

## Significantly higher COGS/pair dents profitability...

**About the stock:** Relaxo is India's leading footwear manufacturing company, boasting of largest capacity of 10.0 lakh pairs per day. Relaxo is a dominant player in the open footwear space (~76% of sales), with its strong portfolio of brands ('Flite', 'Bahamas', 'Sparx', 'Relaxo).

- Market leader in value priced segment selling ~19 crore pairs annually
- Over the years, it has maintained b/s prudence with controlled working capital cycle, healthy asset turn of 2.5x and generated RoCE of 20%+

**Q2FY23 Results:** Higher raw material (RM) prices dented profitability. EBITDA margins came in at an all-time low (single digit).

- Revenue de-grew 6% YoY to ₹ 669.7 crore (flattish QoQ). Volumes continued to remain under pressure (< 4.0 crore pair), declining 15% YoY. Average realisation was at ₹ 170/pair (up 11% YoY)
- Gross margins have slipped below the 50% mark to one of its lowest levels at 48.9% (down 590 bps YoY, 520 bps QoQ) owing to significantly higher cost RM inventory (EVA). Subsequently, EBITDA margins contracted to an all-time low of 8.9% (down 750 bps YoY, 400 bps QoQ)
- PAT for the quarter declined 67% YoY (down 42% QoQ) to ₹ 22.4 crore

**What should investors do?** Relaxo witnessed ~30% decline in share price on a YTD basis owing to unprecedented inflation scenario (35% of its RM is based on crude derivatives) and uncertainties on the demand outlook. While we do remain structurally positive on the business model given its strong brand salience in tier II/III towns and healthy balance sheet to weather the crisis, premium valuations and near term headwinds may limit upsides. Also, with high cost inventory still existing, Q2FY23 margins may not have completely bottomed out yet.

- Hence, we reiterate **HOLD** on the stock with a revised target price. With correction in ASPs, key monitorable remains recovery in the volume trajectory that has stagnated in the past couple of quarters to ~ 4 crore pairs

**Target Price and Valuation:** We value Relaxo at ₹ 930 i.e. 65x FY24E EPS.

### Key triggers for future price performance:

- Despite selling ~18 crore pairs, Relaxo's current market share is <10%. Given its robust balance sheet and strong brand patronage, we believe there is enough headroom for long-term growth and market share gains
- While the north region remains the main fortress for the company (50%+ revenues), west and south remain relatively underpenetrated markets. Relaxo has geo-tagged ~100000 outlets (currently present in ~60000 outlets), which signifies immense opportunity to penetrate new territories
- We model revenue CAGR of 11% in FY22-24E with volumes recovering to ~20.0 crore pairs in FY24 (FY21: 19.0, FY22: 17.5, FY23: 16.8 crore pairs)

**Alternate Stock Idea:** Apart from Relaxo, in our retail coverage we also like Bata.

- Bata India has a strong b/s, diversified branded product portfolio and pan India network. BUY with a target price of ₹ 2225



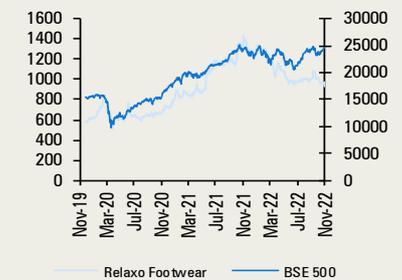
### Particulars

Particulars	Amount
Market Capitalisation (₹ crore)	23,321.4
Total Debt (FY22) (₹ crore)	20.0
Cash & investment (FY22) (₹ crore)	206.8
EV (₹ crore)	23,134.7
52 Week H / L	1447 / 910
Equity Capital (₹ crore)	24.9
Face Value (₹)	1.0

### Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	70.9	70.8	70.8	70.8	70.8
FII	3.6	3.8	3.2	3.2	3.1
DII	7.2	7.1	6.9	7.1	7.4
Others	18.4	18.3	19.1	19.0	18.7

### Price Chart



### Key risks

**Key Risk:** (i) Faster than expected recovery in volumes may aid revenue growth (ii) Higher RM cost may subdue margins

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### Key Financial Summary

Financials	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	2,410.5	2,359.2	2,653.3	10.0%	2,801.9	3,270.3	11.0%
EBITDA	409.0	495.5	415.8	12.0%	344.6	591.9	19.3%
Adjusted PAT	226.3	291.6	232.7	14.0%	174.5	354.6	23.4%
P/E (x)	103.1	80.1	100.6		134.1	66.0	
EV/Sales (x)	9.7	9.8	8.8		8.2	7.0	
EV/EBITDA (x)	57.1	46.4	55.9		66.8	38.7	
RoCE (%)	23.9	26.0	18.3		13.4	23.5	
RoE (%)	17.8	18.5	13.2		9.3	16.9	

