Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Relaxo Footwear

Modest Q1; growth prospects to improve ahead

Consumer Discretionary	Sharekhan code: RELAXO
Reco/View: Buy ↔	CMP: Rs. 980
	Price Target: Rs. 1,130 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Relaxo Footwear registered modest performance in Q1FY2023 despite the low base of Q1FY2022 (affected by COVID-19 lockdown), as high inflationary pressures hit revenue growth while margins decreased due to higher input prices.
- Revenues grew by 34.2% y-o-y to Rs. 667.2 crore. Gross margins and OPM decreased by 40 bps each to 54.1% and 12.9%, respectively, affected by higher input cost inflation.
- A diversified portfolio, recent capacity addition, enhanced distribution network, sustained investment on brands and a customer-centric approach will aid Relaxo in achieving consistent topline growth in the medium to long term. Settling down of EVA prices (key input) would help margins to improve in the coming quarters.
- The stock has corrected by 22% in the past six months and trades at 87.8x/65.0x its FY2023/ FY2024E EPS. We maintain Buy with a revised PT of Rs. 1,130.

Relaxo Footwear (Relaxo) posted modest numbers in Q1FY2023 as compared to other discretionary companies, as high inflationary environment hit sales (especially in rural markets). Also the people shifting from open ended footwear products to close-ended footwear had an impact on the Q1 performance. Revenues in Q1FY2023 grew by 34.2% y-o-y to Rs. 667.2 crore on back of low base of Q1FY2022 (affected by covid-19 second wave) and price hikes undertaken to mitigate a sharp rise in input prices. Gross margins and EBIDTA margins fell by 40 bps each to 54.1% and 13.5% respectively. The operating profit grew by 30.1% y-o-y to Rs. 86.1 crore and the PAT grew by 25% y-o-y to Rs. 39 crore.

Key positives

- Prices of key input – EVA Polymer have corrected from highs due to improved global supply..

Key negatives

- Inflationary pressures affected sales volumes, which we believe were almost flat or marginally declined.
- Gross/EBITDA margins declined by 40 bps y-o-y, each, due to raw material inflation and additional margin offered to neutralise the impact of GST rate hike.

Management Commentary

- Q1FY2023 revenue growth was affected by high inflationary environment impacting consumer spending of mass population and rural regions. However, management expects the situation to improve from Q2FY2023, as raw material inflation cools and higher demand is witnessed for close-ended footwear due to opening up of schools/colleges and corporate offices. The company has regularly aligned itself with the strategy to match consumers evolving expectations.
- The company expects margins to improve as well from Q2FY2023 as raw material inflation eases, while price hikes undertaken in December 2021 will provide a good cushion in the coming quarters.
- The company has existing capacity of 10 lakh pairs per day. To derive the benefits of synergies, meet peak season demand and enhanced the product portfolio in Sports shoes/ Sandals category, Relaxo is proposing to add capacity of 50,000 pairs per day of Sports shoes/ Sandal footwear at Bhiwadi, Rajasthan. The capacity will be added by March 2023. Investment required for the capacity expansion will be around Rs. 60 crore, which will be fun.ded through internal accruals.

Revision in estimates – We have lowered our earnings estimates for FY2023/FY2024 by 3%/2%, respectively, to factor in lower than expected operating performance in Q1FY2023.

Our Call

View: Maintain Buy with a revised PT of Rs. 1,130: Relaxo is well poised to achieve revenue and earnings CAGR of 16% and 27%, respectively, over FY2022-FY2024E, with a strong portfolio of value-for-money footwear products, enhanced capacity of 10.5 lakh pairs per day, and expansion in distribution reach (especially in southern markets). The company has a strong balance sheet (zero net debt) with good cash generation ability. Stock price has corrected by 22% in the past six months and any further correction can be considered as a buying opportunity in the quality stock with its long-term growth prospects intact. The stock currently trades at 88x/65x its FY2023E/FY2024E earnings. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,130.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	2,359	2,653	3,075	3,603
EBITDA margin (%)	21.0	15.7	16.0	17.5
Adjusted PAT	305	233	277	374
Adjusted diluted EPS (Rs.)	12.3	9.4	11.2	15.1
P/E (x)	79.8	-	87.8	65.0
P/B (x)	15.5	13.9	12.4	10.7
EV/EBITDA (x)	48.9	58.8	49.7	38.5
RoNW (%)	21.4	14.0	14.8	17.6
RoCE (%)	29.5	17.5	20.7	23.8

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 16.36

Updated July 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 24,408 cr
52-week high/low:	Rs. 1,447 / 928
NSE volume: (No of shares)	1.7 lakh
BSE code:	530517
NSE code:	RELAXO
Free float: (No of shares)	7.3 cr

