Independent Equity Research

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Important disclosure on the last page

Vaibhav Global Ltd

Vaibhav Global Ltd (VGL) is a global electronic retailer of fashion jewellery, fashion accessories and lifestyle products with current presence mainly in USA & UK. After years of struggle, VGL zeroed on a right business model and turned around in FY11. It sells through its own TV shopping channels and internet shopping websites. VGL has just scratched the surface of the huge global electronic retail market.

DCF Value Rs.300 | **Current Price Rs.104** | **Potential 3x**

At current price, stock trades at 4x FY13E EPS and 2.6x expected EPS for FY15 with expected earnings growth of ~25% till FY15. Our fair value of Rs.300 is 9.4x FY114 EPS and 7.5x FY15 EPS. RoE is expected to be in the range of 27-31% with D/E falling from 1x in Mar-12 to 0.23x in Mar-15.

Key Data

Market Cap	Rs.332cr US$60mn
Shares Outstanding	3.17 cr
52 wk Hi-Lo	125 – 27
Avg Trading Vol	No. of shares
1 month	91,000
3 months	131,000
1 year	48,000
BSE Scrip Code	532156
BSE Group	T
NSE Code	VAIBHAVGEM
Shareholding %	**30SEP12**
Promoters	40.92
FIIs	19.92
Others	39.16
Valuation	**FY13E**
EV/ EBITDA	5.3x
Market Cap/Sales	0.36x
P/E	4.1x

Products

Fashion Jewellery, fashion accessories & lifestyle products through own TV shopping channels & internet shopping sites in US & UK.

Key Investment Points

- Electronic (TV & Internet) Retailing is a $65bn market in US & UK. Of this 15% is from sales of jewellery, accessories & lifestyle products that VGL sells. VGL currently has revenues of mere $135mn.
- Electronic retailing is growing in double digits there at a time when overall retail sales are hardly growing. Once consumer spending picks up in these markets, the growth can be much higher.
- VGL is a fully vertically integrated retailer with presence from being mine sight holder to manufacturer to direct to consumer retailer.
- VGL transformed itself from B2B player a few years back to completely B2C player now. Years of experience in procurement, manufacturing & selling to retailers provide it competitive edge in terms of efficient & cost effective supply chain.
- Asset light business model – no more investments in manufacturing. Now resorting to sub-contracting and outsourcing.
- Addition of product categories, geographical expansion, presence on additional channel distribution platforms and lower price points are additional growth drivers.
- High operating leverage & improvement in US economic conditions will help margins in the face of margin headwinds like low entry barriers & existence of exit barriers resulting in intense competitive activity.

Watch out for

- Rising competition due to low entry barriers and presence of exit barrier.
- VGL's ability to catch up with marketing & trend spotting strength of its entrenched competitors.
- Frequent clearance sale may be a sign of inventory sourcing not being in sync with fashion trends.

Introduction

Vaibhav Global Ltd (VGL), till recently known as Vaibhav Gems Ltd, has annual revenues of Rs.825cr and is the only Indian company through which one can invest in fast growing TV shopping retail business in developed markets of US & UK. VGL is a direct to consumer retailer of fashion jewellery, fashion accessories and lifestyle products through its own TV shopping channels and internet shopping sites in US and UK.

VGL markets and sells consumer products by means of a televised shopping program. VGL broadcasts live programs and uses hosts and hostesses to describe and demonstrate the products which can be purchased by viewers. VGL has its own studios in Austin-US and London.

It's vertically integrated from being a gemstone mine sight holder to manufacturer to wholesaler to retailer. It has been mainly into gemstone-studded jewellery, primarily made of silver, stainless steel, brass with gold plating. Lately, it forayed into lifestyle products like bags, scarves, i-phone/i-pad covers, etc.

Key Investment Point

Sustainable turnaround after years of losses

VGL started as a gemstone and jewellery wholesaler. It used to sell to retailers in the US and the UK including large departmental stores (Wal-mart, Macy's), speciality jewellery retailers (Zales), TV shopping networks (Argos, QVC). It was a completely B2B company. In FY06, it raised substantial equity funds. It acquired STS group of companies in the US. It invested heavily in a retail jewellery chain in the cruise route of Carrabin Islands and Alaska. As this brick & mortar retail chain did not succeed, the company incurred heavy losses there.