## Key takeaways of Q2FY23 results and conference call highlights

- The revenue trajectory for Relaxo continued to remain sluggish as higher RM prices and subsequent steep price hikes (~25% in FY22) have materially impacted demand since the target audience is price sensitive. The management highlighted that volumes in the mass category of open footwear (Hawaii and Flite brands) had declined due to customers shifting to cheaper unbranded products. The closed footwear category continues to grow and witnessed 30% growth. Revenue for the quarter declined 6% YoY (flattish QoQ) to ₹ 669.7 crore. Overall ASP for Relaxo was at ₹ 170 whereas ASP for Sparx brand was ~₹ 450. **From September onwards, the company has taken a price correction of 15-20% in the open footwear category.** For PU and sports segment, the company has not done any price correction. The company intends to stimulate the volumes of the open footwear category through the recent price cuts and is expecting volumes to pick up from November 2022 onwards.
- **In the previous four quarters, average quarterly volumes have stagnated to ~ 4.0 crore pairs after hitting an all-time quarterly high of 5.7 crore pairs in Q4FY21.** Relaxo in FY21 had recorded its highest sales volume (19.1 crore pairs) as the pandemic led restrictions had given a fillip to demand for open footwear (slippers & sandals). However, as restrictions eased from Q2FY22 onwards, demand for open footwear (~75% of sales) started to moderate. Also, as more than 35% of raw material (RM) is crude based derivatives, sharp inflation has impacted volumes, especially for Hawaii categories
- EVA, which is a major raw material for the company, has seen huge volatility in prices. Prices increased from ₹ 120/kg to ₹ 300/kg, declined to ₹ 160/kg and have now moved up again to ₹ 200/kg. **In Q2FY23, owing to high cost inventory, cost of goods sold (COGS) per pair increased to an all-time high of ₹ 88/kg (up 25% YoY).** The company continues to carry high cost inventory (management expects old inventory to be exhausted by December), which could further lead to deterioration in gross margins in Q3FY23 (as per our estimates by ~100 bps QoQ) owing to correction in ASPs. On the positive side, cuts in prices could result in enhanced volumes in ensuing quarters (leading to positive operating leverage). Factoring in Q2FY23 performance, we revise our EBITDA estimates downwards by 25% in FY23E (EBITDA margin: 12.3%). With stabilisation in RM prices and recovery in volumes, we expect EBITDA margins to revert back to pre-Covid levels by Q1FY24E
- Brand Sparx is performing well as demand for sports and athleisure category continues to be strong. The brand contributes ~38% to revenues with closed shoes contributing ~60%. The management indicated that currently capacity of sports shoes/sandals is almost fully utilised (capacity: 50000 pairs per day). Hence, it has proposed to add another 50000 sports shoes capacity per day to cater to the strong demand. The plant is expected to be operational from April 2023. For the Sparx brand, the company is looking to expand presence in the north and eastern region as the brand has a good foothold in the southern and western regions. It believes that athleisure footwear segment will grow at a fast clip owing to a shift in consumer behaviour towards fitness based products
- The online channel contributed 12% of revenues in FY22. The company expects it to increase to 15% over the next two to three years. For Sparx brand, the contribution from the online channel is at 20-25%. The same is expected to increase, going ahead
- On the overall capex front, the management indicated that capex for FY23 would be ~ ₹ 140 crore while for FY24 it would be between ₹ 80-100 crore

