Sharekhan
by BNP PARIBAS

Kewal Kiran Clothing

Mixed quarter

Sector: Consumer Discretionary
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 1,000**	
Price Target: **Rs. 1,155**	↔

↑ Upgrade ↔ No change ↓ Downgrade

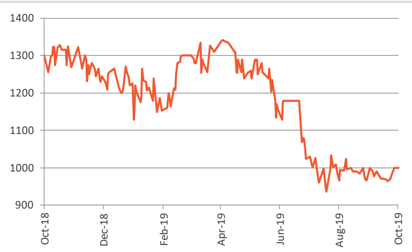
Company details

Market cap:	Rs. 1,233 cr
52-week high/low:	Rs. 1425/925
NSE volume: (No of shares)	620 lakh
BSE code:	532732
NSE code:	KKCL
Sharekhan code:	KKCL
Free float: (No of shares)	0.3 cr

Shareholding (%)

Promoters	74.3
FII	9.5
DII	11.8
Others	4.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.9	-2.3	-21.8	-21.8
Relative to Sensex	-1.5	-4.9	-23.1	-32.4

Sharekhan Research, Bloomberg

Revenue grew by 9.5% y-o-y, as volumes and realisations each rose ~4% and the core brand Killer clocked strong sales growth. However, gross margins plunged by 473 bps owing to a rise in cost of goods sold, higher discounts and trade margins. The management expects gross margins to stabilise in the coming quarters. Consumer demand is yet to recover, while primary sales (from company to trade-channels/retail partners) are affected by liquidity crisis. Hence, KKCL is expected to end FY2020 with high single-digit revenue growth. The company is organising trade fairs, offering margins to selective trade partners and boosting promotional activities to improve revenue growth in the near to medium term. It is confident of maintaining OPM above 20% for 2-3 years and maintaining working capital cycle at around 120 days. Any significant improvement in revenue growth would be a key re-rating trigger. We maintain our Hold rating with an unchanged price target (PT) of Rs. 1,155.

Key positives

- Revenue grew 9.5%, driven by volume and realisation growth, beating our expectation of 4%.
- Core brand Killer clocked strong sales growth of 24.2% y-o-y, while Easies grew by 11.4% y-o-y.
- Impact of implementation of Ind AS 116 on PAT was negligible as majority of stores are franchisee owned, franchisee operated (FOFO)

Key negatives

- A rise in cost of goods sold, discounts and trade margins affected gross margins, which along with higher selling expenses affected the operating performance of the company.
- Integriti and Lawman reported a weak quarter with a steep decline in revenue growth.

Our Call

Valuation: We have broadly maintained our earnings estimates for FY2020/21 to factor in lower than earlier expected operating margins which will be set-off by a lower corporate tax rate of 25.2%, keeping PAT estimates largely unchanged. We expect KKCL's volume growth to recover gradually, propelled by a turnaround in performance of core brands and higher investments on promotional activities (especially in H2FY2020 supported by the festive season). The stock is currently trading at 7.3x its FY2021E EV/EBIDTA, at a discount to its historical trading multiple. We maintain our Hold rating with an unchanged PT of Rs. 1,155.

Key Risks

- Slowdown in consumption and heightened competition would affect sales in the near term.
- Surge in working capital requirements would affect cash flows in the backdrop of muted operating performance.

Valuations (Standalone) Rs cr

Particulars	FY17	FY18	FY19	FY20E	FY21E
Revenues	477	460	502	557	630
OPM (%)	20.7	21.3	22.4	21.5	21.7
Adjusted PAT	75	73	80	93	105
% YoY growth	*9.8*	*-1.8*	*9.7*	*15.7*	*12.5*
Adjusted EPS (Rs.)	60.5	59.4	65.1	75.3	84.8
P/E (x)	16.5	16.8	15.4	13.3	11.8
P/B (x)	3.3	3.1	2.9	2.6	2.4
EV/EBIDTA (x)	10.1	10.0	9.2	8.3	7.3
RoNW (%)	22.2	18.9	19.3	20.6	21.0
RoCE (%)	19.3	17.3	16.9	16.0	16.6