In addition, it had launched a German TV shopping channel, which was also closed later, as that was taking longer than expected to break-even. TV shopping channel business has to sustain substantial losses in initial few years. VGL's US TV channel lost $20mn in the first year of its operation. The company went through 3-4 years of critical customer building phase and turned around in FY11. The turnaround took longer due to the US sub-prime crisis. VGL is currently in the third year of profitable growth. It transitioned its business from high-value jewellery to low-value fashion jewellery and accessories to grow sales and customer base in a recession like environment. It resorted to outsourcing to reduce cost and improve time to market. All these contributed to the turnaround. VGL continues to strengthen each of these aspects.

Forward integration into electronic (TV & Internet) retailing

From FY07, VGL started forward integrating into retail with increasing focus on becoming a B2C player. Currently, over 90% of VGL's sales are B2C. Approximate 10% B2B business involves supplying to other TV shopping cahnnels like QVC, Shopnbc, and sterling.

The forward integration helped VGL turn profitable, make a brand for itself in the US and the UK consumer markets. VGL now has about a million registered customers in the US & UK. It now reaches out to 60mn homes out of 115mn US homes. QVC, the largest competitor, reaches out to 105mn homes. As VGL's channel is distributed through more & more platforms (cable & satellite TV carriers like DirecTV, FreeView, Comcast, DishTV, Roku, TimeWarner, Charter, OceanMedia, Cox, VerizonFios, Sky, freesat, VirginMedia), VGL's reach will enhance leading to enhanced sales. In UK, VGL has access to 31mn homes out of total 41mn.

Efficient supply chain & cost management are VGL's key strengths

Years of experience in gemstone procurement, processing, jewellery manufacturing & supplying to TV channels & other retailers in US & UK provides VGL with a unique competitive advantage. It has a much better understanding of the entire value-chain and claims to have the most efficient & cost effective supply chain. The full vertical integration not only offers cost advantage but reduced time to market. It is vertically integrated from being mine sight holder to consumer retailing.

It is one of the eight sight holders for the mining company Tanzanite One Ltd (TNZ.LS). TNZ has 50% access to all the production of Tanzanite gemstone. VGL is the largest buyer of tanzanite. VGL also participates in gemstone (precious & semi-precious) auctions in Singapore, Hong Kong, Thailand and India. This minimises cost of gemstone procurement.

It has its own processing & jewellery manufacturing at Jaipur. Besides, it gets jewellery manufactured from sub-contractors in India and China.

It also has a sizeable outsourcing operation wherein it buys ready merchandise from manufacturers in China, India, Bali and Thailand. VGL's years of experience in manufacturing helps it in negotiation with sub-contractors and in outsourcing. VGL has around 120 vendors in China, 10-15 in India, 40 in Indonesia and 60 in Thailand. VGL currently offers 65,000 SKUs.

Electronic retail offers huge opportunity space to VGL

The total jewellery market in US & UK is about $65bn and about 10% of this is via electronic commerce. The US & UK electronic retail market size for the company's product categories is about $11bn. VGL with sales of $135mn is a tiny player in this large and fast growing space. Even small incremental market share gain can offer VGL substantial growth. QVC (part of Liberty Interactive), the largest player, has sales of $9bn including $6bn from the US. HSN, another major player, has sales of over $2bn. Both QVC and HSN have much wider product portfolio than what VGL has. QVC & HSN gets 17-18% of revenues from jewellery and 25% from lifestyle products. VGL offers lowest price guarantee and has positioned itself as a discount retailer. This is a key competitive edge and will greatly help it gain market share.

Growing share of electronic (TV & Internet) channels in retail trade

Retail trade, especially in the US, continues to be sluggish with hardly any growth due to recession like condition there. However, electronic retail continues to grow in double digits gaining market share in the retail trade. We expect electronic channels to continue to gain retail market share due to a large number of advantages that electronic channels offer over traditional (brick & mortar) retail. Lower product prices, cost and time savings in commuting to market & from shop to shop, convenience of shopping from home, ease & convenience of comparing products & prices across retailers are some of the advantages that e-channels offer. E-retailing is a small percentage of the overall retail market and has a long way to go to gain a decent share.