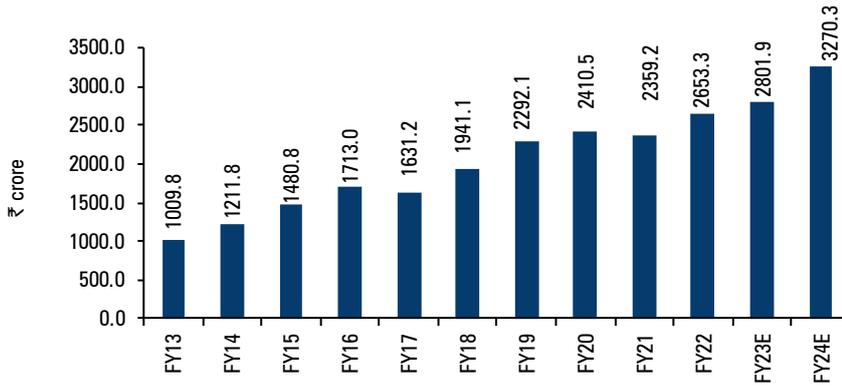
**Exhibit 1: Variance Analysis**

	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	669.7	714.4	-6.3	667.2	0.4	Volumes declined 15% YoY. Hawaii category impacted the most. Average realisations up 11%
Raw Material Expens	342.2	323.0	5.9	306.3	11.7	
Gross Profit	327.5	391.5	-16.3	360.9	-9.3	
Gross Profit Margin	48.9	54.8	-589 bps	54.1	-519 bps	Gross margins have slipped below 50% mark to one of its lowest levels at 48.9% owing to significantly higher cost RM inventory (EVA & PU).
Employee exp	84.5	86.0	-1.8	87.2	-3.1	
Other Exp	183.6	188.3	-2.5	187.6	-2.1	
EBITDA	59.4	117.2	-49.3	86.1	-31.0	
EBITDA Margin (%)	8.9	16.4	-753 bps	12.9	-403 bps	Furthermore, owing to negative operating leverage, EBITDA margins declined by 750 bps YoY
Depreciation	30.5	28.3	7.8	29.8	2.3	
Other Income	5.7	7.1	-19.9	4.2	35.7	
Interest	4.1	3.6	13.2	6.9	-40.0	
Exceptional Income	-	-	-	-	-	
PBT	30.4	92.3	-67.0	53.6	-43.2	
Tax Outgo	8.0	23.3	-65.4	14.9	-46.1	
PAT	22.4	69.1	-67.6	38.7	-42.1	

Source: Company, ICICI Direct Research

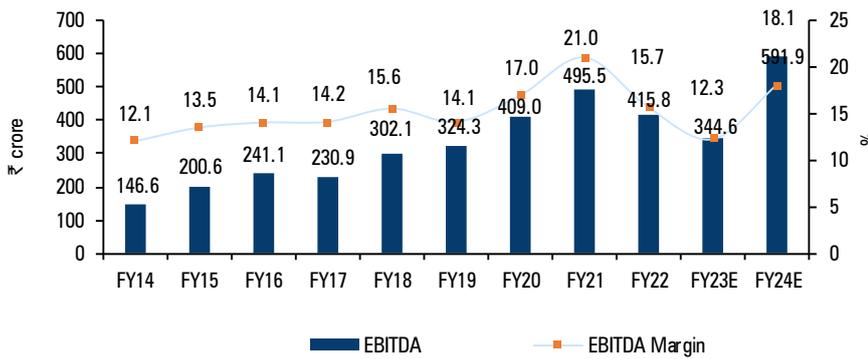
## Financial story in charts

Exhibit 2: Revenue growth trend



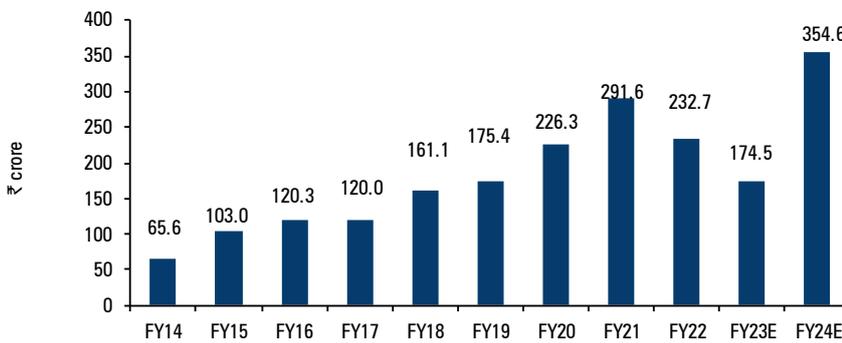
Source: Company, ICICI Direct Research

Exhibit 3: EBITDA and EBITDA margin trend



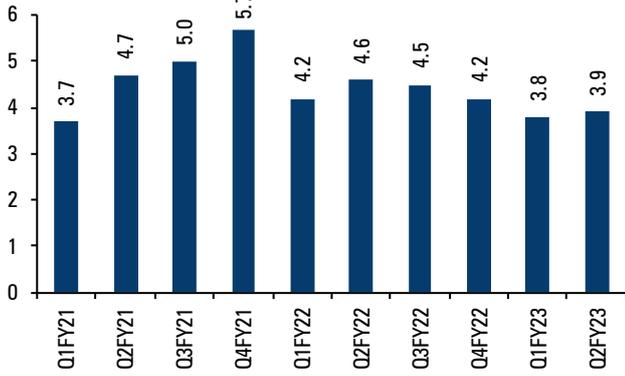
Source: Company, ICICI Direct Research

Exhibit 4: Net profit trend



Source: Company, ICICI Direct Research.

