Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Relaxo Footwears

Set for a steady run ahead

Consumer Discretionary	Sharekhan code: RELAXO	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 809**	
Price Target: **Rs. 930**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 20,108 cr
52-week high/low:	Rs. 830/493
NSE volume: (No of shares)	2.5 lakh
BSE code:	530517
NSE code:	RELAXO
Free float: (No of shares)	7.2 cr

Shareholding (%)

Promoters	71.0
FII	3.4
DII	7.0
Others	18.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	11.6	22.1	28.5	32.2
Relative to Sensex	4.7	-3.3	-8.0	16.4

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy on Relaxo Footwears Limited (Relaxo) with a revised PT of Rs. 930; it remains one of our top picks in the consumer discretionary space with value-for-money offerings; strong profitability and a lean balance sheet.
- Unlike other retail or footwear companies, Relaxo's business recovered faster (with revenues returned to 93% of pre-COVID levels in Q2), led by strong demand for open-ended value footwear products (contributed 80% revenues in H1).
- Volumes and realisations clocked CAGRs of 10% and 3% over FY2017-20. Sustained innovation, focus on improving penetration in southern and western India and shift to branded products will aid sustained volume growth. A better mix led by strong traction in premium products will drive realisations.
- OPM improved to 17% in FY2020 from 14% in FY2017. We expect margins to keep rising in the coming years with higher sales volume and better operating efficiencies.

Unlike other retail or footwear companies, Relaxo Footwear (Relaxo) saw a faster recovery in Q2FY2021 with business recovery to 93% of pre-COVID levels, led by strong demand for open-ended footwear products, such as slippers, hawai chappals. These products saw strong demand in H1FY2021 and fetched ~80% of total revenue. We expect business to recover 100% in Q3FY2021 with improving demand for close-ended footwear products due to an increase in inter-city mobility post the lockdown and higher demand in the festive season. This will also be supported by strong demand in rural markets and small towns, which saw good traction for value-for-money products. Improving out-of-home mobility, opening of schools /colleges and better consumer sentiments would lead to strong double digit growth in FY2022. Volume and realisation clocked CAGRs of 10% and 3%, respectively over FY2017-20. We expect high single-digits to low double digit volume growth momentum to sustain in the medium term, led by the company's focus on improving penetration in the southern and western market, strong presence in the value segment would help in upgrading from unorganised low price products, sustained product launches and improving online presence (currently 10%). The company's ad spends have been at 3-4% of sales in the past few years. We expect the ad spends to go up to 5-6% of sales with large focus on improving brand visibility. Operating margins (OPM) improved to 17% in FY2020 from 14% in earlier years. This was mainly on account of better gross margins and efficiencies. Further, lower administrative expenses, rationalisation of portfolio (20% of portfolio is restyled every year) and lower raw material cost will help the OPM be higher in FY2021 at 18-19%. However, we expect them to expand gradually by 50-60 bps in subsequent years. Better cash flows helped debt levels (excluding lease liability) reduce by ~90% over FY2016-20 to Rs. 46 crore.

Our Call

View - Retained Buy with a revised PT of Rs. 930: With a strong portfolio of value-for-money footwear products and improving distribution reach, Relaxo is well-poised to achieve revenue and earnings CAGR growth of 10% and 19% over FY2020-23E. The stock is currently trading at 62.9x/52.5x its FY2022/23E EPS. Strong earning visibility and strengthening of balance sheet will keep the valuations at premium. We maintain our Buy recommendation on the stock with a revised price target of Rs. 930.

Key risk

Any slowdown in recovery in sales or a spike in key input prices would act as a key risk to our earnings estimates in the near term.