Shareholding (%)

Promoters	70.8
FII	3.5
DII	7.1
Others	18.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.3	-10.3	-22.7	-16.3
Relative to Sensex	-4.7	-7.4	-19.2	-22.4

Sharekhan Research, Bloomberg

Modest Q1; Revenue and PAT grew in double digits on low base

Q1FY2023 revenues increased by 34.2% y-o-y to Rs. 667 crore, lower than our expectation of Rs. 702 crore. Gross margins and EBITDA margins declined by 40 bps y-o-y, each to 54.1% and 12.9%, respectively as impact of higher input prices was offset by price hikes undertaken during the quarter. Gross margins and EBIDTA margins were lower than our expectation of 55.5% and 14.2%, respectively. EBITDA increased by 30.1% y-o-y to Rs. 86 crore. However lower other income, higher interest cost and higher tax led to 24.9% y-o-y growth in reported PAT to Rs. 38.7 crore, lower than our expectation of Rs. 53.9 crore. There was a fire at one of the Company's rented warehouse in Haryana on May28,2022 where finished goods were stored and goods worth Rs. 31.9 crores were destroyed. It has accounted for a loss of Rs. 1.6 crores as per excess clause of insurance policy. The company has filed the insurance claim, which will be settled in due course.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	y-o-y (%)	Q4FY22	q-o-q (%)
Net Revenue	**667.2**	**497.1**	**34.2**	**698.2**	**-4.4**
Raw-material cost	306.3	226.2	35.4	319.5	-4.1
Staff cost	87.2	73.7	18.3	89.9	-3.0
Other expenses	187.6	131.1	43.1	177.7	5.6
Total expenses	581.0	431.0	34.8	587.1	-1.0
Operating profit	**86.1**	**66.2**	**30.1**	**111.1**	**-22.5**
Other Income	4.2	5.3	-20.9	5.9	-29.4
EBITDA	90.3	71.4	26.4	117.0	-22.9
Interest expenses	6.9	3.7	84.2	3.9	76.2
Depreciation & Amortization	29.8	27.5	8.7	28.7	4.0
Profit before Tax	**53.6**	**40.3**	**33.1**	**84.4**	**-36.5**
Tax	14.9	9.3	60.5	21.5	-30.7
Adjusted PAT	**38.7**	**31.0**	**24.9**	**62.9**	**-38.6**
EPS	1.6	1.2	24.9	2.5	-38.6
			bps		bps
GPM (%)	54.1	54.5	-40	54.2	-15
OPM (%)	12.9	13.3	-40	15.9	-301
NPM (%)	5.8	6.2	-43	9.0	-322
Tax rate (%)	27.8	23.1	475	25.5	235

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - long-term growth prospects intact

India is the second-largest footwear manufacturer with consumption of ~26 billion pairs after China with ~42 billion pairs. The domestic market makes up ~90% of India's overall footwear market. The domestic footwear market was badly affected by the lockdown during the pandemic in FY2021. FY2022 was volatile as the second and third wave of COVID-19 impacted demand but a rapid vaccination programme and dropping cases helped in recovery. In the near term, demand is expected to be subdued owing to continued extraordinary inflation impacting consumers' discretionary spends. However, low per capita consumption at 1.9 pair per annum, footwear now being considered as an important fashion accessory rather than a necessity, growing trend of premiumisation in the Indian footwear industry, and the shift to branded footwear provide a huge opportunity for top brands to scale up operations in the medium-long term. The Indian footwear market is expected to post a CAGR of ~11% over CY2021-CY2025 compared to global market growth of 5.5% CAGR over CY2021-CY2025.

