nature and must be viewed in conjunction with the risk and uncertainties we faced. A more detailed statement and explanation of this risk is included in our earnings presentation. The Company does not undertake to update these forward looking statements publicly.

I would now like to invite Mr. Sunil Agrawal to make his opening remarks.

Sunil Agrawal: Good morning and I welcome everyone to Vaibhav Global's Q1 FY15 results conference call. I will quickly provide an overview of the first quarter and then Hemant will discuss some key financial performance parameters for the quarter. As most of you know, the Vaibhav global is an electronic retailer of Fashion and Lifestyle product in US, UK and Canada markets sold on our proprietary TV shopping and web platforms with direct access to over 100 million TV households. We deliver a deep valley proposition to discount seeking customers. Q1 witnessed moderation in revenue and volume growth on TV platforms while web platform continue to grow rapidly.

Operational performance was influenced by some teething issues during the transition to an outsource call center and also due to inventory compression in previous quarter.

We have successfully overcome most of these issues and are confident of maintaining our growth trajectory during the course of the year. Recently we have undertaken several initiatives; like enhancing our manufacturing and sourcing capabilities, expanding our US facility and moving to a new indicative state of the art facility in UK. We also expanded our management team with multiple senior level appointments and recently implemented and upgraded SAP based ERP platform for improved customer experience.

All these initiatives will have transformed us into a noteworthy global player and also help deliver sustainable growth in the coming years. I will now ask Hemant Sultania, our group CFO to give you a brief overview of the Q1 FY15 Results.

Hemant Sultania: Good morning everyone and once again welcome to this VGL's Q1 FY15 results earnings call. I will give you an update on the operational and financial detail for the quarter and then we can proceed for the question and answer session.

In the first quarter, revenue increased by 20% to Rs. 301 crore from Rs. 251 crore in the quarter corresponding last year. In dollar terms, revenues were higher by 12% as compared to last year. The top line growth was led by 38% increase in volumes of web sale with growth in TV sales was muted at 3% due to some of the reasons shared earlier by Sunil.

Web sales now contribute 34% of sales volume as compared to 28% in Q1 FY14. Another positive, is that a large proportion of web sales are coming from catalog based transaction rather than rising auction. Therefore web revenues are rising faster than volumes due to higher average realization. In Q1, web revenues rose 78% and TV 11%. EBITDA before exchange gain for the quarter stood at Rs. 26 crore translating to a margin of 9%. Q1 had margin impact from cost structures that were created ahead of volume expansion. We see the company progressing beyond these issues over the rest of the year.

Now covering the operating performance:

Revenue growth was driven both by volumes and higher realization per unit. Retail volumes increased by 13% to 2.2 million units in the first quarter. There was volume growth of 3% in TV and 38% in web segment respectively. Web sales contributed 32% of retail sales volume in FY14, up from 28% in Q1FY14. We believe that the mixed is therefore getting more desirable in line with our objectives.

The Company continues to generate robust cash flow and repay debt. Net debt as on 30th June 2014, stood at Rs. 40 crore as against Rs. 126 crore in Q1 FY14. Free cash flow for the quarter was at Rs. 22 crore, net current assets remains flat at Rs. 225 crore in Q1 FY15 as compared to Rs. 255 crore in Q1 FY14, even though revenue increased by 20%. ROE and ROCE remains healthy at 53% and 52% respectively.

Let me highlight some customer centric data points which we deem important. Customer repeat buying activity increased to 17.1 from 15.6 in the same period last year. In Q1 FY15, we added 49,000 new customers and we now serve 1.4 million total customers. Customer Lifestyle in the US operation has increased to over 2 years from 1.55 years in FY11. Customer retention rate has improved to 48.5% in the US from 45.6% in the corresponding period last year for the group as a whole. These data points are an outcome of our improving relationship with customers backed by a multi-channel marketing initiative. We are confident of further progress on this benchmark as we progress further.

With that, I conclude my opening remarks and now I request the operator to open this forum for questions

Moderator: The first question is from the line of Viraj Mehta from ValueQuest Investment Advisors.

Viraj Mehta: Could you quantify the exact or ballpark the increase in the cost owing transfer of call centers to the third party?