Exhibit 5: Quarterly volume trend (crore pairs)



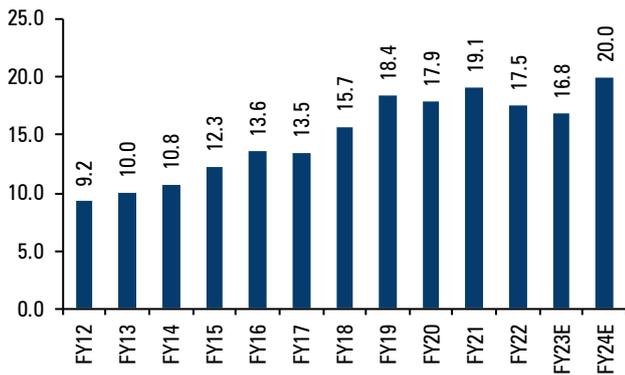
Source: Company, ICICI Direct Research

Exhibit 6: Realisation trend (₹/pair)



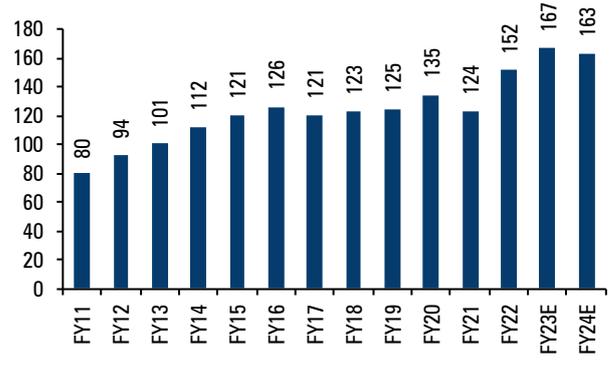
Source: Company, ICICI Direct Research

Exhibit 7: Annual volume trend (crore pairs)



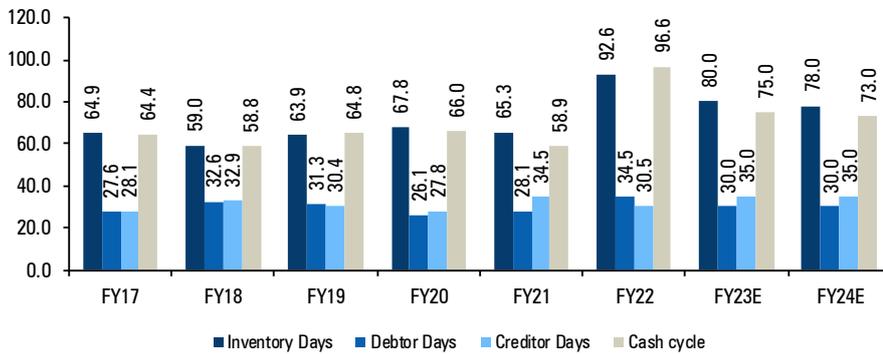
Source: Company, ICICI Direct Research

Exhibit 8: Realisation trend (₹/pair)



Source: Company, ICICI Direct Research

Exhibit 9: Net working capital cycle



Source: Company, ICICI Direct Research.

## Financial Summary

Exhibit 10: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Net Sales</b>	2,359.2	2,653.3	2,801.9	3,270.3
Growth (%)	(2.1)	12.5	5.6	16.7
Total Raw Material Cost	1,003.3	1,216.7	1,361.7	1,488.0
Gross Margins (%)	57.5	54.1	51.4	54.5
Employee Expenses	301.4	334.7	344.6	379.4
Other Expenses	559.0	686.1	750.9	811.0
Total Operating Expenditure	1,863.7	2,237.5	2,457.2	2,678.3
<b>EBITDA</b>	495.5	415.8	344.6	591.9
EBITDA Margin	21.0	15.7	12.3	18.1
Interest	17.1	15.3	17.9	20.2
Depreciation	110.0	113.5	123.5	132.8
Other Income	22.8	23.7	30.0	35.0
Exceptional Expense	-	-	-	-
PBT	391.2	310.6	233.2	473.9
Total Tax	99.6	77.9	58.7	119.3
<b>Profit After Tax</b>	291.6	232.7	174.5	354.6