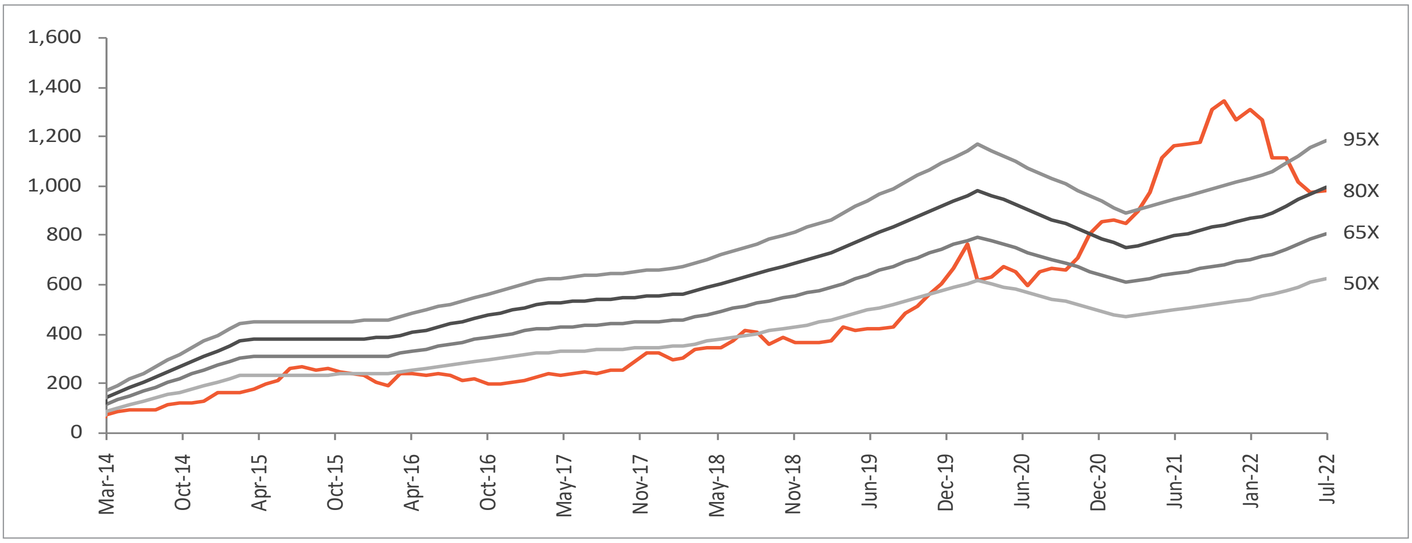
■ Company outlook - Margins under pressure in the near term; Long-term outlook intact

A sharp increase in raw-material prices compelled domestic players to pass it to consumers through price hikes. Overall inflation and slowdown in the rural economy will are key headwinds in the near term. For full year FY2023, we expect good growth on y-o-y basis, driven by market share gains from unorganised players, higher presence in e-commerce channels, and higher demand for value-for-money products. Lower per capita consumption in India, Relaxo's under-penetration in the South Indian market, and sustained product additions remain long-term growth drivers. The company expects margin improvement from Q2FY2023 as raw material inflation is cooling off as global supply improves and price hikes undertaken in December 2021 will provide good cushioning in the coming quarters.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,130

Relaxo is well poised to achieve revenue and earnings CAGR of 16% and 27%, respectively, over FY2022-FY2024E, with a strong portfolio of value-for-money footwear products, enhanced capacity of 10.5 lakh pairs per day, and expansion in distribution reach (especially in southern markets). The company has a strong balance sheet (zero net debt) with good cash generation ability. Stock price has corrected by 22% in the past six months and any further correction can be considered as a buying opportunity in the quality stock with its long-term growth prospects intact. The stock currently trades at 8x/65x its FY2023E/FY2024E earnings. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,130.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Bata	-	61.6	40.4	50.0	26.9	20.1	5.3	12.5	16.9
Relaxo Footwears	-	87.8	65.0	58.8	49.7	38.5	17.5	20.7	23.8

Source: Company; Sharekhan Research

About company

Relaxo is a leading footwear company with annual turnover of over Rs. 2,600 crore. The company has eight manufacturing facilities across northern India with a capacity to produce ~10 lakh pairs per day. The company sells close to 18 crore pairs per annum through its wide distribution network of over 60,000 retailers, ~650 distributors, and 394 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 unique selling preposition (USP), whereas Schoolmate is specifically for school shoes. The company also exports its products to ~30 countries and has an overseas office in Dubai.

Investment theme

Relaxo's revenue reported a CAGR of ~10% with volume CAGR of 5% over FY2017-FY2022. Inflationary environment and GST rate hike on footwear below Rs. 1,000 per pair will affect the performance in the near term. However, the long-term growth prospects of the domestic footwear sector are intact. 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 crore – Rs. 60,000 crore Indian footwear market, of which ~50% is unbranded. Capacity expansion, investment on brands, steady volume growth, and improving presence in untapped markets along with increasing price differential in imported and domestic footwear as a result of 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 competition in highly penetrated categories:** Heightened competition would threaten revenue growth.
- **Increased input costs:** Any significant increase in rubber prices or that of crude oil derivatives would affect profitability.

Additional Data

Key management personnel

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

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management	5.72
2	VL Finance SASU	3.8
3	Vanguard Group Inc	1.09
4	UTI Asset Management Co Ltd	0.88
5	Blackrock Inc	0.34
6	Capital Group Companies	0.29
7	Dimensional Fund Advisors	0.2
8	William Blair and Co LLC	0.16
9	Sudaram AMC Ltd	0.14
10	Norges Bank	0.13

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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