Sunil Agrawal: We spend about $250,000 to $300,000 every month for the call center. So for the quarter, we spent almost $850,000 for the call center. In fact, to a part of the duration we kept our in-house team as well in place because in case there was a major disruption, we could get the lines come back to us.

Viraj Mehta: Now with the entire transition being over, would it be fair to say that this spend would at least be reducing, if not completely off over the next quarter?

Sunil Agrawal: Mostly yes. Some of the agents we transfer to improve our customer service, is still in house. We earlier had longer wait time, which has dropped dramatically now and is in line with the best of the other TV shopping companies in US. But here to your point, most of the transition has been completed.

Viraj Mehta: In your annual report there is a point which says that the Company has increased the borrowing limits to Rs. 1,000 crore, whereas in the MDA we talk about being debt free by the end of the year. There is just a small gap in my understanding here, can you clear this?

Hemant Sultania: Generally, these are all provisional approval which you take from your shareholder. It does not mean the Company will go and take this loan. If you go for a shareholder approval, it takes around 4-5 months. In future, there may be some business activity in which the Company could need funds. These are all provisional approval and this was there with the Company under the old Companies Act. Since the Companies Act has changed, we were forced to again go to the shareholder.

Viraj Mehta: If I understand you correctly, there is no new significant event that is probably on the anvil for you to take any kind of shareholder approval for this kind, as in Rs. 1,000 crore is reasonably a big amount for Company like us.

Hemant Sultania: Four years ago also, when we had taken approval it was present... Since the CompaniesAct has changed, we had to take the approval again.

Sunil Agrawal:: To add to your point, we have no plans to raise any substantial loans for any business expansion in near future. There is no visibility at this time.

Moderator: The next question is from the line of Sunil Jain from Nirmal Bang Securities. .

Sunil Jain: My question is related to realization. I see the improvement in realization both in Web and TV. So was this intentional or was there anything in that?

Sunil Agrawal: Mostly it is driven by customers. The customers and inventory merchandizing based on the trends. So, we move within a band, but within that band, it is driven by the customer and merchandizing.

Sunil Jain: In the last 3 quarters, consistently in Web sales, the average realization has increased from $12 to $13 and now $14 and similarly in TV sales, from $23 to $24 and $25. So, is it your management intention to improve the value of merchandizing and which is already getting accepted by the customer?

Sunil Agrawal: This is driven by customer choice and merchandizing based on the trend happening in the world. So, it is not our intention to drive it up. As I had mentioned earlier also in one of the calls, we have a certain band and it may move within that certain band.

Sunil Jain: My next question is with respect to the volume growth. We were targeting around 20% volume growth for the full year, but in Q1FY15 we had a low volume growth. Is the yearly growth target still intact or do we need to bring it down a bit?

Sunil Agrawal: As I had mentioned earlier in the earnings call, the television volumes were specially impacted because of the call center movement. We also installed a new software in our US operation. There is operating software for all our TV auctions for our scheduling for customer service which was a bit disruptive as it was the change of operating software after 6 years of original software.

Also in the inventory compression, as you would see in last quarter, we had continued to keep the inventory at Rs. 200 crore, so while our volume grew substantially and we felt that we went a bit too far in inventory compression that we are building up now. So because of these reasons the volume did not grow as we expected. But we expect in Q3 FY15 and Q4 FY15; the volume would grow over last year as per our trajectory.

Moderator: The next question is from the line of Dixit Doshi from Whitestone Financial. .

Dixit Doshi: What is the breakup of sales in US and UK?

Sunil Agrawal: We usually do not provide breakup between our TV channels for competitive reasons. But the total retail sales has been given to you.

Dixit Doshi: You take the returns in the UK operations. What is the percentage of return you have in UK?

Sunil Agrawal: It is approximately 24-25% returns, which is industry standard for larger player like QVCs or Ideal Shopping in UK.

Dixit Doshi: What is our staff strength in US and UK operations?

Sunil Agrawal: US is a little over 500 people and UK is little over a 100 people.

Dixit Doshi: Suppose someone orders in the US, so do we transport the goods all the way from India or we have some warehouse in the US, from where we transport the goods to the last mile?

