

20 November 2018

## Mirza International

*Positive on domestic business growth; retaining our Buy rating*

Rating: **Buy**

Target Price: ₹113

Share Price: ₹80

Driven by ~41% y/y growth in its branded business, Mirza's H1 FY19 revenue rose 13% to ₹5,576m. The gross margin shrank 406bps resulting in the EBITDA margin contracting 220bps to 15.4%. As management lowered its growth guidance and as margins would continue under pressure in the near future, we cut FY19e/FY20e EBITDA 13%/11% and PAT 27%/23%. Due to a steep fall in the stock price, we maintain our Buy rating on the stock, with a new, ₹113, target price (earlier ₹148).

**Branded business continues to drive revenue growth.** In H1 FY19 Mirza's branded business clocked ~41% revenue growth to ₹2,719m. Higher input prices, however, led to the business' EBIT margin shrinking 482bps to 18.4%.

**Margins under pressure.** The H1 FY19 EBITDA margin declined 220bps, because of a one-time loss in the tannery business (inventory cleaning once in 4-5 years), rupee depreciation making imported non-leather branded footwear for the domestic market costlier and higher discounting. For the next 9-12 months, margins would continue under pressure.

**Store expansion affected balance-sheet strength.** In Q2 FY19, Mirza added 16 stores. The store expansion and greater growth in its home business resulted in higher working capital (mainly inventory). Hence, borrowings rose to ₹3,420m (₹2,700m in FY18). From Apr'18 Chairman Irshad Mirza let go his part of guarantee commission, a welcome step to good corporate governance.

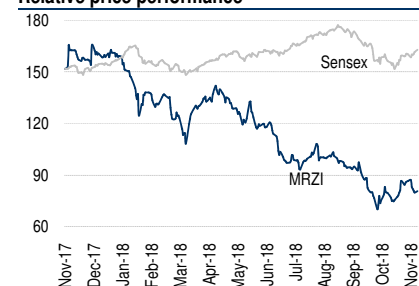
**Valuation.** We introduce FY21e and roll forward our valuation to FY21. The lower growth guidance, higher input cost and rising debt lead us to cut FY19e EBITDA/PAT 13%/27% and 11%/23% for FY20 and reduce our target multiple to 15x from 18x earlier. On the sharp fall in the stock price, we retain our Buy rating, valuing the stock at 15x FY21e EPS to arrive at a target of ₹113 (earlier ₹148). **Risks:** Higher interest expense would eat into EPS growth; stiff competition in domestic footwear, export- recovery failure.

Key data	MRZI IN / MRZ.BO
52-week high / low	₹175 / 68
Sensex / Nifty	35775 / 10763
3-m average volume	\$0.3m
Market cap	₹10bn / \$135.5m
Shares outstanding	120m

Shareholding pattern (%)	Sep'18	Jun'18	Mar'18
Promoters	70.2	70.4	70.4
- of which, Pledged	-	-	-
Free float	29.8	29.6	29.6
- Foreign institutions	1.4	3.0	3.6
- Domestic institutions	2.5	2.9	2.9
- Public	25.9	23.7	23.1

Estimates revision (%)	FY19e	FY20e
Sales	-1.3	-1.3
EBITDA	-12.9	-11.2
EPS	-27.0	-23.2

### Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY17	FY18	FY19e	FY20e	FY21e
Sales (₹ m)	9,357	9,721	10,790	12,049	13,475
Net profit (₹ m)	717	784	643	760	906
EPS (₹)	6.0	6.5	5.3	6.3	7.5
PE (x)	13.4	12.3	15.0	12.7	10.6
EV / EBITDA (x)	6.9	7.0	7.7	6.7	5.9
PBV (x)	1.9	1.7	1.5	1.4	1.3
RoE (%)	15.1	14.6	10.8	11.6	12.5
RoCE (%)	17.4	16.3	12.6	13.3	14.1
Dividend yield (%)	1.1	1.1	1.1	1.1	1.1
Net debt / equity (x)	0.3	0.4	0.6	0.6	0.5

