Sharekhan
by BNP PARIBAS

# Relaxo Footwears

## Strong quarter; margins expand steadily

**Sector: Consumer Discretionary**
**Result Update**

| | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 721** | |
| Price Target: **Rs. 845** | ↑ |

↑ Upgrade ↔ No change ↓ Downgrade

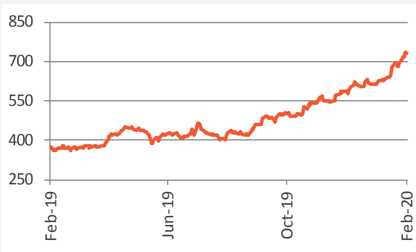
### Company details

| | |
|---|---|
| Market cap: | Rs. 17,899 cr |
| 52-week high/low: | Rs. 754/344 |
| NSE volume: (No of shares) | 1.4 lakh |
| BSE code: | 530517 |
| NSE code: | RELAXO |
| Sharekhan code: | RELAXO |
| Free float: (No of shares) | 7.2 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 71.0 |
| FII | 3.6 |
| DII | 6.3 |
| Others | 19.2 |

### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 19.7 | 35.0 | 76.1 | 101.2 |
| Relative to Sensex | 21.3 | 33.0 | 61.7 | 77.1 |

*Sharekhan Research, Bloomberg*

**Relaxo Footwears' (Relaxo's) Q3FY2020 reported numbers are not comparable y-o-y due to implementation of Ind-AS 116. Revenue grew by ~9% y-o-y driven by premiumisation. Benign raw material prices and a favourable revenue mix helped gross margins expand by 504 bps whereas cost efficiencies drove up comparable operating margins by ~180 bps to 15%. Reported PAT grew by ~52% y-o-y aided by strong operating performance and a lower corporate tax rate. Implementation of Ind-AS 116 impacted profit before tax by Rs. 2.2 crore. The government hiked customs duty on footwear in the Union Budget to 35% from 25% currently, which will augur well for domestic footwear players such as Relaxo in the near to medium term. Numbers were robust amid a slow discretionary environment and going ahead, operating performance is likely to remain steady, backed by steady volume growth and premiumisation strategies. We expect reported OPM to come in at 16.5% in FY2020 aided by benign raw material prices and operating efficiencies.**

### Key positives

- Revenue grew by ~9% y-o-y to Rs. 600 crore, in line with ours as well as the street's expectation, led by good growth across the portfolio of brands.
- Gross margins rose by 504 bps y-o-y because of softening raw-material prices and a favourable product mix.
- Comparable operating margins improved by ~180 bps to 15% as a result of operating efficiencies, while reported operating profit grew by ~40% y-o-y; reported OPM improved by 376 bps to 16.9%.

### Our Call

**Valuation – Maintain Buy with a revised PT of Rs. 845:** We broadly maintain our estimates for FY2020, FY2021 and FY2022. The increase in customs duty on footwear will widen the price difference between imported and domestically manufactured footwear, which augurs well for footwear companies to gain in terms of volumes in the near term. Steady volume growth and consistent improvement in OPM will help Relaxo clock revenue and earnings CAGR of 17.1% and 30.3%, respectively, over FY2019-FY2022. The stock is currently trading at 59.8x its FY2021E earnings and 46.1x its FY2022E earnings. Given the company's strong business prospects and better earnings visibility, we maintain our Buy recommendation on the stock with a revised PT of Rs. 845 (rolling it forward to FY2022 earnings).

### Key Risks

Any slowdown in demand and stiff competition would threaten revenue growth whereas inflation in key raw material prices would affect profitability.