Sunil Agrawal: We have our respective warehouses in US and UK. We never present the goods on TV or on web, unless the product is in the warehouse in local location. The reason is that we want the customer to get the product quickly within 4-5 business days maximum, so that they do not change their mind.

Dixit Doshi: What would be our dividend policy going forward given we do not have much of expansion plans and also there also exist a possibility of the Company becoming debt free by couple of quarters?

Sunil Agrawal: We have not finalized the policy. But we will definitely consider giving dividends end of this financial year.

Moderator: The next question is from the line of Nisarg Vakharia from Lucky Investments.

Nisarg Vakharia: What is the expected tax rate in this year and for the next financial year?

Hemant Sultania: India and US; both will pay tax. We have some brought forward losses in India, so at least MAT will come, so that is 20%. On an average, we see 25% tax impact this year.

Nisarg Vakharia: 25% tax impact would be for the consolidated entity?

Hemant Sultania: Yes, 25% for the consolidated entity.

Nisarg Vakharia: I wanted to understand something with respect to the shifting of the call center and everything else a little better. The EBITDA margin impact; that we have seen because of the slower TV sales, what according to you would probably be adjusting for that impact? What according to you could be the EBITDA margin that you could sustain in the next 3, 4 quarters going ahead or whatever?

Sunil Agrawal: We usually do not give guidance, but since the first quarter was a little abnormal for us, we expect overall for the year to be in double digit. Where it will be, we do not know. Whether it will be 10% or 11%, we do not know, but we are confident that we will attain 10% and up.

Moderator: The next question is from the line of Aksh Vora from Praj Investments.

Aksh Vora: In this quarter, our web percentage of revenue has come up around 34% and that was mainly due to lower volumes from TV. So, I think again then from next quarter, it will be around 65:35. What would be the mix between Web and TV?

Sunil Agrawal: Web continues to grow because the impact on Web was not as much from the disruptions. So Web has grown on a normal pace, I would say, slightly below normal, but TV was impacted more than Web. So, I do not see a reason for Web growth to slow down in coming quarters, but we expect TV to grow better than what it did in the last quarter.

Aksh Vora: This quarter the mix is a little bit higher on Web side i.e 34%. So would it come back to 30% odd levels or will it sustain this level?

Sunil Agrawal: We do not give exact guidance on a particular segment's growth potential. But we expect Web generally to continue to grow because our Web penetration is just about 20% of total sales whereas our competitors like QVC, HSN, and Shop Embassy are around 40%. So there is a room for us to continue to grow the web faster than television.

Aksh Vora: We are seeing all the possible factors like; we have overcome our issue. So probably the volume growth; which is a lower single digit this time, will it be higher in next coming quarters, in TV segment?

Sunil Agrawal: Yes, we expect it to be higher in the coming quarters.

Aksh Vora: What is the gross debt and cash figure?

Hemant Sultania: Gross debt is around Rs. 94 crore and the cash accounts Rs. 154 crore.

Moderator: The next question is from the line of Ankit Babel from Shubhkam Ventures.

Ankit Babel: In your cash flows, there is one line item which is amounting to Rs 3 crore which has been provided as direct taxes paid. Why it has been added back in your cash flow?

Hemant Sultania: This is because we have paid this to the department as there is a transfer pricing case going on. We have paid this against the demand. The asset is created as a current asset and then this is shown below.

Ankit Babel: As it has been paid, so shouldn't it be deducted?

Hemant Sultania: Yes, but it is in the current also. So above, when your current asset increases, you have to take it out, eliminate it to tally the cash flow.

Ankit Babel: Was there no actual cash outflow this quarter?

Hemant Sultania: There is a cash outflow of Rs. 3 crore. Asset is also created as we have disputed the demand. There is no tax provision against that. It is not current year's tax; it is an old transfer pricing dispute case against which we have paid.

Moderator: The next question is from the line of Viraj Mehta from Value Quest.

Viraj Mehta: It was mentioned earlier that the repeat customer was around 17 and not 24?

Sunil Agrawal: There are 2 data points here. One is, the 'repeat orders' and one is the 'quantity'. Now, in case of quantity, it is for the quarter-over-quarter. It was 22 last year for the same quarter and this year it is 25.38 for the same quarter. This is annualized for trailing 12 months.