Source: Company, Anand Rathi Research

Harsh Thakar

Vaishnavi Mandhaniya  
Research Analyst

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
Net revenues	9,357	9,721	10,790	12,049	13,475
Growth (%)	1.1	3.9	11.0	11.7	11.8
Direct costs	5,033	4,808	5,773	6,356	7,075
SG&A	2,713	3,173	3,291	3,681	4,123
<b>EBITDA</b>	<b>1,611</b>	<b>1,740</b>	<b>1,726</b>	<b>2,012</b>	<b>2,277</b>
EBITDA margins (%)	17.2	17.9	16.0	16.7	16.9
- Depreciation	291	316	363	389	415
Other income	8	4	10	10	10
Interest expenses	259	250	400	482	500
PBT	1,069	1,178	974	1,152	1,372
Effective tax rate (%)	32.9	33.5	34.0	34.0	34.0
+ Associates / (Minorities)					
Net income	717	784	643	760	906
Adjusted income	717	784	643	760	906
WANS	120	120	120	120	120
FDEPS (₹ / sh)	6.0	6.5	5.3	6.3	7.5
FDEPS growth	(8.2)	9.4	(18.0)	18.3	19.2
Gross margins (%)	46.2	50.5	46.5	47.3	47.5

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
PBT (adj for int. income & exp.)	1,317	1,433	1,364	1,623	1,862
+ Non-cash items	291	316	363	389	415
Oper. prof. before WC	1,608	1,749	1,726	2,012	2,277
- Incr. / (decr.) in WC	134	1,650	1,205	649	769
Others incl. taxes	337	338	331	392	467
Operating cash-flow	1,136	-238	190	971	1,042
- Capex (tang. + intang.)	333	596	800	500	500
Free cash-flow	803	-834	-610	471	542
Acquisitions					
- Div. (incl. buyback & taxes)	72	130	130	130	130
+ Equity raised					
+ Debt raised	-491	1,274	1,200	150	150
- Fin investments	32				
- Misc. (CFI + CFF)	257	247	390	472	490
Net cash-flow	-49	63	70	19	72

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

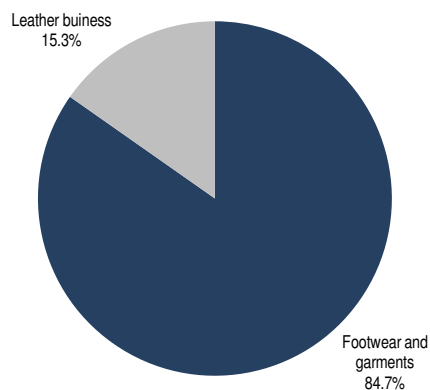
**Fig 2 – Balance sheet (₹ m)**

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
Share capital	241	241	241	241	241
Net worth	5,020	5,718	6,230	6,860	7,635
Debt	1,560	2,696	3,896	4,046	4,196
Minority interest					
DTL / (Assets)	167	177	177	177	177
<b>Capital employed</b>	<b>6,747</b>	<b>8,591</b>	<b>10,303</b>	<b>11,083</b>	<b>12,008</b>
Net tangible assets	3,516	3,570	4,007	4,118	4,203
Net intangible assets	-	-	-	-	-
Goodwill	27	-	-	-	-
CWIP (tang. & intang.)	19	246	246	246	246
Investments (strategic)	-	-	-	-	-
Investments (financial)	6	6	6	6	6
Current assets (ex cash)	4,011	6,040	7,399	8,230	9,203
Cash	65	128	198	218	289
Current liabilities	896	1,399	1,553	1,734	1,940
Working capital	3,115	4,641	5,846	6,495	7,264
<b>Capital deployed</b>	<b>6,747</b>	<b>8,591</b>	<b>10,303</b>	<b>11,083</b>	<b>12,008</b>
Contingent liabilities	-	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
P/E (x)	13.4	12.3	15.0	12.7	10.6
EV / EBITDA (x)	6.9	7.0	7.7	6.7	5.9
EV / sales (x)	1.2	1.3	1.2	1.1	1.0
P/B (x)	1.9	1.7	1.5	1.4	1.3
RoE (%)	15.1	14.6	10.8	11.6	12.5
RoCE (%) - after tax	17.4	16.3	12.6	13.3	14.1
RoIC	11.7	10.9	8.4	8.8	9.4
DPS (₹ / sh)	0.9	0.9	0.9	0.9	0.9
Dividend yield (%)	1.1	1.1	1.1	1.1	1.1
Dividend payout (%) - incl. DDT	18.2	16.6	20.3	17.1	14.4
Net debt / equity (x)	0.3	0.4	0.6	0.6	0.5
Receivables (days)	26	50	56	53	53
Inventory (days)	103	144	160	162	162
Payables (days)	15	32	32	32	32
CFO : PAT %	158.5	-30.4	29.6	127.8	115.1

