Lovable Lingerie Ltd. - IPO Note

Issue Details	
Issue Date	March 08, 2011 – March 11, 2011
Issue Size	Rs.887-933mn
Price Band	Rs.195-205
FV	Rs.10
Fresh Issue	4.55 mn equity shares
QIB	50 %
Non Institutional/HNIs	15 %
Retail	35%
Equity shares prior to issue	12.25 mn equity shares
Equity shares post issue	16.8 mn equity shares
Post issue market capitalization	Rs. 3.4bn
IPO Rating	Grade 3 by CARE
Lot size	30 equity shares and multiples thereof
Issue Manager	Anand Rathi Advisors Ltd.
Registrar to the issue	Link Intime India Pvt. Ltd.

Note: The company has allotted one million equity shares to SCI Growth Investments for Rs. 200 per share pursuant to a Pre –IPO Placement through a board resolution

Objects of the issue

Particulars	Rs. in mn
Setting up of manufacturing facility to create additional capacity at Bengaluru	228.4
Expenses to be incurred on brand building	180
Brand development expenses for its brand – 'College Style'	60
Investment in Joint Venture	250
Setting up of Exclusive Brand Outlets (EBOs)	141.2
Setting up of retail store modules for 'shop-in-shop'	36.1
Up gradation of design studios	75.9
Total	**971.6**

Source: RHP, Ajcon Research

About the company

Incorporated in the year 1987, it is one of India's leading women's innerwear manufacturers. The company's product range includes brassieres, panties, slips / camisoles, homewear, shapewear, foundation garments and sleepwear products.

On December 26, 1995, Lovable was licensed the brand "*Lovable*" from Lovable World Trading Company, USA. Subsequently, by an agreement dated December 23, 2000, the company acquired the brand "*Lovable*" from Lovable World Trading Company, USA on an exclusive basis for the territories of India, Nepal, Sikkim and Bhutan**.**

The innerwear products manufactured under the brand "*Lovable*" cater to the premium segment market in India. *"Lovable"* and *"Daisy Dee"* are its flagship brands. Its brand *"Lovable"* is amongst the top three most preferred brand in women's innerwear in India *(Source: CARE Report).*

It has diversified its portfolio of brands and acquired brands like "*Daisy Dee*" from Maxwell Industries Limited to cater the mid segment market in India and also acquired the brand "*College Style*" from Levitus Trading Limited, Hong Kong to cater to the young segment of India.

The company has also in the past marketed the "*Vanity Fair*" brand of women's innerwear garments, which was licensed from VF Corporation Inc., USA. The company's core competency lies in understanding the prevailing trends in the women's innerwear market and the buying preferences of its customers and accordingly manufacturing quality innerwear garments to assure its customers of product quality and fit consistency in trendy women's innerwear.

In addition, the company's competency also lies in identifying the gaps and foraying into the untapped women's innerwear market segments with unique products. In the year 1995, the company identified that the Indian market was developing and there was potential for launching and sustaining a premium women's innerwear brand and pursuant to a license agreement with Lovable World Trading Company, USA ("LWTC"), it acquired the technical expertise for producing international standard innerwear for women.

It has its design studio since 1996. It was started and managed by its designers who were trained in the women's innerwear design at Lovable USA's studio in Atlanta.

Key positives

1) **Globally successful brand:** *"Lovable"* is an 85 years old brand with global presence. The company had introduced the international "*Lovable*" brand in the Indian market and making it amongst the top three most preferred brand in women's innerwear in India *(Source: CARE Report)*. The company presently commands 20% share in the Indian lingerie market.

2) **Strong distribution capabilities:** The company's distribution channel is one of its key strengths. The products are retailed through 103 distributors in India. These distributors are segmented geographically and also on the basis of the product range ("*Lovable*" and

"*DaisyDee*" being the key segments). It caters to approximately 1,425 retail outlets for its "*Lovable*" brand and its distributors cater to approximately 7,500 retail outlets for its "*Daisy Dee*" brand. Retail outlets selling its products can be categorized in the following three (03) formats:

a) Chain stores i.e. large format stores ("LFS");
b) Multi Brand Lingerie Outlets ("MBOs"); and
c) Hosiery products / innerwear stores.

Women's innerwear in India is largely sold through the MBOs, hosiery products outlets and LFS. Management believes that it has an entrenched and a strong presence in MBOs and LFS serviced through its distributors or directly from its warehouses.

3) **Strong industry fundamentals, impressive past performance:** The lingerie industry in India is characterized by a high degree of fragmentation with almost two-third of the market controlled by the unbranded and unorganized regional players and the balance one-third share goes to the few big organized and branded players. The advent of some international brands in the Indian market place has brought about some realignment in the fragmented lingerie market. The companies have started advertising boldly through advertisements, fashion shows etc., to catch up with the consumers to understand their preferences.

The lingerie market grew at a faster pace in terms of value as compared to volumes during the 2006-2009 period. This signifies a jump in the average selling price which grew from Rs. 100 in 2006 to Rs. 121 in 2009. The lingerie segment witnessed a CAGR of 6.7 % during the same period.