**Valuation (Consolidated)** Rs cr

| Particulars | FY18 | FY19 | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Revenues | 1,949 | 2,292 | 2,612 | 3,065 | 3,676 |
| OPM (%) | 15.5 | 14.1 | 16.5 | 17.0 | 17.6 |
| Adjusted PAT | 161 | 175 | 239 | 299 | 388 |
| *% YoY growth* | *34.3* | *8.9* | *36.4* | *24.9* | *29.8* |
| Adjusted diluted EPS (Rs.) | 6.5 | 7.1 | 9.7 | 12.1 | 15.6 |
| P/E (x) | 111.0 | 101.9 | 74.7 | 59.8 | 46.1 |
| P/B (x) | 23.5 | 16.2 | 13.8 | 11.6 | 9.6 |
| EV/EBIDTA (x) | 59.6 | 55.4 | 41.8 | 34.4 | 27.4 |
| RoNW (%) | 23.6 | 18.8 | 19.9 | 21.1 | 22.8 |
| RoCE (%) | 34.6 | 23.8 | 28.5 | 29.3 | 30.2 |

*Source: Company, Sharekhan estimates*
**we have included the impact of Ind AS 116 in FY2020, FY2021 and FY2022 estimates*

**Revenue grew by ~9% y-o-y, soft input costs drive up margins:** Revenue grew by 8.8% y-o-y to Rs. 599.8 crore, in line with our expectation, mainly led by premiumisation and good growth across the portfolio of brands. Gross margins increased by 504 bps y-o-y to 57.8%, largely on account of benign raw material costs and a favourable product mix. Strong revenue growth and implementation of Ind-AS 116 drove up reported operating profit by 39.8% y-o-y, while reported OPM rose by 376 bps y-o-y to 16.9%. On a comparable basis, OPM improved by ~180 bps to 15% (ahead of our expectation of 13.4%) as a result of operating efficiencies. Comparable operating profit rose by 23.8% y-o-y to Rs. 90 crore. Post Ind-AS 116, reported depreciation and finance costs rose significantly to Rs. 27.5 crore and 4.4 crore in Q3FY2020, respectively, as against Rs. 16.7 crore and Rs. 2 crore in Q3FY2019. Comparable profit before tax (PBT) increased by 22.6% y-o-y at Rs. 69.7 crore and the net effect of the shift to Ind-AS 116 on profit before tax (PBT) was Rs. 2.2 crore. Reported PBT grew by 26.4% y-o-y to Rs. 71.9 crore. Reduction in the corporate tax rate to 25.17% and strong operating performance drove up reported profit after tax (PAT) by ~52% y-o-y to Rs. 54.2 crore.

**Result Snapshot (Standalone)** Rs cr

| Particulars | Q3FY20 | Q3FY19 | y-o-y (%) | Q2FY20 | q-o-q (%) |
|---|---|---|---|---|---|
| Net Revenue | 599.8 | 551.3 | 8.8 | 621.8 | -3.5 |
| Raw-material cost | 252.9 | 260.2 | -2.8 | 271.6 | -6.9 |
| Staff cost | 75.6 | 64.8 | 16.6 | 72.2 | 4.7 |
| Other expenses | 169.8 | 153.6 | 10.6 | 173.3 | -2.0 |
| Total expenses | 498.2 | 478.6 | 4.1 | 517.1 | -3.6 |
| Operating profit | 101.6 | 72.7 | 39.8 | 104.7 | -3.0 |
| Other Income | 2.2 | 3.0 | -26.9 | 1.7 | 31.5 |
| EBITDA | 103.8 | 75.6 | 37.2 | 106.4 | -2.4 |
| Interest expenses | 4.4 | 2.0 | - | 4.3 | 1.9 |
| Depreciation & Amortization | 27.5 | 16.7 | 64.2 | 27.8 | -1.0 |
| Profit Before Tax (PBT) | 71.9 | 56.9 | 26.4 | 74.3 | -3.2 |
| Tax | 17.8 | 21.3 | -16.5 | 3.8 | - |
| Reported PAT | 54.2 | 35.6 | 52.0 | 70.5 | -23.2 |
| EPS | 2.2 | 1.5 | 46.7 | 2.8 | -23.7 |
| | | | **bps** | | **bps** |
| GPM (%) | 57.8 | 52.8 | 504 | 56.3 | 153 |
| OPM (%) | 16.9 | 13.2 | 376 | 16.8 | 10 |