Geographical expansion

VGL has recently expanded its reach to Canada & Mexico in addition to US & UK. This kind of geographical expansion also drives growth. VGL has the option to replicate its business model in many other developed countries after it achieved reasonable market share in existing markets. In fact, e-retailing is slowly catching up in developing countries too.

Shift to low-priced items driving growth

The average selling price (ASP) per item has been coming down over the years, as the company has been witnessing higher sale of low-priced items. As the company sells discretionary items and its key market US is in recession like condition, low-priced items are likely to sell more and company has been offering more such low-priced products in line with demand. VGL has also shifted focus away from high-value precious jewellery to low-value fashion jewellery. ASP in the US has come down from $53 in FY10 to $19 in H1FY13. Similarly, ASP In the UK has come down from $115 in FY10 to $31 in H1FY13. In fact, this lowering of the price points was a key factor that contributed to the company’s turnaround. ASP for QVC and Shopnbc is $45 and $100 respectively. The lower ASP is likely to help VGL grow faster than competitors. However, the company has launched a second channel in UK (TJC-Gold) to refocus on fine jewellery. This will utilise free hours available on one of the existing distribution platforms and not entail additional investment.

Addition of product categories to drive growth

Lately VGL entered lifestyle products (hand bags, phone covers, scarves, artefacts) category as well besides jewellery & accessories. Lifestyle products market size is much bigger than that of jewellery. Currently, lifestyle products contribute less than 10% to VGL sales. VGL plans to take it to 50% in two years. Lifestyle products category encompasses a very large number of products and hence offers scope for faster growth.

Asset light business model

VGL does not intend to invest further in manufacturing facilities except for maintenance capex. For its growing requirements, it has entered into sub-contracting arrangements in India and China. It also procures ready merchandise from China, Thailand, India and Indonesia. Share of sub-contracting & outsourcing will keep rising, as the company maintains its own manufacturing at the existing level. While the company owns its existing studios in the US and UK, it will take on lease any further requirement of studios and warehouses. It recently expanded its warehousing space from 15,000 sf to 50,000 sf by taking additional space on lease. Minimal capex is required for storage, work stations and equipments in the warehouse.

VGL may strengthen internet shopping inorganically

While VGL has made a reasonably strong presence in TV channel space, it is yet to achieve meaningful presence in internet shopping space. Currently only 10% of the retail sales come from internet sites (www.liquidationchannel.com and www.thejewellerychannel.tv). VGL may invest to grow this part of the business inorganically.

Ability to sustain losses in initial years acts as an entry barrier

As mentioned earlier, VGL had to incur $20mn loss in the 1st year of operation in the US channel. The nature of the business is such that it takes time to build a critical customer base. Hence, any serious player has to sustain losses of $40-50mn in initial years to find a foothold in this space. This acts as an entry barrier in this space. We recognise that this is not a very strong entry barrier, as there are entrepreneurs with deep pockets and private equity players have been funding such ventures.

Margin Levers

VGL has high operating leverage due to high fixed costs. Material cost and call centre charges are major variable costs. Other cost items are fixed or semi-fixed. As volume grows, there will be margin expansion due to operating leverage. Currently, the benefit of operating leverage is not visible due to content & broadcasting cost (CBC) rising faster than revenues. CBC, at 19-20% of revenues, is the biggest cost item for VGL. However, this should stabilise once the company has reasonable presence on most major TV distribution platforms. Such stabilisation will give a significant boost to margins.

US is still in recession like condition with overall retail sales hardly growing. With pick up in overall consumer spending and retail sales in US, we expect both higher volume growth and up-trading in terms of average product price. These will be positive for the company's margins. We have built-in improved consumer spending in the US from FY15.

VGL focuses on maximising per household revenues and maximising gross margin/airtime minute to maximise profits as households and airtime are limited.

These margin levers may enable company to weather margin pressure due to competition, slowdown, and/or inventory clearance.

Risks/Concerns:

VGL needs to catch up with marketing & trend understandings of its large competitors

Large & well entrenched competitors like QVC, HSN, Argos, ShopNBC are stronger than VGL in marketing and trend spotting. Besides efficient & cost-effective supply chain, marketing & trend understanding are also important success factors in this business. VGL hires services of trend spotting companies that guide the company on likely fashion trends (colours, patterns, material, etc) 3-6 months ahead. VGL also invites buyers for live product evaluations. Procurement and manufacturing of merchandise is based on spotting & understanding of such trends. To be in market with in-fashion merchandise in-time is critical.