Valuations (Standalone) Rs cr

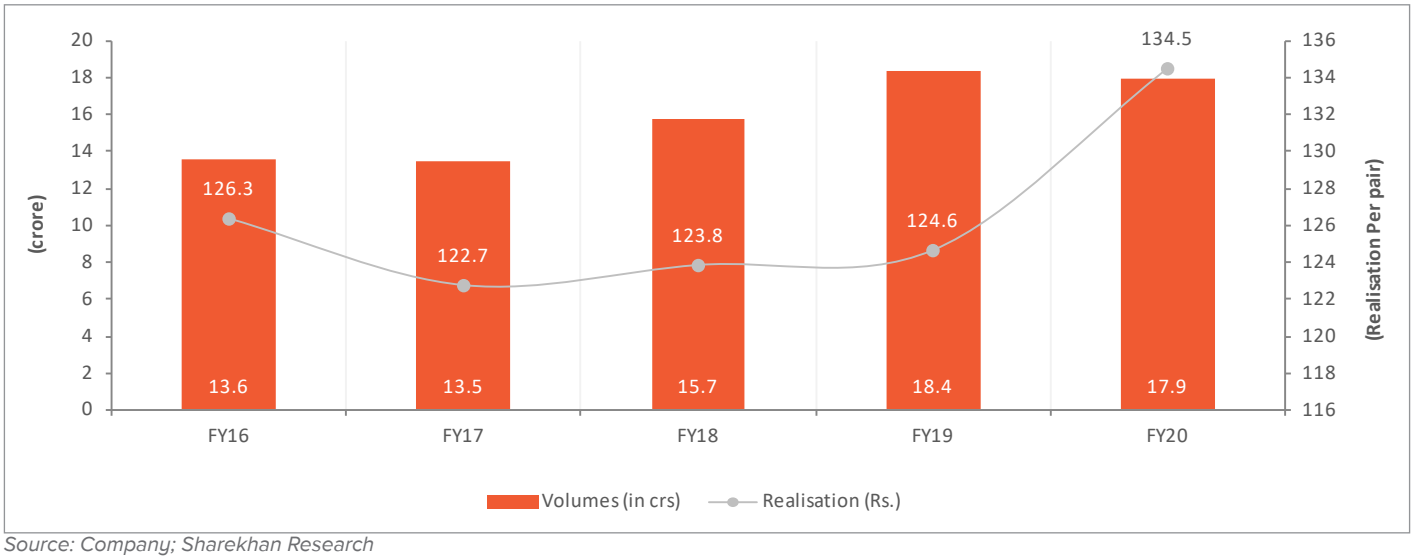
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	2,292	2,410	2,221	2,856	3,228
OPM (%)	14.1	17.0	18.6	19.2	19.7
Adjusted PAT	175	226	231	321	385
% YoY growth	8.9	29.0	2.0	39.3	19.7
Adjusted diluted EPS (Rs.)	7.1	9.1	9.3	12.9	15.5
P/E (x)	115.2	89.3	87.5	62.9	52.5
P/B (x)	18.3	15.9	13.9	11.7	9.9
EV/EBIDTA (x)	62.6	49.8	48.9	36.5	31.0
RoNW (%)	18.8	19.0	16.9	20.2	20.4
RoCE (%)	23.8	27.4	23.1	28.2	26.3