*Source: Company, Sharekhan estimates*

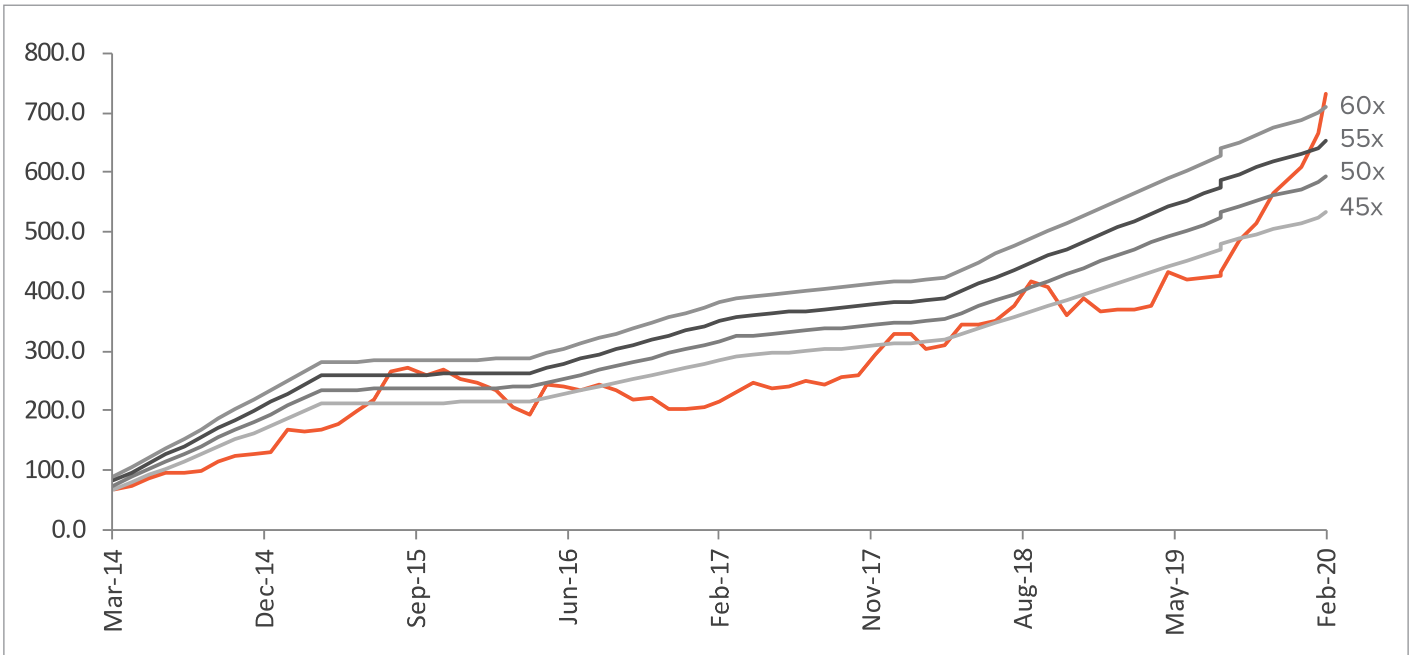
## Outlook

**Steady growth momentum to sustain:** Overall, Relaxo posted a good set of numbers in 9MFY2020 with revenue and operating profit growing by 13% and 36.5%, respectively, while reported OPM stood at 16.7%. Numbers were good despite a slowdown in discretionary demand. We expect volume growth to stay steady in the near term. An improving product mix and benign input costs along with premiumisation strategies would help the company expand margins. Reported OPM is expected at 16.5% in FY2020. Relaxo is a leading player in the value footwear segment with an array of strong brands and a vast pan-India distribution network. It has a 5% share in the footwear industry space and thus, has a huge scope for expansion going ahead. Moreover, a shift in consumer preference from unorganised to organised players along with innovation and increasing presence in untapped markets will drive operating performance in the near to medium term.