The company caters to women's lingerie segment, in premium and super premium segment. With increasing urbanization and rising women workforce, brand awareness would tend to rise, leading to higher demand for company's branded products. According to rating agency, CARE, premium segment and super premium segment is expected to grow at a CAGR of 33% for the next 3-4 years. Lovable Lingerie has witnessed revenue CAGR of 30% and registered earnings CAGR of 38% over FY06-10. We believe, the company would be able to cash on the changing mindset of Indian women towards branded lingerie.

3) **Healthy return ratio, virtually debt free company:** The company has generated ROE of over 40% (four times out of last five years) which is a good sign for value investors. It has virtually no debt in its books, providing no burden to profit and loss account in terms of interest outgo. We believe, this trend would continue has company its constantly improving its product mix and making efforts to concentrate on branded lingerie products which will yield higher margin for the company.

4) **Efficient working capital cycle, positive operating cashflow** Company's cash conversion cycle has reduced significantly by more than 50% to touch 34 days in FY10. Overall working capital cycle has improved from 92 days in FY06 to 34 days in FY10. This was mainly on account of reduction in inventory cycle by 51 days over the period of 4 years to touch 55 days in FY10. The above factor has resulted in company enjoying positive cashflow at the operating level in the last four years.

Key risks

a) The company operates in a single product segment as compared to players like Page Industries which operate in multi product segment.

b) It faces competition from key players like Page Industries, Triumph and Enamor in lingerie segment.

c) Debtor days have significantly increased from 57 days in FY10 to 73 days (9MFY11) which may put pressure on company's working capital requirement.

Financials

Income Statement (Rs. in mn.)

Particulars	FY06	FY07	FY08	FY09	FY10	9MFY11
Total Income	**307**	**415**	**601**	**692**	**870**	**881**
Operating Profit	**51**	**55**	**74**	**85**	**161**	**167**
Other Income	1	-	1	1	1	9
EBITDA	**52**	**55**	**75**	**86**	**163**	**175**
Depreciation	(2)	(2)	(3)	(4)	(13)	(10)
Interest	(6)	(2)	(6)	(14)	(9)	(4)
Excp. items	-	-	-	(32)	-	-
PBT	**44**	**51**	**66**	**36**	**140**	**161**
Tax	(15)	(17)	(24)	(8)	(34)	(34)
PAT	**29**	**34**	**42**	**28**	**106**	**127**
EPS*	**1.7**	**2**	**2.5**	**1.7**	**6.3**	**10#**
P/E(x)*	**118**	**102**	**82**	**118**	**33**	**21**

Source: RHP, Ajcon Research

Note: EPS is calculated on post FPO equity, P/E taken on upper price band of Rs.205 per share, #annualized EPS

Balance Sheet (Rs. in mn.)

Particulars	FY06	FY07	FY08	FY09	FY10	9MFY11
Sources of Funds						
Equity Capital	5	5	15	15	75	113
Reserves	55	66	105	132	169	257
11% Re. Cum. Pref. shares	5	5	-	-	-	-
Borrowings	45	63	70	64	3	3
Deferred Tax Liability	-	-	-	5	9	11
Total	**110**	**139**	**190**	**216**	**256**	**384**
Application of Funds						
Net Fixed Assets	27	31	36	132	128	126
Investments	-	-	10	10	20	-
Net Current Assets (excl. cash)	78	93	125	57	82	237
Cash	5	15	19	17	26	21
Total	**110**	**139**	**190**	**216**	**256**	**384**

Source: RHP, Ajcon Research

Cash Flow Statement (Rs. in mn.)

Particulars	FY06	FY07	FY08	FY09	FY10
Profit before Tax	45	51	66	37	140
Operating Cash flow	29.7	4.2	34.2	121.6	96.9
Investing Cash flow	(7.5)	(6.3)	(17.2)	(101.9)	(16.1)
Financing Cash Flow	(21.4)	12.3	(12.7)	(22.2)	(71.7)
Net Increase in Cash	0.8	10.2	4.3	(2.5)	9.1
Opening Cash balance	3.7	4.5	14.7	19	16.5
Closing Cash balance	4.5	14.7	19	16.5	25.6

Source: RHP, Ajcon Research

Ratio Analysis

Particulars	FY06	FY07	FY08	FY09	FY10	9MFY11
OPM (%)	16.7	13.3	12.3	12.2	18.6	18.9
NPM (%)	9.5	8.2	7	4.2	12.1	14.3
ROE (%)	49.1	48.1	35	41.3	43.3	34.1
Net Debt/Equity(x)	0.7	0.7	0.4	0.3	(0.1)	(0.1)
Debtor days	52	48	37	46	57	73
Inventory days	106	116	101	71	55	59
Creditor days	74	76	86	134	78	-

Source: RHP, Ajcon Research

VALUATION AND RECOMMENDATION

At the upper end of the price band of Rs.205 per share, the stock is valued at 21x at 9MFY11 annualized EPS on post issue equity which is at a discount to its immediate peer Page Industries Ltd which is trading at a P/E of 28x on 9MFY11 annualized EPS.

With due consideration to factors like a) globally successful brand, b) strong industry fundamentals, c) impressive revenue CAGR of 30% and earnings CAGR of 38% over the last four years, d) CARE rating of 3, indicating average fundamentals; we believe the fundamentals of the company are sound. However, considering the secondary market conditions, we recommend **'AVOID'** to the issue as there is a possibility stock trading at a discount, post listing.

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