Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Relaxo Footwear

## Weak Q2; recovery likely with price correction

| Consumer Discretionary | Sharekhan code: RELAXO |
|---|---|
| Reco/View: Buy ⇔ | CMP: Rs. 932 |
| | Price Target: Rs. 1,185 ⇔ |

↑ Upgrade ⇔ Maintain ↓ Downgrade

### 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 Oct 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. 23,208 cr |
| 52-week high/low: | Rs. 1,447 / 928 |
| NSE volume: (No of shares) | 1.4 lakh |
| BSE code: | 530517 |
| NSE code: | RELAXO |
| Free float: (No of shares) | 7.3 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 70.8 |
| FII | 3.5 |
| DII | 7.4 |
| Others | 18.3 |

### Price chart


### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -8.7 | -6.6 | -14.0 | -33.9 |
| Relative to Sensex | -13.5 | -10.8 | -23.2 | -35.6 |

*Sharekhan Research, Bloomberg*


### Summary

- Relaxo Footwear registered weak numbers in Q2FY2023 as multiple headwinds hit both revenue and profitability. Revenue was affected by decline in sales volume due to weak consumer sentiments, while margins were lower due to higher inventory of high-priced raw materials.
- Revenues/PAT declined by 6.3%/67.2% y-o-y, to Rs. 669.7 crore and Rs. 22.4 crore, respectively, while gross margin and EBITDA margin fell by 589 bps and 743 bps y-o-y, respectively.
- However, a recovery is expected in the coming quarters as the company has slashed prices by 15-20%, which will help boost volumes, while falling raw material prices will help improve margins from Q4FY2023. The management targets to achieve 19 crore pair sales volume by FY2024.
- Drivers are in place to achieve consistent earnings growth and improving return profile in the medium term. The stock trades at 82.8x/57.4x its FY2024E/FY2025E EPS. We maintain Buy with an unchanged PT of Rs. 1,185.


**Relaxo Footwear (Relaxo) posted weak numbers in Q2FY2023 as poor consumer sentiments and higher input prices took a toll on performance. Revenues fell by 6.7% y-o-y to Rs. 669.7 crore. The company sold 3.9 crore pairs in Q2FY2023, down from 4.6 crore pairs sold in Q2FY2022. Gross margins and EBITDA margins declined by 589 bps and 743 bps y-o-y to 48.9% and 8.9%, respectively affected by higher inventory of high-priced raw materials and passing by effect of corrective price revisions taken by the company at the fag-end of the quarter. EBITDA fell by 49% y-o-y to Rs. 59.4 crore. In line with a decline in EBITDA, coupled with lower other income and higher interest cost, reported PAT fell by 67.2% y-o-y to Rs. 22.4 crore. For H1FY2023, revenue grew by 10.3% y-o-y to Rs. 1,336.8 crore, while PAT declined by 38.5% y-o-y to Rs. 61.1 crore and EBITDA margin contracted by 419 bps y-o-y.**

### Key positives

- Prices of key input materials - Ethylene-Vinyl Acetate (EVA) and Polyurethane (PU) have corrected from highs due to better global supply.
- Sparx brand (~40% of revenues) registered a growth of 30% with strong demand for sport shoes and sandals.

### Key negatives

- Volumes were lower by 15.2%/12.5% y-o-y in Q2FY2023/H1FY2023 due to inflationary pressures.
- Gross/EBITDA margins declined by 589/743 bps y-o-y, hit by a revenue decline and higher inventory of high-priced raw materials.

### Management Commentary

- Q2FY2023 revenue growth was hit by high inflation impacting consumer spending of mass population and rural regions. This and consumers shifting to cheaper alternatives hit volumes which declined by 15.2% y-o-y in Q2. Hawai Chappals under the brand – Bahamas, flite and Relaxo witnessed 20% decline in value terms.
- The company took aggressive price corrections in September 2022 (of 15-20% in open-ended products) to remain competitive in the market and to pass on benefits of falling raw material prices to the consumers. The management has indicated that price rationalisation approach has been welcomed by trade and consumers and expects benefit from price cuts to be visible from Q3FY2023 once the new inventory with revised prices is available with channel partners.
- Prices of certain raw materials have slumped in the past few months and have started to decline from their highs. As the company maintains sufficient inventory to support the long supply chain, there is a time lag for the costs to influence pricing. The management expects the advantage of falling raw material prices to start flowing in from Q4FY2023 as the inventory of high cost raw material will phase out in Q3.
- Sports shoes under the Sparx brand is gaining strong traction. The company is planning to double capacity by April 2023. Management is confident of maintaining 30% growth in the Sparx brands due to strong demand in retail and online platform.
- The company is planning to do capex of Rs.140 crore for FY2023 (including doubling shoes' capacity) and capex of Rs. 80-100 crore for FY2024-25.