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit/(Loss) after taxation	291.6	232.7	174.5	354.6
Add: Depreciation	110.0	113.5	123.5	132.8
Net Increase in Current Assets	56.0	-271.6	66.9	-137.9
Net Increase in Current Liabilities	62.0	-12.2	47.9	45.9
<b>CF from operating activities</b>	<b>519.6</b>	<b>62.5</b>	<b>412.8</b>	<b>395.5</b>
(Inc)/dec in Investments	-338.0	143.9	-107.2	45.0
(Inc)/dec in Fixed Assets	-123.3	-150.5	-139.8	-107.0
Others	-13.4	1.7	9.1	0.0
<b>CF from investing activities</b>	<b>-474.7</b>	<b>-4.8</b>	<b>-238.0</b>	<b>-62.0</b>
Inc / (Dec) in Equity Capital	0.0	0.1	0.0	0.0
Inc / (Dec) in Loan	-19.2	20.0	-20.0	0.0
Others	-22.2	-72.8	-99.7	-164.5
<b>CF from financing activities</b>	<b>-41.3</b>	<b>-52.8</b>	<b>-119.7</b>	<b>-164.5</b>
Net Cash flow	3.6	4.9	55.2	169.0
Opening Cash	4.1	7.7	12.6	67.7
<b>Closing Cash</b>	<b>7.7</b>	<b>12.6</b>	<b>67.8</b>	<b>236.7</b>

Source: Company, ICICI Direct Research

Exhibit 12: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Equity Capital	24.8	24.9	24.9	24.9
Reserve and Surplus	1,547.6	1,735.0	1,848.5	2,079.0
Total Shareholders funds	1,572.4	1,759.9	1,873.4	2,103.9
Total Debt	-	20.0	-	-
Non Current Liabilities	164.0	173.9	173.9	173.9
<b>Source of Funds</b>	<b>1,736.4</b>	<b>1,953.8</b>	<b>2,047.3</b>	<b>2,277.7</b>
Gross block	975.3	1,099.6	1,249.6	1,379.6
Less: Accum depreciation	254.2	330.2	415.2	507.6
Net Fixed Assets	721.1	769.4	834.4	871.9
Capital WIP	112.2	145.2	135.0	112.0
Intangible assets	39.1	32.4	32.4	32.4
Investments	338.2	194.3	301.5	256.5
Inventory	422.1	673.3	614.1	698.9
Cash	7.7	12.5	67.7	236.7
Debtors	181.5	250.8	230.3	268.8
Loans & Advances & Other CA	146.1	97.2	110.0	124.6
Total Current Assets	757.3	1,033.7	1,022.1	1,328.9
Creditors	222.8	221.7	268.7	313.6
Provisions & Other CL	216.6	205.5	206.4	207.4
Total Current Liabilities	439.4	427.2	475.1	521.0
Net Current Assets	318.0	606.5	546.9	807.9
LT L& A, Other Assets	207.9	206.1	197.1	197.1
Other Assets	0.0	0.0	0.0	0.0
<b>Application of Funds</b>	<b>1,736.4</b>	<b>1,953.8</b>	<b>2,047.2</b>	<b>2,277.7</b>

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Per share data (₹)</b>				
EPS	11.7	9.3	7.0	14.2
Cash EPS	16.2	13.9	12.0	19.6
BV	63.3	70.7	75.3	84.5
DPS	0.0	2.5	2.5	5.0
Cash Per Share	0.3	0.5	2.7	9.5
<b>Operating Ratios (%)</b>				
EBITDA margins	21.0	15.7	12.3	18.1
PBT margins	16.6	11.7	8.3	14.5
Net Profit margins	12.4	8.8	6.2	10.8
Inventory days	65.3	92.6	80.0	78.0
Debtor days	28.1	34.5	30.0	30.0
Creditor days	34.5	30.5	35.0	35.0
<b>Return Ratios (%)</b>				
RoE	18.5	13.2	9.3	16.9
RoCE	26.0	18.3	13.4	23.5
RoIC	34.6	20.8	16.1	30.6
<b>Valuation Ratios (x)</b>				
P/E	80.1	100.6	134.1	66.0
EV / EBITDA	46.4	55.9	66.8	38.7
EV / Sales	9.8	8.8	8.2	7.0
Market Cap / Revenues	9.9	8.8	8.4	7.2
Price to Book Value	14.8	13.3	12.5	11.1
<b>Solvency Ratios</b>				
Debt / Equity	0.0	0.0	0.0	0.0
Debt/EBITDA	0.0	0.0	0.0	0.0
Current Ratio	1.7	2.4	2.0	2.1
Quick Ratio	0.7	0.8	0.7	0.8

Source: Company, ICICI Direct Research

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Sell: <-15%



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