Exit barrier and lack of strong entry barrier

As mentioned earlier, ability to withstand substantial initial losses is an entry barrier but not too strong an entry barrier. Gems TV US, a close competitor of VGL, closed down a few years back. Gems TV UK was sold to another competitor in the UK. Now Gems TV has re-entered the US market as Rocks TV.

There exists an exit barrier in the form of contractual arrangements with TV carriers (channel distributors). TV channels have to enter into a multi-year (three years or higher) contracts with them. There are normally substantial pay-outs involved for early termination. This acts as an exit barrier for TV channels. In the event of low profitability, players will strive to be there instead of exiting. VGL had outstanding guarantees of Rs.155cr as on 31MAR12. Bulk of this is to TV carriers for fulfilment of multi-year contracts. TV channels, especially less established ones, are dependent on TV carriers (cable & DTH) to carry their channels to homes.

This combination of lack of strong entry barrier and presence of an exit barrier is potentially detrimental for margins. Margin pressure is likely to be visible during slowdown and periods of heightened competition.

Wrong call on likely fashion trends may suppress margins significantly

As we mentioned earlier, spotting & understanding upcoming fashion trends is a critical success factor. If the company ends up creating inventory of merchandise that is not in sync with fashion trend of the time, then it may be saddled with non-moving and/or slow-moving inventory. The company will then be required to liquidate such inventory at discounted prices leading to suppressed margin during the period of such liquidation. VGL runs a liquidation day on one Thursday in a month to liquidate such inventories. It ran a clearance sale during QE Sep-12 to clear such inventories leading to substantially reduced EBITDA margin of 6% for QE Sep-12 as against 16.5% for QE Jun-12.

Dependence on channel surfing habit of TV viewers

VGL does not advertise its channel. Consumers reach its channel by way of channel surfing. There are about 800 channels in the US. The chance that a TV channel surfer will reach its channel, stop there for a while and make a purchase appear very low. The company is heavily dependent on channel surfing habit of TV viewers. There are consumers who purposely reach out to TV shopping channels with the intention of purchasing. However, the growth in consumers is largely going to come from conversion of surfers into customers. This does not appear an easy task. Yet, the company has achieved annual sales of $135mn with about a million registered customers. VGL has also been successful in making them buy repeatedly with average eight purchases per customer in FY12 and this is up from 6.5 in FY11. VGL introduces 50 new SKUs every day to make customers keep coming.

Such dependence on surfers may also impact margins in times when other channels are able to attract and hold attention of viewers. For example, during recent US elections and hurricane sandy, news channels had a much higher share of viewers' time. This adversely impacted time spent by viewers on the company's channel. As a result, the company pushed sales of special value items leading to likely lower margin. Therefore, we once again expect lower EBITDA margin in QE Dec-12.

Seasonality

VGL's business is seasonal. Bulk of the sales takes place around special occasions like Christmas, New Year, Valentine's Day, etc. As a result, QE Dec tend to be the best, followed by QE Mar and QE Jun. QE Sep tend to be the lean season. Such seasonal volatility leads to volatility in earnings and may lead to volatility in stock price too.

Impaired Goodwill

VGL's consolidated balance sheet carries Rs.180cr of goodwill, which was relates to acquisition of STS group of companies. As current cash flows are mainly from self created business of TV channels, the goodwill of Rs.180cr appears impaired and recognition of this impairment loss will hit reported profits, as impairment losses are required to be recognised in P&L account as per AS-28. As the recognition of impairment loss does not change business dynamics or future cash flows, it does not have any impact on fair value estimate. Hence, this should normally be shrugged off as a one-time extra-ordinary/exceptional item. However, reported lower profits or losses due to the impairment recognition may cause stock price volatility.

Management & Ownership

Promoters owned 41% in VGL as on 30SEP12. Executive chairman Sunil Agrawal controls around 32% and Managing Director Rahimullah and director Nirmal Bardiya control around 4.5% each. FIIs held around 20% as on 30SEP12. Of this ~13% was held by Nalanda India Fund and ~7% by FID Fund. FID Fund has been selling its stake lately. As executive chairman, Sunil Agrawal continues to lead the management team which includes professionals at key positions especially in US & UK. Sunil Agrawal is an MBA from Columbia University and a first generation entrepreneur, who established VGL in 1980. MD Rahimullah has 38 years of experience in sourcing rough stones and in gemstones business.