Source: Company; Sharekhan estimates

Volumes and realisations drive up revenue; higher selling expenses hurt margins: Revenue grew by 9.5% y-o-y to Rs. 166.7 crore (slightly better than our expectation) led by a ~4% growth each in volumes and realisations. Apparel sales stood at 13 lakh units in Q2FY2020, as against 12.5 lakh units in Q2FY2019, while realisations improved to Rs. 950 a unit from Rs 911 a unit during the same period. Gross margins declined 473 bps to 58.3%, mainly owing to additional trade discounts given to intermediary channel partners and higher cost of goods sold. These, along with higher advertisement and selling expenses dragged down OPM by 874 bps to 22.7%. Operating profit decreased by 21% y-o-y to Rs. 37.8 crore. Q2FY2020 was the fourth consecutive quarter where selling expenditure as a percentage of sales remained high at 17% as against 9.8% in Q2FY2019. This is positive as the company continues to invest on brands for a better future. Higher interest costs and depreciation affected the Profit before tax (PBT) by ~20% which came in at Rs. 39.5 crore. However, a lower effective tax rate limited the decline in reported PAT to ~6% y-o-y, which stood at Rs. 31.6 crore. The effect of a change in accounting standards to Ind AS-116 was negligible at Rs. 5.7 lakh as most of the company's stores are franchisee stores.

Killer clocks strong revenue growth; Lawman yet to recover: KKCL's flagship brand Killer (68% of overall sales) saw revenue grow by 24.2% to Rs. 112 crore. Integriti, being the second-largest brand with a 13% revenue share saw revenue decline by 27.8% y-o-y whereas Lawman registered a decline of 17.2% y-o-y. Easies sustained its market share with a revenue growth of 11.4% y-o-y. In terms of product mix, though jeans remain dominant with a share of 58%, shirts and trousers outperformed this quarter, growing by 18% each in Q2FY2020. Jeans revenue stood flat at Rs. 95.8 crore. Revenue from National Chain Stores (large format stores) and factory outlets grew strongly by 46% and 54% respectively, whereas Multi-brand outlets (MBOs) continue to remain the dominant channel registering a 7% growth in sales. Retail (K-Lounge) and e-commerce channels had a subdued quarter. East continues to be the major revenue contributing region for the company with 39% revenue share, However, North is the fastest growing region with 28% growth y-o-y.

Other key highlights

- Working capital cycle increased by 12 days in the six months ended H1FY2020 to 128 days, mainly on account of a 15-day increase in debtors; inventory cycle was stable at 50 days and creditor cycle improved to 45 days.
- Despite an increase in working capital requirements, the company had an adequate cash balance of Rs. 56.8 crore. The debt/equity ratio remains negligible at 0.2x.
- Return ratios remained in double digits, with RoE and RoCE standing at 10% and 11.6% respectively.
- The reduction in the tax rate to 25.2% (from ~33% earlier) would cushion the bottomline in a declining margin environment.

Result Snapshot (Standalone) Rs cr

Particulars	Q2FY20	Q2FY19	y-o-y (%)	Q1FY20	q-o-q (%)
Net revenue	166.7	152.3	9.5	110.2	51.2
Cost of goods sold	69.5	56.3	23.5	41.1	69.1
Staff cost	19.1	19.7	-2.8	15.3	24.8
Selling & Administrative Expenses	28.3	14.9	89.6	23.5	20.3
Other expenses	11.9	13.5	-11.8	7.8	53.5
Operating profit	37.8	47.8	-21.0	22.5	68.1
Other income	6.4	4.7	35.9	1.8	261.8
Interest	2.3	1.6	44.4	2.2	6.4
Depreciation	2.4	1.7	37.9	2.4	-0.8
Profit before tax	39.5	49.2	-19.8	19.6	101.1
Tax	7.9	15.6	-49.5	5.5	43.9
Reported PAT	31.6	33.6	-5.9	14.1	123.3
EPS (Rs.)	25.6	27.2	-5.9	11.5	123.3
			BPS		**BPS**
GPM (%)	58.3	63.0	-473	62.7	-440
OPM (%)	22.7	31.4	-874	20.4	228