Source: Company, Anand Rathi Research

**Fig 6 – Revenue break-up (H1 FY19)**


Source: Company

## Financial highlights

Fig 7 – Financial performance

	Q2 FY19	Q2 FY18	% Y/Y	Q1 FY19	% Q/Q	H1 FY19	H1 FY18	% Y/Y
Sales	2,958	2,404	23.0	2,618	13.0	5,576	4,925	13.2
Gross margins (%)	44.5	50.6	-618bps	46.2	-170bps	45.3	49.3	-406bps
EBITDA	426	424	0.3	432	-1.4	858	866	-0.9
EBITDA margins (%)	14.4	17.7	-326bps	16.5	-210bps	15.4	17.6	-220bps
Interest	91	53	70.7	73	23.2	164	112	46.2
Depreciation	85	75	12.1	79	7.5	163	147	11.0
Other Income	1	0	1,283.6	1	38.8	1	1	133.4
PBT	252	296	-15.0	280	-10.3	532	607	-12.4
Tax	90	102	-11.8	100	-9.1	190	209	-9.3
Tax rate (%)	36.0	34.6	133bps	35.5	45bps	35.7	34.5	122bps
PAT	161	193	-16.7	181	-10.9	342	398	-14.0

Source: Company, Anand Rathi Research

## Segment-wise performance

Fig 8 – Segment-wise revenues (₹ m)

Sales	Q2 FY19	Q2 FY18	% Y/Y	Q1 FY19	% Q/Q	H1 FY19	H1 FY18	% Y/Y
Shoes	2,747	2,238	22.7	2,425	13.3	5,172	4,515	14.6
Branded	1,382	975	41.7	1,337	3.3	2,719	1,932	40.8
Unbranded	1,365	1,263	8.1	1,088	25.4	2,453	2,583	(5.1)
Leather	446	417	7.0	487	(8.4)	932	1,038	(10.2)

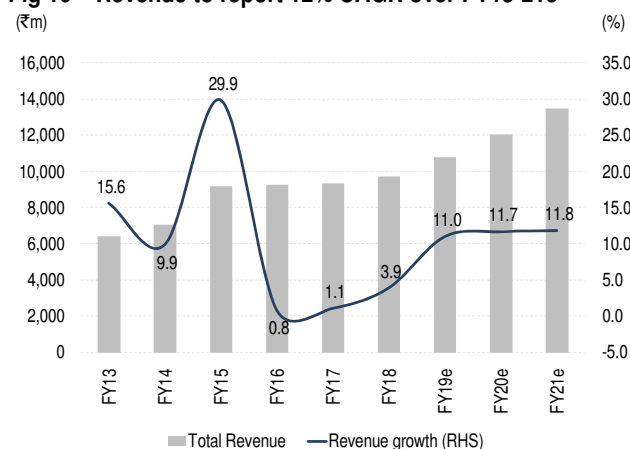
Source: Company, Anand Rathi Research

Fig 9 – Segment-wise EBIT margins (%)