Now repeat buy, so that means customer makes per order or order sometimes more quantity. Therefore, the 'repeat orders buys' is 17.14 against last year 15.62. So per individual order, it could be on the Web or it could be on an IVR, it is approximately 1.5 constant. So per order is 1.48, quantity that they have done. So repeat orders were 17.14, repeat quantities are 25.38 in trailing 12 months.

Viraj Mehta: If I look at few of the competitors that you had mentioned in the AGM that you really admire i.e something like a Pandora Bracelets, or even Lumber Liquidator., If I look at the growth trajectory for even these companies. Also, probably Pandora is a Copenhagen Company and therefore it is slightly more to your feel. Their gross margins are similar to our levels, around 65% but in spite of being in brick and mortar, their EBITDA margins are extremely high, north of 30%. Is there any reason, I mean what kind of aspirations do we have and when I say that, I am not talking one quarter, one year down the line, I am probably thinking ten years down the line. Is there an aspiration figure that we are working with?

Sunil Agrawal: We want to be one of the major players in the space that we are in. I cannot discuss the numbers that we have in mind or what we are looking for. But we have a potential to be one of the major players because of our cost structure and the way we have been set up. Now, why Zara is (+20%) EBITDA, why Pandora is (+30%) EBITDA, it is a factor of scale. Pandora is already above a billion dollar company and they have achieved a certain scale and brand recognition although it is all in-house brands that they do, similar to ours. But the scale benefits the EBITDA and we hope to your point, 5-10 years down the road, we will have more robust EBITDA than we are currently.

Viraj Mehta: So as you mentioned, you have cost advantages, I would assume your cost advantages over your current players also, like QVC or others that I do not really know of. If you can just point out 2 to 3 major factors which leads to this cost advantage for better understanding? What are the exact sources of this cost advantage? Would it be, your factory being in India and the labor cost being cheaper or would it be sourcing as an advantage, i.e a broader 2, 3 points which gives you a mote over these competitors?

Sunil Agrawal: Sure. As I had earlier mentioned to you when you were present in the AGM. QVC, Home Shopping Network or Shopping Embassy who are competitors in US and Ideal Shop and QVC in UK, they are predominantly selling 3rd party brands. When they sell brands, the first thing is, the margins are lower and they get lower margin and they do not have the ownership of their own pricing because brands detect what price can you sell, for example, Dell or Samsung tell them what price can they sell. Whereas, we like Zara or Pandora Bracelets, we sell our own product, in house product. We decide our own pricing based on the market capacity to absorb the pricing. So, we get more margin of the house product. Now, vertical helps us definitely into cost and also in time. So we take position into promising product which market has potential in and then convert those products into the market acceptable designs and therefore owning company supply chain affords a better margin, very much similar to Zara or Pandora.

Viraj Mehta: What is the lead time set? As the channel by which you are selling is your own and you will probably have all the quantitative data in terms of what are the latest trends. How much is the lead time in terms of a product that you see the demand in and the supply being up, I mean upped of that product. What is the kind of a lead time in that, let us say, the feedback loop that you receive?

Sunil Agrawal: Usually, we plan for quite some time, depending on the pantone color research then which usually is done 6-8 months in advance and then we go for setting colors of stone or colors of scarves or colors of bags and then we merchandize based on the plan that we have in place. If certain item has done better than our expectation, we can turnaround the product within 2-4 weeks, most of the product. Very heavy like handbags or decorative items, that comes by sea and takes 8-10 weeks. But if any item like fashion jewelry or scarves that comes by air, that can come very quickly.

Viraj Mehta: The bags and other accessories that we sell, do we buy it from someone at this point?

Sunil Agrawal: Yes, we do. We do not manufacture bags or scarves or decorative items, but we have advantage of understanding the manufacturing and component cost structure. So as I had explained to you in AGM, we first go to the component manufacturer, understand the cost structure of say bags, what is the cost of findings, what is the cost of the PU, how much is the stitching cost, how much is the cost of zippers and then we go to the bag manufacturer and then ask them to quote for us based on these component prices as we know. Similarly we do in watches and now we have started taking positions in watch movements and watch batteries, we buy them and supply to the manufacturers at a very competitive price. This is because we have a scale and we can buy at a very competitive price, the components.