Valuation

There is no comparable company in India. Global TV shopping networks like QVC (LINTA.US), HSN (HSNI.US) and Argos (HOME.LN) are currently trading at around 20x CY12 earnings. We valued VGL using DCF method and our modelling takes into account its smaller size, competitive advantages & disadvantages, industry & company specific risk factors enumerated above.

VGL currently trades at mere 4x FY13 earnings. Our model values the company at ~12x FY13 earnings. VGL is currently trading at 80% discount to global TV channel retailers. Even at our fair value, VGL will trade at 40% discount to them.

Financials

Income Statement

Rs. Cr.	FY12	FY13E	FY14E
Net Revenues	656	918	1102
EBIT	76	94	115
PBT	69	82	105
PAT-Adj.	63	81	102
EPS Rupees	19.81	25.55	32.16

Ratios

%	FY12	FY13E	FY14E
Revenue Gr%	22.1	40.0	20.0
EPS Growth %	79.5	29.0	25.9
RoE %	32.8	30.9	28.7
D/E x	1.01	0.68	0.39
Debtors Days	21	21	21
Creditors Days	74	74	74
RM Days	238	238	238
FG Days	136	136	136
WIP Days	4	4	4

Balance Sheets

Rs. Cr.	31Mar12	31Mar13	31Mar14
Assets			
Net Block	23	24	24
CWIP	1	-	-
Goodwill	180	180	180
Net Curr. Assets	228	303	361
Investments	13	-	-
Liabilities			
Equity Capital	32	32	32
Reserves	190	271	375
Pref Sh Capital	44	44	-
Debt	179	160	158

Interim Performance

Rs.Cr.	Dec11	Mar12	Jun12	Sep12
Months	**3**	**3**	**3**	**3**
Revenues	206	192	204	222
EBITDA	30	28	34	13
EBITDA+fx adj	39	28	36	14
EBIT	37	26	33	12
PBT	33	22	30	8
PAT-Adjusted	31	25	28	7
Eq Capital	31.7	31.7	31.7	31.7
1% Pref Cap	44	44	44	44
EPS Rs.	9.46	7.55	8.54	1.87
EBIT Margin %	17.8	13.4	16.3	5.2
Other income/PBT %	-	-	-	-
Tax/PBT %	6.6	-13.3	5.1	14.6
RM/Sales%	36.7	31.6	29.4	34.9
Staff cost/sales	11.9	14.8	13.3	16.5
Overheads/sales	36.7	39.2	40.7	42.6

Multiple Valuation

	FY12	FY13E	FY14E
EV/EBITDA x	6.5	5.3	4.4
EV/EBIT x	7.3	5.9	4.8
Mkt. Cap/Sales x	0.51	0.36	0.30
P/E x	5.3	4.1	3.3
Price/Book x	1.5	1.1	0.8

Free Cash Flow

Rs. Cr.	FY12	FY13E	FY14E
NOPLAT	68	94	114
Change in Net Working Capital	44	75	58
Operating Cash Flows	**24**	**18**	**56**
Net Capex & others	-2	-	-
Free Cash Flow	**26**	**18**	**56**
Non-opr. Cash flow	8	1	2
Cash Flow to Investors	**34**	**19**	**59**

Financing Cash Flow

Rs. Cr.	FY12	FY13E	FY14E
Post-tax Interest	14	13	12
Repayment/ (issue) of Debt	23	18	2
Pref Sh Dividend	-	-	2
Pref Sh Redemption	-	-	44
Equity Share Dividend	-	-	-
Equity Buyback/(issue)	-	-	-
Inc / (Dec) in surplus cash/Investments	-4	-13	-2
Financing Cash Flow	**34**	**19**	**59**

DCF Valuation

Key Assumptions	%
Terminal Growth Rate	2.5
WACC	14.4
Cost of Equity	16.6
Terminal ROIC	17.4
Outcome	**Rs.**
Fair Value Per Share (Rs.)	**300**

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