**Revision in estimates –** We have reduced our earning estimates for FY2023 to factor lower than earlier expected OPM while we have marginally reduced them for FY2024 and FY2025. Overall FY2023 is expected to be lull affected by weak performance in H1FY2023. However good recovery is anticipated from FY2024

### Our Call

**View: Maintain Buy with an unchanged PT of Rs. 1,185** - Relaxo posted weak performance in Q2FY2023 as revenue and profitability were hit by multiple factors. Recovery is likely from Q4FY2023 on the back of gradual improvement in volumes and margin pressures to ease as key input prices are falling. 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), Relaxo is well poised to achieve revenue and earnings CAGR of 14% and 20%, respectively, over FY2022-FY2025E, with key levers expected to drive consistent growth. The company has a strong balance sheet (zero net debt) with good cash generation ability. Stock has corrected by ~5% after weak results and 14% in the past six months and is trading at 82.8x/57.4x its FY2024E/FY2025E earnings. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 1,185.

### 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 | FY25E |
|---|---|---|---|---|---|
| Revenues | 2,359 | 2,653 | 2,860 | 3,148 | 3,720 |
| EBITDA margin (%) | 21.0 | 15.7 | 12.5 | 16.0 | 18.0 |
| Adjusted PAT | 305 | 233 | 176 | 279 | 403 |
| Adjusted diluted EPS (Rs.) | 12.3 | 9.4 | 7.1 | 11.3 | 16.2 |
| P/E (x) | 75.9 | 99.5 | - | 82.8 | 57.4 |
| P/B (x) | 14.7 | 13.2 | 12.4 | 11.1 | 9.5 |
| EV/EBITDA (x) | 46.6 | 56.0 | 65.2 | 46.0 | 34.3 |
| RoNW (%) | 21.4 | 14.0 | 9.7 | 14.1 | 17.8 |
| RoCE (%) | 29.5 | 17.5 | 13.4 | 22.0 | 24.1 |

*Source: Company; Sharekhan estimates*

**Weak Q2; Revenue/PAT declined by 6%/67% y-o-y, respectively**

Relaxo's Q2FY23 revenue declined by 6.3% y-o-y to Rs. 669.7 crore, which is largely in-line with our and street expectation of Rs. 660-664 crore owing to lower sales volume due to weak consumer sentiments. The company sold 3.9 crore pairs in Q2FY2023, down from 4.6 crore pairs sold in Q2FY2022 (large drop in volumes was seen in mass products). Average realisation per pair stood at Rs. 169 per pair (average realisation per pair stood at Rs. 172 in Q1) from Rs. 154 per pair in Q2FY2022. Gross margins and EBITDA margins declined by 589 bps and 743 bps y-o-y to 48.9% and 8.9%, respectively affected by higher inventory of high-priced raw materials and corrective price revisions taken by the company at the fag-end of the quarter. Gross margins and EBIDTA margins were much lower than our expectation of 54.3% and 14% (street expectation of 15%), respectively. EBITDA fell by 49% y-o-y to Rs. 59.4 crore. In-line with decline in EBITDA, coupled with lower other income and higher interest cost, reported PAT fell by 67.2% y-o-y to Rs. 22.4 crore, much lower than our and street expectation of Rs. 45-50 crore.

For H1FY2023, revenues grew by 10.3% y-o-y to Rs. 1,336.8 crore while PAT declined by 38.5% y-o-y to Rs. 61.1 crore and EBITDA margins contracted by 419 bps y-o-y. The impact of price hikes undertaken by the company were partially offset by lower volumes as inflationary pressures affected consumption trends. The company sold 7.7 pairs in H1FY2023, lower than 8.8 pairs sold in H1FY2022. Profitability was affected as prices of certain key raw materials remained at elevated levels. Capex for H1FY2023 stood at Rs. 60 crore and cash flow from operations came in at Rs. 185 crore.