Moderator: The next question is from the line of Deepak Poddar from Sapphire Capital.

Deepak Poddar: Is there any kind of revenue guidance you can give us for FY15 and FY16? Considering this quarter was bad because of teething issues but we expect the volume to grow to normal 20% kind of level especially in TV, in the coming quarter?

Sunil Agrawal: Sure, our dollar growth of last quarter was 12%, rupee growth was 20%. As there is a difference in exchange rate in Q1 of 13-14 and Q1 of 14-15, it was Rs. 54 versus Rs.59 now. Due to this there is a difference of dollar versus rupee. So, from 12% we expect to grow decently in coming quarters, so we do not give exact guidance where we will be, but I can definitely say that we will be higher than 12% in coming quarters, especially quarter 3 and 4, in dollar terms.

Deepak Poddar: Any kind of view on FY16?

Sunil Agrawal: We do not usually give guidance. But we do not see a reason for any slowing of the growth, unless there is onetime reason like it happened in last quarter.

Moderator: The next question is from the line of Mayur Gathani from OHM group.

Mayur Gathani: Does the competition have a discounting model as you do or they are on a premium side?

Sunil Agrawal: In TV cum web space, I do not know of any player who is on discount model at this time. QVC, Home Shopping Network, Shop NBC, Ideal Shopping in US, UK they are all full service kind of Macy's etc. revenue kind of model, where they sell 3rd party brands predominantly for most of their revenue. They do some OEMs but they do not manufacture anything of themselves, they only source from 3rd parties.

Mayur Gathani: Does it worry you that tomorrow they might come out with the discounting model kind of a TV channel or a web model?

Sunil Agrawal: We do not worry for them as such because I will study other players; just say like an Airline industry. People try to open a separate discount division like South West and compete in South West, but none succeeded. So they reverted back to their full service model. Also, fact is that most of these channels are profitable and with good EBITDA. So there is no reason that they would want to change the model. So I do not fear from them but I do worry that there might come a new competitor tomorrow that we do not know of, like we came in the market. Somebody with the right thing in a right place in a right time with a right capital, right understanding, right team play, right team work and everything. It could happen, but we do not have visibility of any such competitors at this time, but you never know.

Mayur Gathani: But the key competitor advantage that you put forward is your cost. Is there anything else that you would also put up saying that 'No', we are a little ahead in this region as well?

Sunil Agrawal: We measure our organizational success for long term on four things. One thing is, our product understanding is deep at least I have been in business for 34 years. So we understand product deeply and we constantly innovate ourselves into new product categories, so the understanding we put this culture in whole of our operations to understand the product better. Second thing is to engage with the customers. I am not saying we are better than QVC or HSN to engage with the customer, but we are going towards engagement with the customer constantly and we are putting in many strategies or many promotions that has been new to the industry. Just example, we do sweepstakes few times a year when the winner will get the item delivered to them personally by The President of our respective channels. They travel there and we have a camera team go to their homes along with the President and then we publicize that on Facebook, on other social media as well as on our TV channels. We also started with free gift giving to top 40,000 to 50,000 customers, four times a year. That nobody does and has been received very well by our customers. The third thing is team engagement. We give a 'Stock' option, the setting of process to give shares as a profit share; a certain percentage of company, a certain percentage of profit will be given as shares to the employees of the company, like Walmart had done, putting those processes in place. So cost advantage, product understanding, customer engagement, and employee development, these are four areas we constantly look at.

Mayur Gathani: The onetime hit that we took for Quarter 1, they are more or less done with and we would not see that impact in Quarter 2?

Sunil Agrawal: Largely, yes.

Moderator: The next question is from the line of Aksh Vora from Praj Investments. .

Aksh Vora: How is the July month panning out with respect to the factors like the demand? How is the growth going for TV sales in this month, as of now?

Sunil Agrawal: TV sales are tracking better than last quarter. We cannot show the exact number, we are tracking better than last quarter.

Moderator: There are no further questions, so I now hand the conference over to the management for their closing comments.

Sunil Agrawal: Thank you everybody for participation. I will look forward to interacting further review in coming quarters. In the meantime, if you have any questions or queries, please feel free to talk, we will share with you at CDR or Hemant Sultania at your term.