Source: Company; Sharekhan estimates

Volume growth at ~10% over FY2017-20

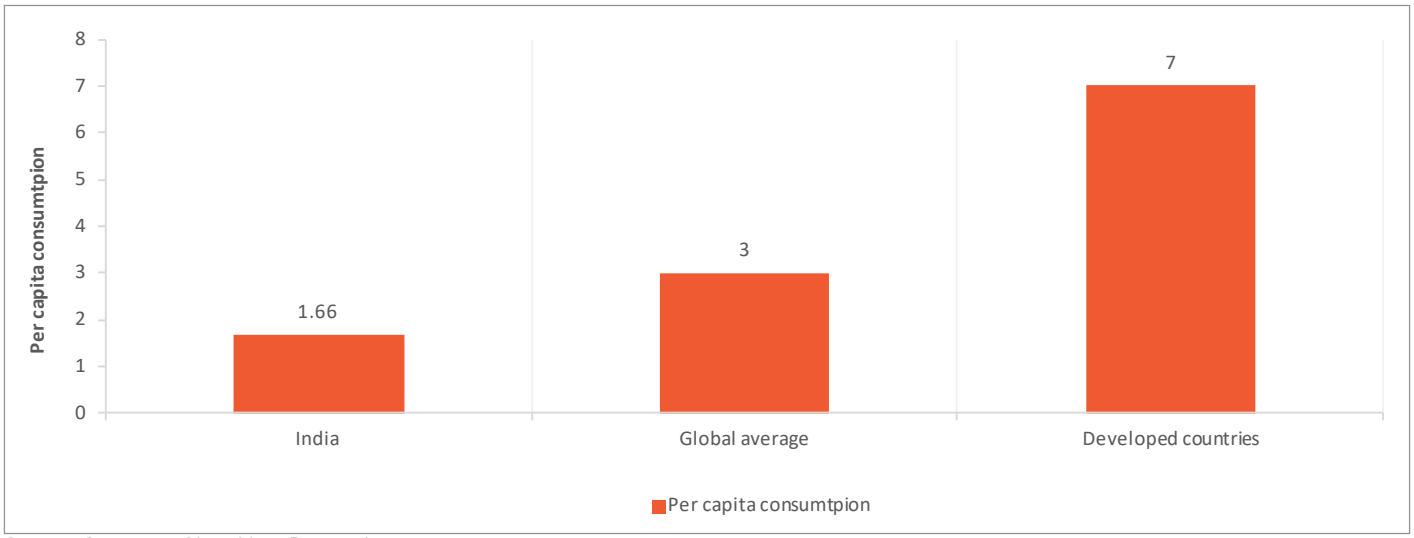
Relaxo's sales volume grew by ~10% over FY2017-20 driven by strong portfolio of value-for-money portfolio, sustained new product addition based on consumer buying behaviour and expansion in distribution reach (50000+ retailers/MBOs). The company has eight manufacturing facilities with a capacity to 7.5lakh pair/day. The company is continuously focusing on optimising operations through a dedicated line of manufacturing fast-moving SKUs and better yields. Volumes grew by 2% and realisations declined by 9% resulting in a 7% y-o-y decline in revenue. There was higher demand for open footwear (value-for-money segment). This change in revenue mix resulted in a gap between volume and value growth. Volumes declined by 13% in H1FY2021. We expect volume growth to further improve to mid single digit in Q3FY2021 with improved demand for close-ended footwear products due to increase in mobility and higher festive sales. We expect volume growth to improve to high single digit to low double-digits, driven by improved penetration in the southern and western markets, shift from unorganised products, increase in per capita consumption to 2 pairs per annum and better demand in rural markets.

Trend in sales volume and sales realisation



Source: Company; Sharekhan Research

India's lower per capita consumption provides good opportunity



Source: Company; Sharekhan Research

Distribution expansion and higher e-commerce sales to provide support to the top-line

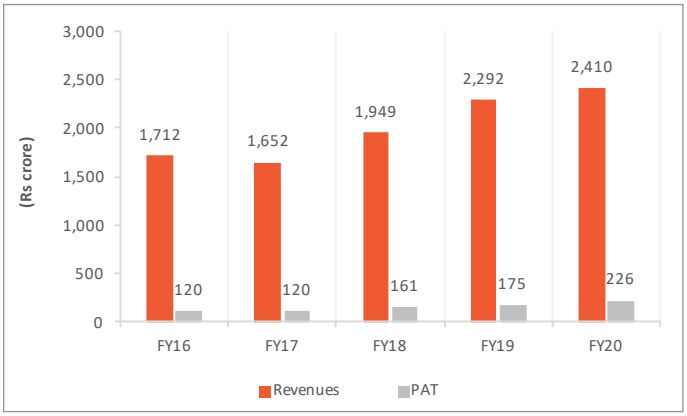
Relaxo currently sells through over 50,000 retail outlets and its focus is to increase outlets by 5-10% every year. There are ~700 distributors and the number of exclusive branded outlets (EBOs) is at 396 currently. The company plans to maintain the target of covering 400 EBOs. The company has strong penetration in North India while it is focusing on improving its penetration in the southern and western market. Contribution from e-Commerce to total revenues has increased to 10%. The company expects it to increase to 12% in FY2021.