Sales	Q2 FY19	Q2 FY18	% Y/Y	Q1 FY19	% Q/Q	H1 FY19	H1 FY18	% Y/Y
Shoes	17.0	20.3	-321bps	18.4	-138bps	17.7	19.8	-212bps
Branded	16.9	21.3	-439bps	19.8	-290bps	18.4	23.2	-482bps
Unbranded	17.2	19.4	-227bps	16.7	45bps	17.0	17.3	-34bps
Leather	(10.2)	5.0	-1,523bps	0.8	-1,107bps	(4.5)	4.9	-936bps

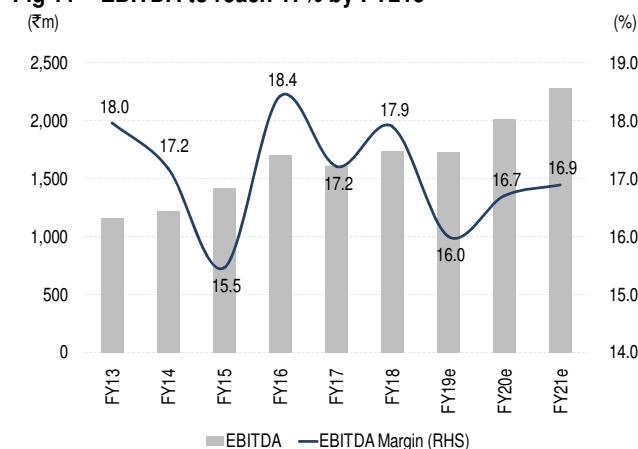
Source: Company, Anand Rathi Research

Fig 10 – Revenue to report 12% CAGR over FY18-21e



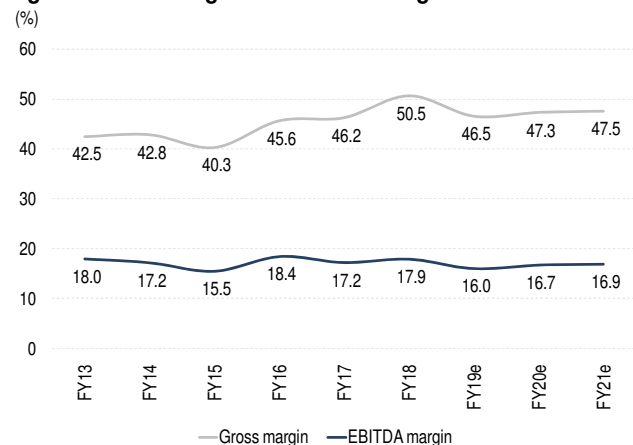
Source: Company, Anand Rathi Research

Fig 11 – EBITDA to reach 17% by FY21e



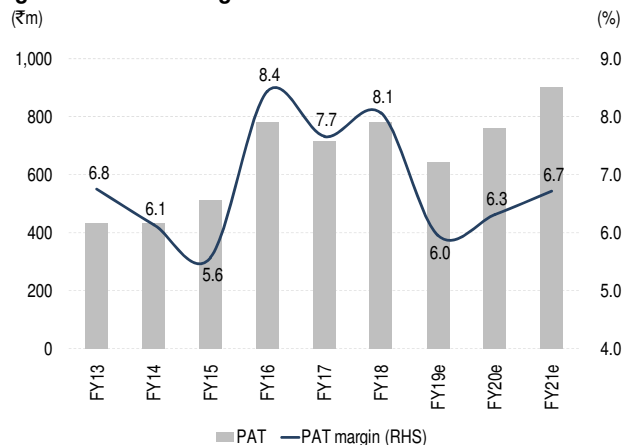
Source: Company, Anand Rathi Research

Fig 12 – Gross margin and EBITDA margin



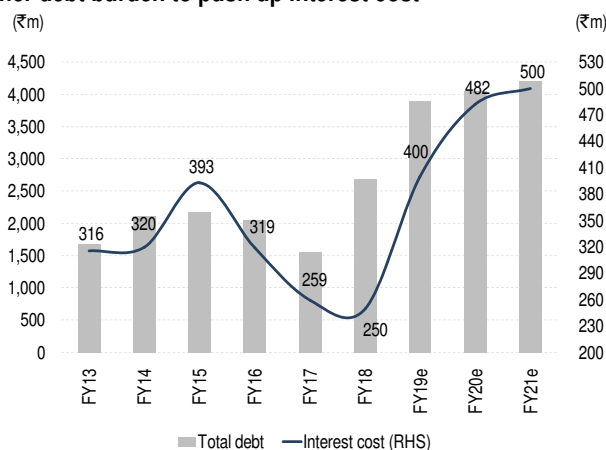
Source: Company, Anand Rathi Research

Fig 13 – PAT and margins



Source: Company, Anand Rathi Research

Fig 14 – Higher debt burden to push up interest cost



Source: Company, Anand Rathi Research

### Concall Highlights Q2 FY19

- In Q2 FY19 the domestic branded business grew ~60% to ₹1,250m; in H1 FY19, ~42% to ₹2,420m.
- Of Q2's ₹1,250m revenue
  - ₹380m came from apparel and
  - ₹860m from footwear.
  - Bondstreet and Athleisure brought 39% to the domestic branded footwear revenue; the rest came from Redtape.
- Chairman Irshad Mirza announced not taking his guarantee commission from 1<sup>st</sup> Apr'18; the other four directors will continue to take their guarantee commissions. Thus, guarantee commission will come down 20% in FY19.
- In Q2 FY19, the company opened 16 stores, taking the store count to 187, including 34 online. Today, it has 194 stores.
- In Q2 FY19, exports grew 3% to ₹1,470m (against ₹1,430m a year ago). Revenue from its UK business declined 7% to ₹900m (against ₹960m) while the US business revenue was flat at ₹310m.
- Margins in Q2 FY19 were lower due to:

- The tannery business suffered a one-time loss of ₹49m as the company clears off inventory once every 4-5 years.