## Key highlights of conference call

- **Volume offtake affected by multiple factors:** Relaxo undertook 3-4 rounds of aggressive price hikes to the tune of 25-30% in key brands such as Relaxo, Bahamas and flite within a short span in H2FY2022. The combined effect of price increases, increase in GST on footwear below Rs. 1,000 to 12% from 5%, higher inflation slowing the consumer demand and competition from new unorganised players affected sales volume in H1FY2023. Volumes were down by 12.5% in H1FY2023. Close-end footwear (contribute 50-60% of revenues) registered a decline of 20% in value terms in Q2FY2023.
- **Price cuts to bear fruits:** The company took an aggressive price correction of 15-20% in September 2022 for close-ended footwear products (especially at the mass end of the category) to remain competitive in the market and to pass on the benefit of falling raw material prices to the consumers. The management has indicated that the price rationalization approach has been welcomed by trade and consumers, which would lead to better volume numbers in the coming quarters. The benefit from the price cut will be visible from Q3FY2023 once the new inventory with revised prices is available with the channel partners.
- **Fall in raw-material prices to provide relief from Q4FY2023:** In the last few months, prices of certain key raw materials witnessed a sharp decline from their highs. Prices of EVA had risen to Rs. 300/kg from Rs. 100/kg and currently saw a drop to Rs. 160/kg in-line with fall in the global commodity prices. The same are currently trading at Rs. 200/kg. The company consumers around 1,000 tonnes of EVA every month. The company maintains sufficient inventory of around six months due to the long supply-chain to ensure there are no disruptions in the manufacturing process. Hence, there is a time lag for costs to influence the pricing. The management expects the advantage of falling raw material prices to start flowing in from Q4FY2023 as inventory of high cost raw material will phase in Q3.
- **Sparx gaining strong traction:** Sparx athleisure brands (contributes around 40% of revenues) grew by 30% in Q2FY2023. This was on back of strong demand for sports shoes and Athleisure products. Strong demand was seen on the retail as well as e-Commerce platform. Management expects strong growth 30% to continue in the quarters ahead. Of the total presence of 60,000 outlets, Sparx is available in 10,000 outlets and the company expects the availability to improve to 15,000-20,000 outlets in the coming years.
- **Focus on closed footwear to continue:** The company is undertaking various steps to capture the increased demand for closed footwear by focusing more on in-house manufacturing, product premiumization with the launch of new products & ranges and e-commerce initiatives. Current capacity for Sparx is around 50,000 pairs, which will doubled by early FY2024. The company expects the contribution from closed footwear to increase upto 20% in the medium term from 15% currently aided by capacity additions and improving demand in the shoes category.

- **EBO model to aid in profitability:** The company recently has started experimenting with the EBO model wherein the company has opened 50-100 stores to store all in-house brands of Relaxo. Through this strategy, the company will focus on improving the sales as well as profitability per store.
- **Growth drivers in place:** The management has identified 4-5 levers, which are expected to drive growth for the company including higher contribution from the e-Commerce channel, expansion in closed footwear, increased export contribution, adoption of the exclusive brand outlet (EBO) model and steady growth momentum maintained in the open footwear category.

**Results (Standalone)** Rs cr

| Particulars | Q2FY23 | Q2FY22 | y-o-y (%) | Q1FY23 | q-o-q (%) |
|---|---|---|---|---|---|
| **Net Revenue** | **669.7** | **714.4** | **-6.3** | **667.2** | **0.4** |
| Raw-material cost | 342.2 | 323.0 | 5.9 | 306.3 | 11.7 |
| Staff cost | 84.5 | 86.7 | -2.6 | 87.2 | -3.1 |
| Other expenses | 183.6 | 188.3 | -2.5 | 187.6 | -2.1 |
| Total expenses | 610.2 | 597.9 | 2.1 | 581.0 | 5.0 |
| **EBITDA** | **59.4** | **116.5** | **-49.0** | **86.1** | **-31.0** |
| Other Income | 5.7 | 7.1 | -19.9 | 4.2 | 35.7 |
| Interest expenses | 4.1 | 3.6 | 13.2 | 6.9 | -40.0 |
| Depreciation & Amortization | 30.5 | 28.3 | 7.8 | 29.8 | 2.3 |
| **Profit before Tax** | **30.4** | **91.6** | **-66.8** | **53.6** | **-43.2** |
| Tax | 8.0 | 23.3 | -65.4 | 14.9 | -46.1 |
| **Adjusted PAT** | **22.4** | **68.4** | **-67.2** | **38.7** | **-42.1** |
| EPS | 0.9 | 2.8 | -67.2 | 1.6 | -42.1 |
| | | | **bps** | | **bps** |
| GPM (%) | 48.9 | 54.8 | -589 | 54.1 | -519 |
| EBITDA Margin (%) | 8.9 | 16.3 | -743 | 12.9 | -403 |
| NPM (%) | 3.3 | 9.6 | -622 | 5.8 | -245 |
| Tax rate (%) | 26.4 | 25.4 | 103 | 27.8 | -141 |

*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 severely affected by the COVIDD-led lockdown in FY2021. FY2022 was volatile as the second and third wave of COVID-19 affected 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 hitting consumers' discretionary spends. However, low per capita consumption at 1.7 pairs 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.