OPM expansion to sustain with better realisation and efficiencies

Operating margins (OPM) improved to 17% in FY2020 from 14% in the earlier years. This was mainly on account of better gross margins and efficiencies. Further lower administrative expenses, rationalisation of portfolio (20% of portfolio is restyled every year) and lower raw material cost will help the OPM to be higher in FY2021 and will stand at 18-19%. Benign raw material costs and efficiencies resulted in significant margin expansion in Q2FY2021. Margins are likely to keep rising, though not in-line with Q2 numbers, but better than the last year. However, we expect them to expand gradually by 50-60 bps in the subsequent years.

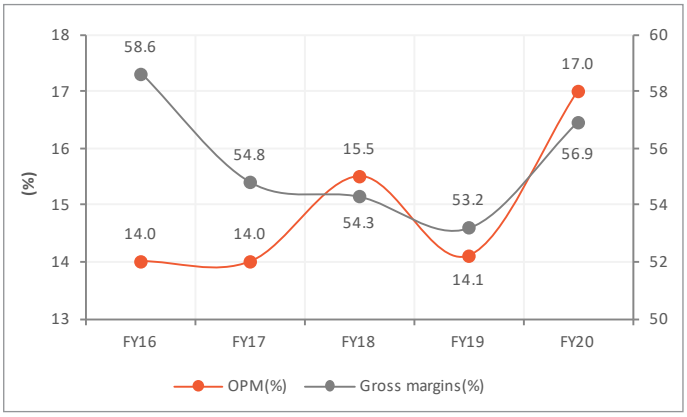
Financials in charts

Trend in revenues and PAT



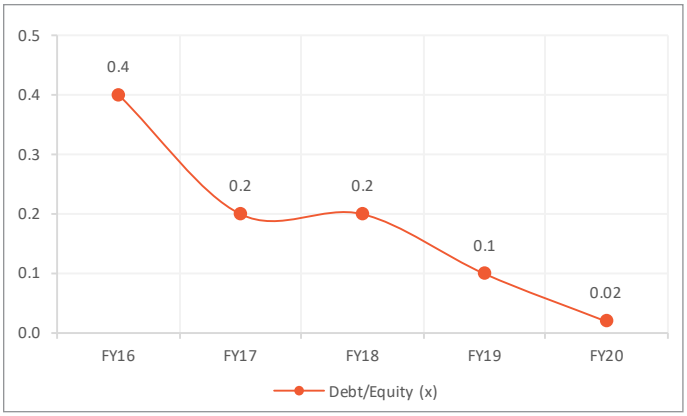
Source: Company, Sharekhan Research

Consistent improvement in margins (%)



