Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Relaxo Footwear

Volumes revive in weak quarter

Consumer Discretionary	Sharekhan code: RELAXO

Reco/View: Buy	↔	CMP: Rs. 788	Price Target: Rs. 930	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Relaxo Footwear (Relaxo) registered another quarter of muted numbers with a decline in revenues and margins. However, strategic initiatives have started showing results with sequential improvement in sales volume.
- The significant impact of price correction would come in from Q4FY2023. Management targets double digit revenue growth in FY2024, which will be largely volume-led growth.
- With raw material prices correcting from its highs, EBIDTA margins are expected to consistently improve in the quarters ahead.
- The stock has corrected by 40% in last one year and is trading at 87.6x/55.4x its FY2024E/ FY2025E earnings. We maintain our Buy rating with revised PT of Rs. 930 with strong recovery expected in the years ahead.

Relaxo Footwear (Relaxo) posted weak numbers for Q3FY2023 with revenues declining by 8% y-o-y to Rs. 681 crore and EBIDTA margins declining by 575 bps y-o-y to 10.6%, resulting in a 58% y-o-y decline in the adjusted PAT to Rs. 30.1 crore. Revenues fell largely on account of a decline in sales volumes, affected by subdued demand in the mass-segment articles and the higher inventory in trade channel in the base quarter due to change GST rate from 1st January, 2022. Gross margins marginally fell by 17 bps y-o-y to 53%, while EBITDA margins declined sharply due to aggressive price corrections in open footwear as well as the liquidation of high-cost inventory in the pipeline. However, the decline in prices of raw materials led to 412 bps/173 bps improvement in gross margins/OPM on a sequential basis. EBITDA declined by 40.6% y-o-y to Rs. 72 crore. Lower other income and higher depreciation expense led to a 57.9% y-o-y decline in PAT to Rs. 30 crore. For 9MFY2023, revenue grew by 3.2% y-o-y to Rs. 2,017.8 crore, while PAT declined by 47% y-o-y to Rs. 91.2 crore and EBITDA margin contracted by 477 bps y-o-y to 10.8%.

Key positives

- Sales volumes improved sequentially by 5% to 4.1 crore pairs.
- Decline in raw material prices led to 412 bps/173 bps q-o-q improvement in gross margins and EBIDTA margins.

Key negatives

- PAT decreased by 58% y-o-y to Rs. 30.1 crore affected by weak performance on y-o-y basis.

Management Commentary

- The company showed marginal improvement in the sales volume on q-o-q basis supported by price corrections.
- Once the major portion of the high-cost inventory gets cleared from the company's distribution channels and a revival in the consumer sentiments with aide in faster volume recovery in the quarters ahead.
- With a consistent improvement in the sales volume and raw material costs stabilising, management expects margins to improve in the quarters ahead.
- Price cut will also help in regaining lost market share once the price gap between Relaxo's products and unorganised players narrows in the coming quarters.
- Closed footwear segment will continue to show healthy growth momentum as wholesale distribution channels and online penetration improve in the coming years.

Revision in estimates – We have reduced our earnings estimates for FY2023, FY2024 and FY2025 to factor in lower than expected Q3 performance and lower than expected EBIDTA margins.

Our Call

View: Maintain Buy with a revised PT of Rs.930 – Relaxo's performance is likely to improve from Q4FY2023 led by 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 12% and 15%, respectively, over FY2022-FY2025E. Stock has corrected by 40% in last one year and is trading at 87.6x/55.4x its FY2024E/ FY2025E earnings. We maintain our Buy rating on the stock with a revised price target of Rs. 930.

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	2,713	3,170	3,745
EBITDA margin (%)	21.0	15.7	11.0	14.0	16.5
Adjusted PAT	305	233	132	223	353
Adjusted diluted EPS (Rs.)	12.3	9.4	5.3	9.0	14.2
P/E (x)	64.2	84.1	-	87.6	55.4
P/B (x)	12.4	11.1	10.7	9.9	8.6
EV/EBITDA (x)	39.3	47.3	66.0	44.3	31.6
RoNW (%)	21.4	14.0	7.4	11.7	16.5
RoCE (%)	29.5	17.5	10.0	21.0	24.4

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 Aug 08, 2022

Medium Risk

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

Source: Morningstar

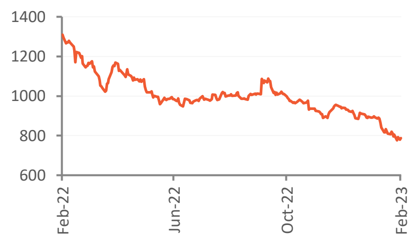
Company details

Market cap:	Rs. 19,615 cr
52-week high/low:	Rs. 1,333 / 772
NSE volume: (No of shares)	1.6 lakh
BSE code:	530517
NSE code:	RELAXO
Free float: (No of shares)	7.2 cr