## Valuation

**Maintain Buy with a revised PT of Rs. 845:** We broadly maintain our estimates for FY2020, FY2021 and FY2022. The increase in customs duty on footwear will widen the price difference between imported and domestically manufactured footwear, which augurs well for footwear companies to gain in terms of volumes in the near term. Steady volume growth and consistent improvement in OPM will help Relaxo clock revenue and earnings CAGR of 17.1% and 30.3%, respectively, over FY2019-FY2022. The stock is currently trading at 61.1x its FY2021E earnings and 47x its FY2022E earnings. Given the company's strong business prospects and better earnings visibility, we maintain our Buy recommendation on the stock with a revised PT of Rs. 845 (rolling it forward to FY2022 earnings).

**One-year forward P/E (x)**




*Source: Sharekhan Research*

**Peer Comparison**

| Particulars | P/E (x) | | | EV/EBIDTA (x) | | | RoCE (%) | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY19 | FY20E | FY21E | FY19 | FY20E | FY21E | FY19 | FY20E | FY21E |
| Bata | 71.9 | 58.5 | 48.3 | 41.9 | 24.5 | 21.0 | 19.4 | 16.7 | 15.3 |
| Relaxo Footwears | 101.9 | 74.7 | 59.8 | 55.4 | 41.8 | 34.4 | 23.8 | 28.5 | 29.3 |

*Source: Company, Sharekhan estimates*

## About company

New Delhi-based Relaxo is a leading footwear company with a turnover of over Rs. 2,000 crore. It has eight manufacturing facilities across northern India with a capacity of over 7.5 lakh units per day. The company sells 184 million pairs per annum through its wide distribution network of over 50,000 retailers and 370 exclusive brand outlets (EBOs). Relaxo produces a wide range of footwear under nine brands including Sparx, Bahamas, Flite, Schoolmate and Relaxo Hawaii selling over 6,000 SKUs. Bahamas and Flite cater to the young and fashionable target consumers, while Sparx is marketed with durability as its USP whereas Schoolmate is specifically for school shoes.

## Investment theme

Relaxo has clocked sustained double-digit volume growth in the last few quarters. With the implementation of GST, there is a shift from unbranded to branded products, which provides further scope for the company in the Rs. 55,000-60,000 crore Indian footwear market, of which ~50% is unbranded. Capacity expansions, investment on brands, steady volume growth and increasing presence in untapped markets along with increasing price differential in the imported and domestic footwear as a result of a hike in customs duty would be key growth drivers in the near to medium term.

## Key Risks

- Slowdown in discretionary demand: Any slowdown in demand would affect revenue growth.
- Increased input costs: Any significant increase in rubber prices or those of crude oil derivatives would affect profitability.
- Increased competition in highly penetrated categories: Heightened competition would threaten revenue growth.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Ramesh Kumar Dua | Managing Director |
| Sushil Batra | Chief Financial Officer |
| Vikas Kumar Tak | Company Secretary |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | VLS Securities Ltd | 6.6 |
| 2 | VL Finance | 5 |
| 3 | SBI Funds Management Pvt Ltd | 4.1 |
| 4 | Capital Group Cos Inc | 1.5 |
| 5 | ICICI Prudential Asset Management | 0.7 |
| 6 | Daiwa Asset Management India Pvt L | 0.3 |
| 7 | Birla Sun Life Insurance Co Ltd | 0.2 |
| 8 | Dimensional Fund Advisors LP | 0.2 |
| 9 | Edelweiss Asset Management Ltd | 0.2 |
| 10 | Aditya Birla Sun Life Asset Management | 0.1 |

*Source: Bloomberg*

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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