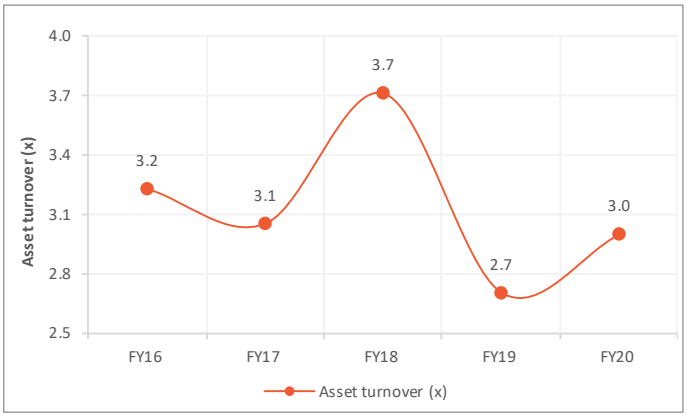
Source: Company, Sharekhan Research

Better cash flows led to reduction debt



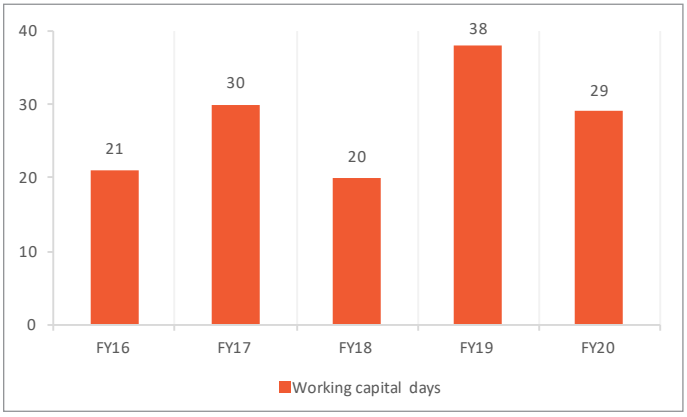
Source: Company, Sharekhan Research

Trend in Asset turnover ratio (x)



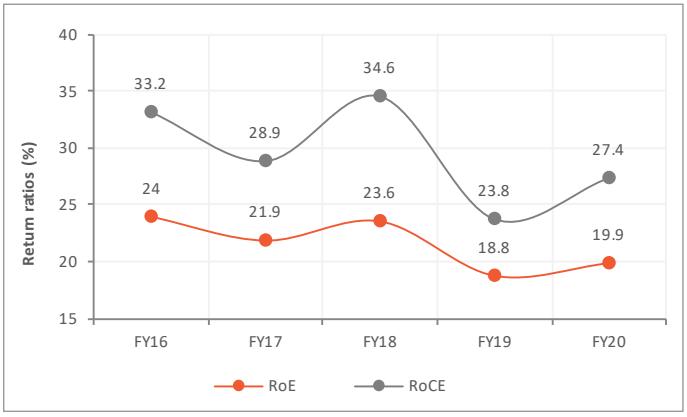
Source: Company, Sharekhan Research

Working capital days remained stable



Source: Company, Sharekhan Research

Trend in return ratios



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – long term growth prospects of Footwear industry is intact

India is the second largest footwear manufacturer after China, accounting for 9% of the world market with 22 billion pair. Domestic market contributes ~90% of overall footwear market in India. The domestic footwear market was badly affected by lockdown during the pandemic environment (Q1 was worst affected). Closure of retail stores and restriction to out of home mobility affected the sales in Q1FY2021. However, with easing of lockdown norms and gradual opening of retail stores/malls, the footwear sales gain some momentum in Q2. With ongoing festive season, gradual opening of economy and likely opening of educational institutes by Q4, we expect the footwear industry should come back to pre-covid level (at least in value segment). Having said with low per capita consumption at 1.66 pairs per annum, a lower share of exports and higher unorganised play provides large opportunity for top brands to scale up operations in the neat to medium term.