Source: Company; Sharekhan Research

Brand-wise revenue (Standalone) Rs cr

Particulars	Q2FY20	Q2FY19	Y-o-Y (%)
Killer	112.0	90.2	24.2
Integriti	22.1	30.6	-27.8
Lawman	13.1	15.8	-17.2
Easies	8.0	7.2	11.4
Others	10.2	6.6	54.5
Total	**165.4**	**150.4**	**10.0**

Source: Company; Sharekhan Research

Channel-wise revenue (Standalone) Rs cr

Channel wise Revenue break-up	Q2FY20	Q2FY19	Y-o-Y (%)
MBO	70.7	66.1	7.0
Retail (K- Lounge)	28.7	32.5	-11.7
National Chain Stores (LFS)	39.5	27.1	45.8
Factory outlet	9.6	6.2	54.3
Exports	3.6	4.1	-13.0
E-commerce	13.3	14.3	-7.1
Total	**165.4**	**150.4**	**10.0**

Source: Company; Sharekhan Research

Break-up of stores Rs cr

Particulars	COCO	COMFO	FOFO	Total
K-Lounge	2	9	192	203
EBO	0	0	118	118
Factory Outlet	0	1	0	1
Total	**2**	**10**	**310**	**322**

Source: Company

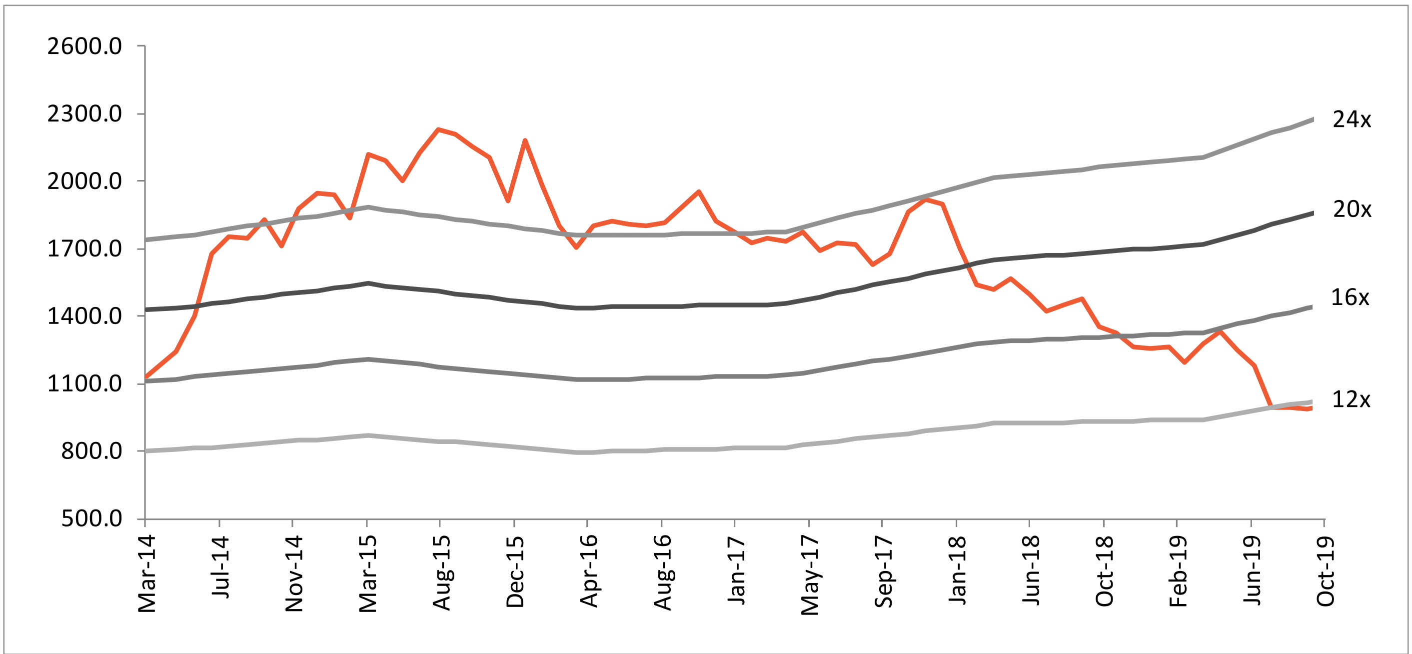
Outlook

H1FY2020 performance was decent with ~7% revenue growth and OPM of 21.8%. Q3FY2020 is expected to be slightly better due to festive season sales but a stark improvement in revenue growth will take some time owing to a domestic liquidity crisis. The management expects high-single digit revenue growth for FY2020. Further, higher investments on brand and promotional activities would provide desired results in the coming quarters. OPM is expected to stay above 20% for FY2020. Working capital cycle is expected to remain stable at around 120 days despite a rise in promotional activities.

Valuation

We have broadly maintained our earnings estimates for FY2020/21 to factor in lower than earlier expected operating margins which will be set-off by a lower corporate tax rate of 25.2%, keeping PAT estimates largely unchanged. We expect KKCL's volume growth to recover gradually, propelled by a turnaround in performance of core brands and higher investments on promotional activities (especially in H2FY2020 supported by the festive season). The stock is currently trading at 7.3x its FY2021E EV/EBIDTA, at a discount to its historical trading multiple. We maintain our Hold rating with an unchanged PT of Rs. 1,155.