- The rupee depreciation hit margins in imported non-leather products.
- The company lost ₹50m-60m on account of higher discounting.
- Margins would return to the earlier level in the next 9-12 months.
- The Q2 FY19 advertising cost was ₹30.8m (₹73.7m a year ago) and ₹59.2m in H1 FY19 (₹110m).
- At end-H1 FY19 the company had borrowings of ₹3,420m. Management expects these to increase by ₹400m-500m from the current level.
- At end-H1 FY19, the company had inventory of ₹4,370m. The amount is higher as the company is in an expansion mode in its home market and is building up its garments inventory for the coming winter.
- Its female-centric brand 'Mode' is in a trial-and-error mode. Management is not very bullish on this brand.
- Hedging policy – The company covers export orders when an order is placed. Till Oct'18 it had no hedging policy for imports. However from November, it has started hedging ~50% of its imports through forward contracts.
- In Q2, a sourcing company was opened in Bangladesh. Earlier this year, a sourcing company was opened in Hong Kong.
- SSG for Q2 FY19 was 30%.

#### Guidance

- Domestic business revenue in FY19 would be ~₹5,500m-6,000m. From its domestic branded business, management eyes ₹10bn revenue by FY21. Revenue from exports in FY19 would be ~₹5,000m-5,500m.
- The EBITDA margins would continue under pressure for the next 9-12 months, after which they would be 17-18%.
- In FY19, debt would increase by ₹400m-500m from Sep'18 level of ₹3,420m.

#### Change in estimates

On management's lower domestic revenue growth guidance, lower H1 FY19 margin (15.4%, against our earlier expected 18.2% for FY19), rupee depreciation, price pressure on input costs, we cut our FY19e EBITDA 13%, and 11% for FY20. On the higher interest cost due to the greater debt burden, we cut our FY19e PAT a steep 27% and 23% for FY20.