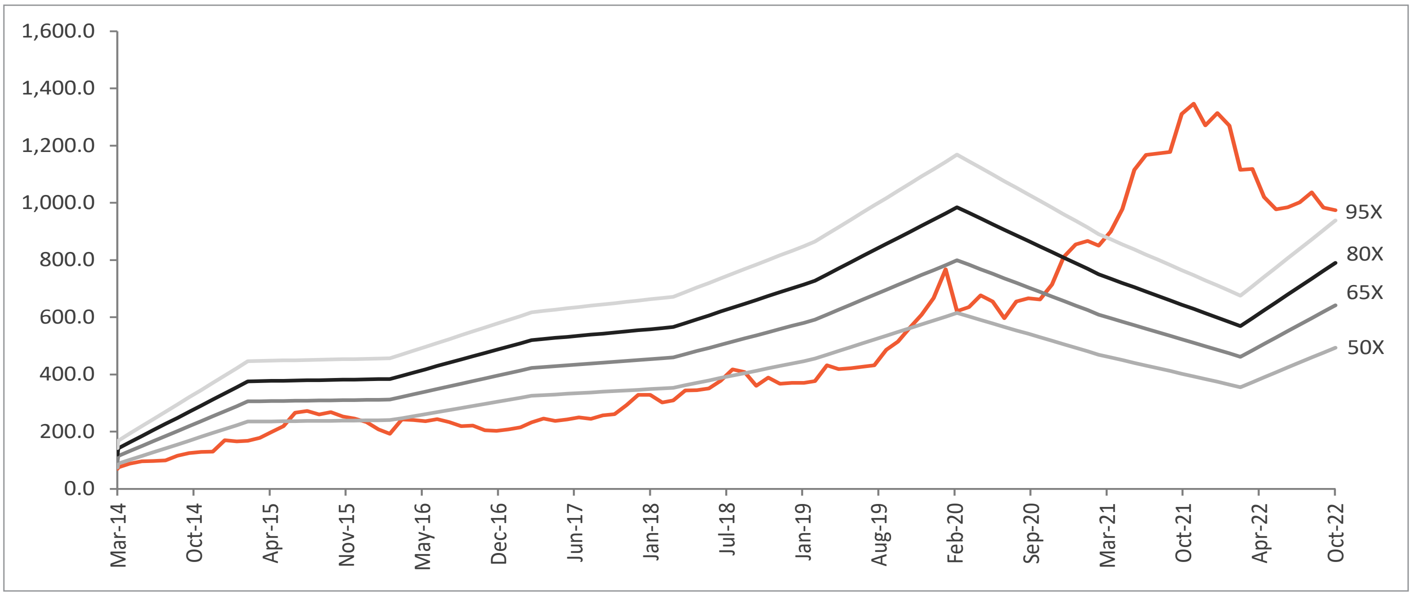
### ■ Company outlook - Margins under pressure in the near term; Long-term outlook intact

With lower sales volumes and sustained margin pressures, the management expects H1FY2023 to muted with lower sales volume and decline in the EBIDTA margins (affected by inflated input prices). The price correction undertaken in key brands and raw material prices stabilising will help in gradual improvement in the sales volume and profitability from H2FY2023. With revamped pricing strategy and strong focus on e-commerce and branding of the products, the company expects strong recovery in FY2024. Lower per capita consumption in India, Relaxo's under-penetration in the South Indian market, focusing on EBO model for key brands and sustained product additions remain long-term growth drivers.

### ■ Valuation - Maintain Buy with an unchanged PT of Rs. 1,185

Relaxo posted weak performance in Q2FY2023 as revenue and profitability were hit by multiple factors. Recovery is likely from Q4FY2023 on the back of gradual improvement in volumes and margin pressures to ease as key input prices are falling. 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), Relaxo is well poised to achieve revenue and earnings CAGR of 14% and 20%, respectively, over FY2022-FY2025E, with key levers expected to drive consistent growth. The company has a strong balance sheet (zero net debt) with good cash generation ability. Stock has corrected by ~5% after weak results and 14% in the past six months and is trading at 82.8x/57.4x its FY2024E/FY2025E earnings. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 1,185.

**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 | - | 57.7 | 40.6 | 50.1 | 25.9 | 20.2 | 5.3 | 13.2 | 16.7 |
| Relaxo Footwears | 99.5 | - | 82.8 | 56.0 | 65.2 | 46.0 | 17.5 | 13.4 | 22.0 |

*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 388 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. 55,000-60,000 crore Indian footwear market, of which ~50% is unbranded. The management has identified 4-5 levers, which are expected to drive growth for the company including higher contribution from e-commerce channel, expansion in closed footwear, increased export contribution, adoption of the EBO model and steady growth momentum maintained in the open footwear category.

## 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 | 0.95 |
| 4 | UTI Asset Management Co Ltd | 0.86 |
| 5 | Blackrock Inc | 0.36 |
| 6 | Sundaram AMC Ltd | 0.31 |
| 7 | Capital Group Companies | 0.29 |
| 8 | Dimensional Fund Advisors | 0.21 |
| 9 | Norges Bank | 0.13 |
| 10 | Tata AMC Pvt Ltd | 0.07 |

*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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