One forward EV/EBIDTA (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Arvind	4.5	5.2	4.7	4.6	4.8	4.7	7.1	6.4	6.5
Raymond	21.9	16.2	12.9	9.5	8.1	7.2	10.5	12.0	13.3
Kewal Kiran Clothing	15.4	14.0	12.5	9.3	8.1	7.1	16.9	16.8	17.4

Source: Company, Sharekhan estimates

About company

Kewal Kiran Clothing Limited (KKCL) is one of India's largest branded apparel manufacturers, engaged in designing, manufacturing and marketing of branded jeans and a wide range of western wear, since 1992. With in-house fashion brands Killer, Integriti, Lawman, Easies, K-Lounge and Addictions, it has created a niche segment for apparel and accessory lovers across India. Jeans constitute around 60% of overall sales followed by shirts and t-shirts. The company has a pan-India presence with close to 341 stores. It operates through both brick-and-mortar retail stores and an e-commerce platform.

Investment theme

KKCL is one of the strong plays in the domestic branded apparels market with strong forte in the jeans category. It has one of the best balance sheets in the retail space with stable working capital requirement, strong cash flow generation and no-debt on books. The company has recently started spending heavily on brands and positive result of the same would be seen in the coming quarters.

Key Risks

- Slowdown in consumption and heightened competition would affect sales in the near term.
- Surge in working capital requirements would affect cash flows in the backdrop of muted operating performance.

Additional Data

Key management personnel

Kewalchand P. Jain	Chairman and Managing Director
Bhavin D. Sheth	Chief Financial Officer
Abhijit B. Warange	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Jain Shantaben P	49.9
2	Nalanda India Fund Ltd	7.1
3	Jain Dinesh Pukhraj	6.1
4	Jain Vikas Pukhraj	6.0
5	Jain Hemant P	5.7
6	Jain Kewalchand Pukhraj	5.7
7	SBI Funds Management Pvt Ltd	5.6
8	Kotak Mahindra Asset Management Co	3.9
9	Aditya Birla Sun Life Trustee Co	2.0
10	Pinebridge Investments LP	1.5

Source: Bloomberg

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