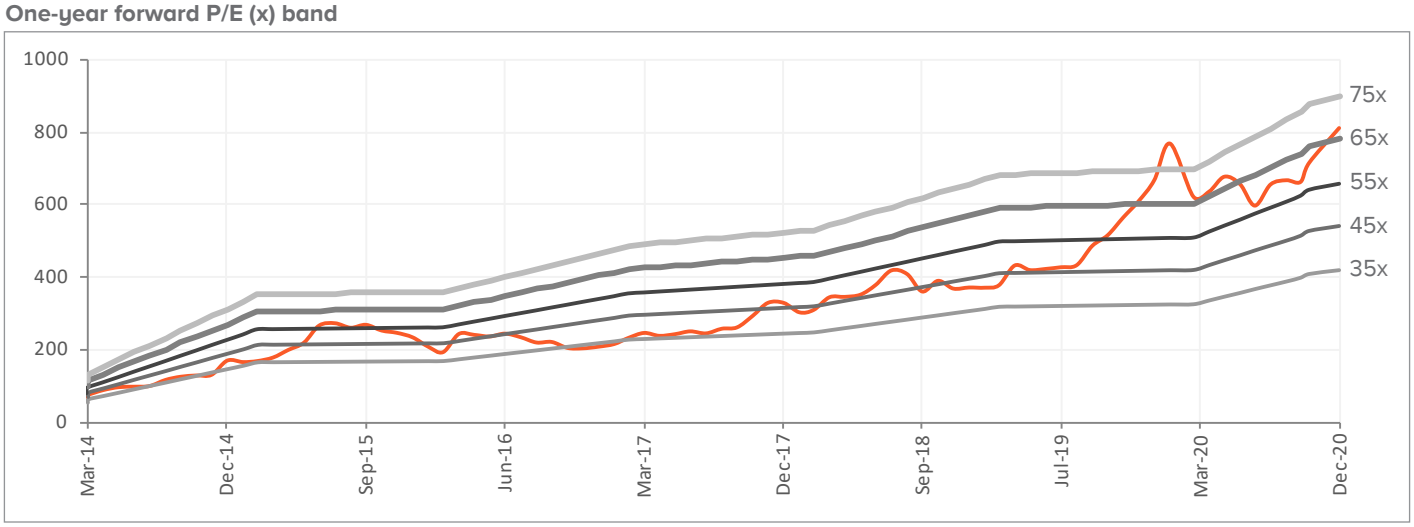
Company Outlook – H2 to be better than H1; margin expansion to sustain

Relaxo's volume growth stood at 2% in Q2FY2020 with strong growth in open-ended footwear having lesser realisation compared to close ended shoes. With October seeing good growth and the economy gradually opening up, we expect to post decent revenue growth in H2FY2021 with open ended footwear maintain the strong growth momentum. Raw material prices have continued to remain benign and we expect margin expansion to sustain in the coming quarters. The management is confident of achieving double-digit revenue growth in FY2022. Further, it expects OPM to improve to 19-20% over the next two years.

Valuation – Retain Buy with revised PT of Rs930

With a strong portfolio of value-for-money footwear products and improving distribution reach, Relaxo is well-poised to achieve revenue and earnings CAGR growth of 10% and 19% over FY2020-23E. The stock is currently trading at 62.9x/52.5x its FY2022/23E EPS. Strong earning visibility and strengthening of balance sheet will keep the valuations at premium. We maintain our Buy recommendation on the stock with a revised price target of Rs. 930.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Bata	-	62.2	46.5	45.2	22.9	18.6	3.1	10.7	12.3
Relaxo Footwears	87.5	62.9	52.5	48.9	36.5	31.0	23.1	28.2	26.3

Source: Company, Sharekhan estimates

About company

New Delhi-based Relaxo is a leading footwear company with a turnover of over Rs. 2,400 crore. It has eight manufacturing facilities across northern India with a capacity of over 7.5 lakh pairs per day. The company sells close to 180 million pairs per annum through its wide distribution network of over 50,000 retailers, ~700 distributors and 396 exclusive brand outlets (EBOs). Relaxo produces a wide range of footwear under nine brands including Sparx, Bahamas, Flite, Schoolmate and Relaxo Hawaii selling over 10,000 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	4.0
3	SBI Funds Management Pvt Ltd	4.0
4	Capital Group Cos Inc	1.0
5	UTI Asset Management Co Ltd	0.7
6	ICICI Prudential Asset Management	0.6
7	Vanguard group	0.6
8	DSP Investment Managers Pvt Ltd	0.5
9	Daiwa Asset Management India Pvt Ltd	0.3
10	Principal Financial Group Inc	0.3

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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