Shareholding (%)

Promoters	71.0
FII	3.4
DII	7.6
Others	18.0

Price chart



Price performance

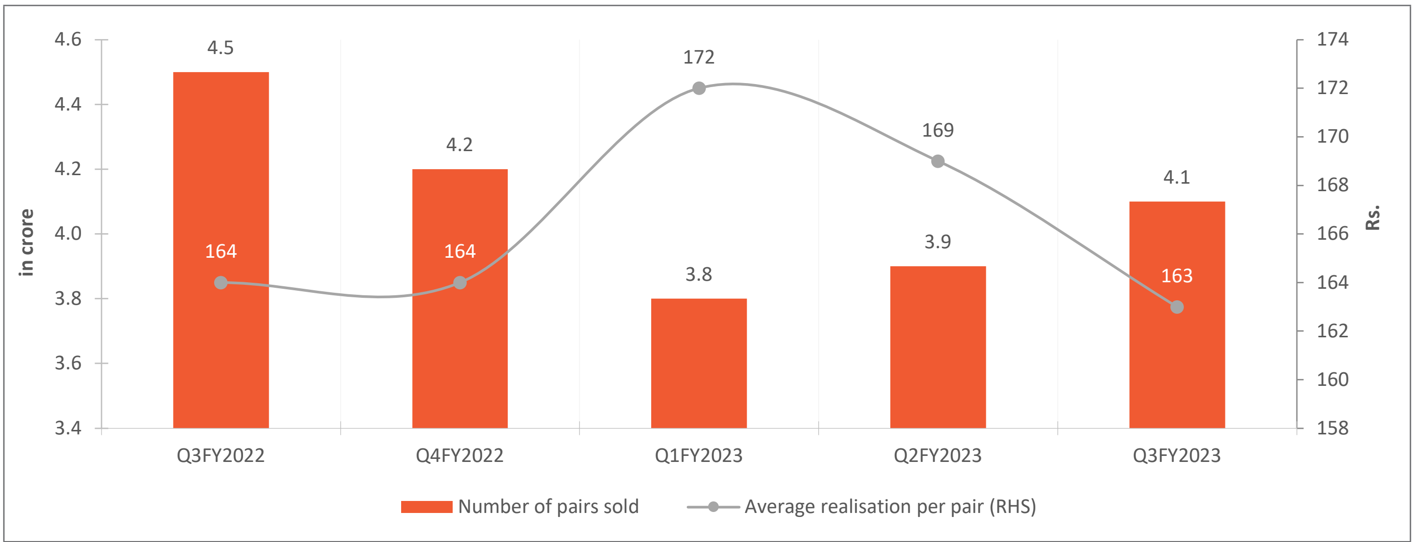
(%)	1m	3m	6m	12m
Absolute	-11.7	-14.8	-21.2	-39.9
Relative to Sensex	-12.6	-13.0	-23.3	-42.8

Sharekhan Research, Bloomberg

Yet another weak quarter; Revenue/PAT decline y-o-y

Relaxo's Q3FY23 revenue declined by 8.4% y-o-y to Rs. 681 crore impacted by the subdued demand in mass segment due to the continuing inflationary pressures on the consumers. During the quarter, volumes (number of pairs sold) declined by 8.9% y-o-y to 4.1 crore pairs, while average realisation per pair stood flat at Rs. 163. On a sequential basis, revenue stood flat with 5% improvement in volumes, while average realisation per pair declined by 3.6%. Gross margins marginally fell by 17 bps y-o-y to 53%, while EBITDA margins declined by 575 bps y-o-y to 10.6% due to aggressive price corrections in open footwear as well as the liquidation of high-cost inventory in the pipeline in the current quarter. However, the fall in prices of raw materials led to 412 bps/173 bps improvement in gross margin/OPM on sequential basis. EBITDA declined by 40.6% y-o-y to Rs. 72 crore. Lower other income and higher depreciation expense led to 57.9% y-o-y decline in PAT to Rs. 30 crore.

Quarterly trend in volume and realisation



Source: Sharekhan Research

Other key highlights

- The company undertook price cuts to counter the competitive and challenging market environment. Relaxo has already started seeing the effect of the same on volumes, however, the company expects full effect of the price correction to come into play from Q4FY2023 onwards.
- The company expects to report an improvement in margins and gain the lost market share once a major portion of the high-cost inventory gets cleared from its distribution channels and the business showing signs of improvement and raw material costs stabilising.
- The management has also indicated that the closed footwear segment will continue to show healthy growth momentum as wholesale distribution channels and online penetration improve.