**Fig 15 – Change in estimates**

	Old estimates		New estimates		Change (%)	
	FY19e	FY20e	FY19e	FY20e	FY19e	FY20e
Revenue	10,928	12,213	10,790	12,049	-1.3	-1.3
EBITDA	1,983	2,266	1,726	2,012	-12.9	-11.2
PAT	880	990	643	760	-27.0	-23.2
EPS	7.3	8.2	5.3	6.3	-27.0	-23.2

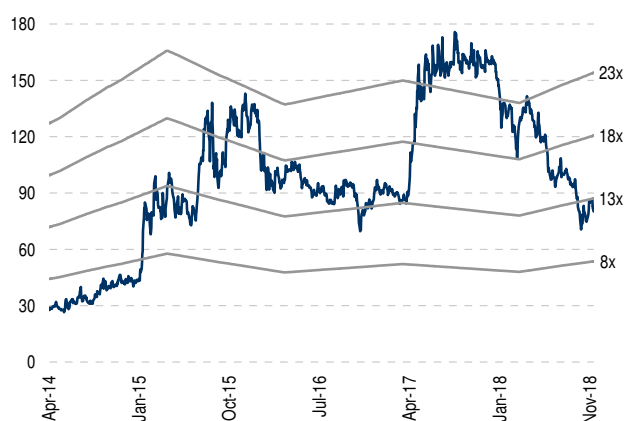
Source: Anand Rathi Research

## Valuation

We believe that the company's growth momentum is poised to accelerate in the next two years, driven by domestic sales, an increase in the number of EBOs and in points of sale. With product launches, the company has broadened its operations in different genres of footwear, increasing its addressable market. This augurs well for growth ahead. The tannery business is expected to generate positive returns through better utilisation and cost-efficiency.

We introduce our estimates for FY21 and roll forward our valuation to FY21. On management's lower growth guidance, higher input costs and increasing debt, we cut FY19e EBITDA/PAT 13%/27% and by 11%/23% for FY20. We also lower our target multiple to 15x from 18x earlier. However due to the sharp fall in the stock price, we maintain our Buy rating on the stock, valuing it at 15x FY21e EPS to arrive at a target price of ₹113 (earlier ₹148).

**Fig 16 – PE band**



Source: Bloomberg, Anand Rathi Research

### Risks

- Greater interest expense would impact EPS growth.
- Stiff competition in domestic footwear.
- Failure of recovery in exports.

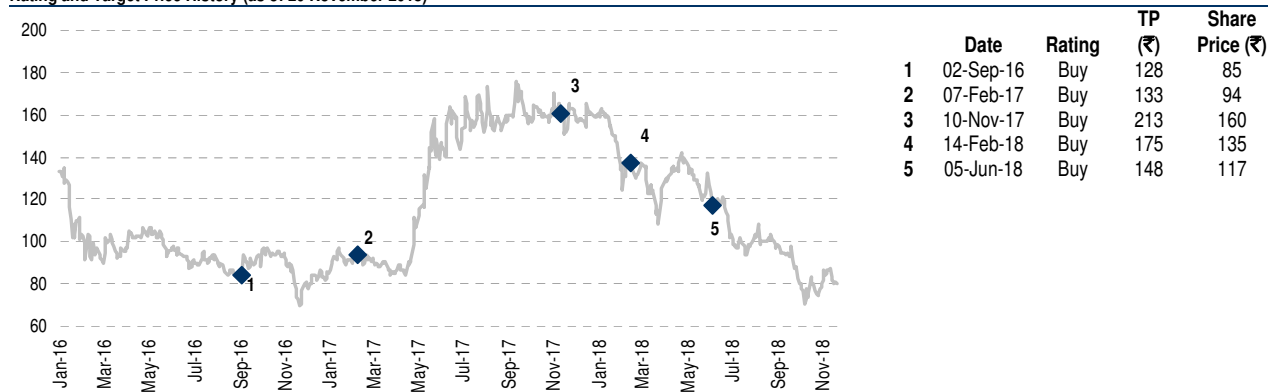
## Appendix

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ARSSBL registered address: 4th Floor, Silver Metropolis, Jaicoach Compound, Opposite Bimbisar Nagar, Goregaon (East), Mumbai - 400 063.  
Tel No: +91 22 4001 3700 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.