Results (Standalone) — **Rs cr**

Particulars	Q3FY23	Q3FY22	y-o-y (%)	Q2FY23	q-o-q (%)
Net Revenue	**681.0**	**743.5**	**-8.4**	**669.7**	**1.7**
Raw-material cost	319.9	348.0	-8.1	342.2	-6.5
Staff cost	86.2	84.7	1.8	84.5	2.1
Other expenses	202.7	189.2	7.1	183.6	10.4
Total expenses	608.8	621.9	-2.1	610.2	-0.2
EBITDA	**72.3**	**121.6**	**-40.6**	**59.4**	**21.6**
Other Income	4.4	5.5	-19.2	5.7	-21.9
Interest expenses	4.1	3.8	9.9	4.1	0.0
Depreciation & Amortization	32.0	28.0	14.2	30.5	4.7
Profit before Tax	**40.6**	**95.4**	**-57.4**	**30.4**	**33.3**
Tax	10.5	23.8	-56.0	8.0	30.3
Adjusted PAT	**30.1**	**71.5**	**-57.9**	**22.4**	**34.4**
EPS	1.2	2.9	-57.9	0.9	34.4
			bps		**bps**
GPM (%)	53.0	53.2	-17	48.9	412
EBITDA Margin (%)	10.6	16.4	-575	8.9	173
NPM (%)	4.4	9.6	-520	3.3	107
Tax rate (%)	25.8	25.0	83	26.4	-59

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 COVID-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, the 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.

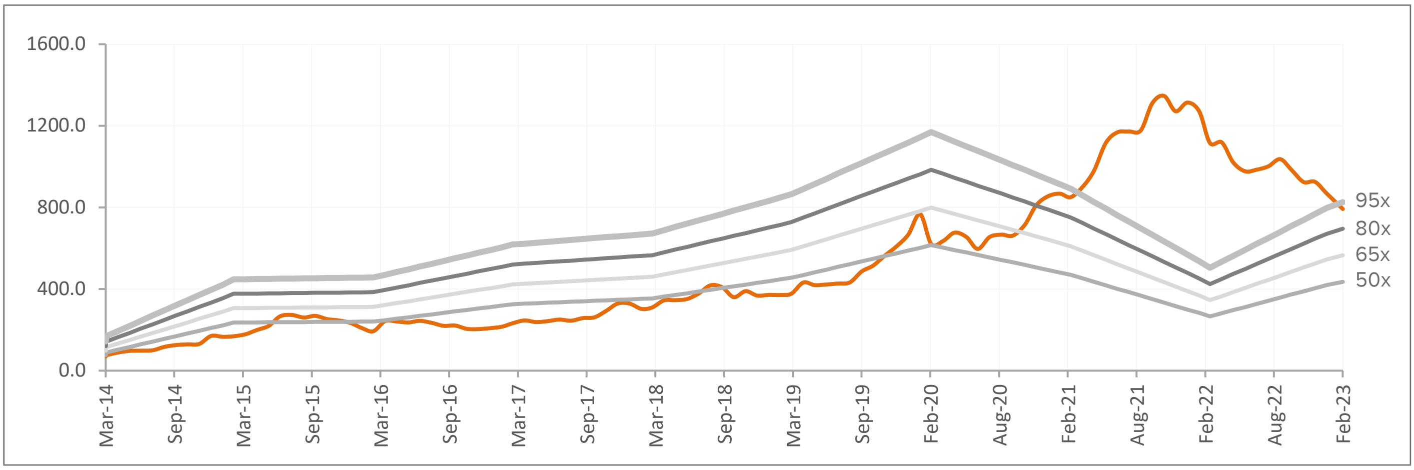
■ Company Outlook – Margins under pressure in the near term; Long-term outlook intact

Relaxo's 9MFY2023 performance was impacted by a decline in the sales volume and margin decline due to raw material inflation. The price correction undertaken in key brands and raw material prices stabilising will help in gradual improvement in the sales volume and profitability from Q4FY2023. 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 a revised PT of Rs. 930

Relaxo's performance is likely to improve from Q4FY2023 led by 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 12% and 15%, respectively, over FY2022-FY2025E. Stock has corrected by 40% in last one year and is trading at 87.6x/55.4x its FY2024E/FY2025E earnings. We maintain our Buy rating on the stock with a revised price target of Rs. 930.

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	-	50.2	36.9	41.6	22.1	17.8	5.3	12.7	15.6
Relaxo Footwears	84.1	-	87.6	47.3	66.0	44.3	17.5	10.0	21.0

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
Ankit Jain	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management	6.11
2	VL Finance SASU	3.83
3	Vanguard Group Inc	0.95
4	UTI Asset Management Co Ltd	0.86
5	Blackrock Inc	0.37
6	Capital Group Companies	0.29
7	Dimensional Fund Advisors	0.21
8	Sundaram AMC	0.17
9	Norges Bank	0.13
10	ICICI Prudential AMC	0.11

Source: Bloomberg

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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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