Sharekhan
by BNP PARIBAS

Relaxo Footwears

Resilient performance in a weak environment

Sector: Consumer Discretionary
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 564**	
Price Target: **Rs. 650**	↑

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 13,993 cr
52-week high/low:	Rs. 625/344
NSE volume: (No of shares)	1.1 lakh
BSE code:	530517
NSE code:	RELAXO
Sharekhan code:	RELAXO
Free float: (No of shares)	7.2 cr

Shareholding (%)

Promoters	71.0
FII	3.5
DII	6.3
Others	19.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	15.2	32.1	28.6	42.9
Relative to Sensex	7.6	21.4	23.1	22.6

Sharekhan Research, Bloomberg

Relaxo Footwears' (Relaxo's) Q2FY2020 reported numbers are not comparable y-o-y due to implementation of Ind-AS 116. Revenue grew by 14.5% y-o-y driven by premiumisation and price hikes, while reported PAT grew by ~79% y-o-y helped by strong operating performance and a lower corporate tax rate. Implementation of Ind-AS 116 impacted profit before tax by Rs. 2.1 crore. Relaxo reported resilient performance amid slow discretionary environment and going ahead, its operating performance is likely to remain steady, backed by sustained volume growth and premiumisation strategies. We expect reported OPM to sustain at ~16.5% in FY2020, aided by benign raw material prices and operating efficiencies. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 650.

Key positives

- Revenue grew by 14.5% y-o-y to Rs. 621.8 crore, better than ours as well as the street's expectation, mainly led by premiumisation and price hikes in select products.
- Gross margins rose by 309 bps y-o-y because of softening raw-material prices and a favourable product mix.
- Comparable operating margins improved by ~150 bps to 15% as a result of operating efficiencies and reported operating profit grew by 42.4% y-o-y; reported OPM improved by 330 bps to 16.8%.
- The effect of Ind-AS 116 on PAT was limited to Rs. 2.1 crore.

Key negatives

- Other income plunged from Rs. 6.3 crore in Q2FY2019 to Rs. 1.7 crore in Q2FY2020.

Our Call

Valuation – We broadly maintain our estimates for FY2020 and FY2021 (we have also introduced FY2022 estimates) as Q2FY2020 performance was better than our expectation in a tough demand environment. The negative impact of Ind-AS 116 on PBT was limited to Rs. 2.1 crore. Capacity expansion will help boost volumes and add to revenue growth. Healthy volume growth and consistent improvement in OPM will help Relaxo clock revenue and earnings CAGR of 17% and 29%, respectively, over FY2019-FY2022. Given the company's strong business prospects and better earnings visibility, we maintain our Buy recommendation on the stock with a revised PT of Rs. 650 (rolling it forward to average of FY2021 and FY2022 earnings).

Key Risks

Any slowdown in demand and stiff competition would threaten revenue growth.

Valuation (Consolidated) — Rs cr

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Revenues	1,949	2,292	2,644	3,103	3,681
OPM (%)	15.5	14.1	16.3	16.8	17.3
Adjusted PAT	161	175	240	296	375
% YoY growth	*34.3*	*8.9*	*36.8*	*23.2*	*26.8*
Adjusted diluted EPS (Rs.)	6.5	7.1	9.7	11.9	15.1
P/E (x)	86.8	79.7	58.3	47.3	37.3
P/B (x)	18.4	12.7	10.8	9.1	7.6
EV/EBIDTA (x)	46.7	43.4	32.8	26.9	21.8
RoNW (%)	23.6	18.8	20.0	20.9	22.2
RoCE (%)	34.6	23.8	28.5	29.2	29.7

Source: Company, Sharekhan Estimates

Robust revenue growth of 14.5% y-o-y, operating efficiencies drive up margins: Revenue grew by 14.5% y-o-y to Rs. 621.8 crore, higher than ours as well as the street's expectation, mainly led by premiumisation and price hikes in selected products. Gross margins increased by 309 bps y-o-y to 56.3%, largely on account of softening raw material costs and favourable product mix. Strong revenue growth and implementation of Ind AS 116 drove up reported operating profit by 42.4% y-o-y and reported OPM by 330 bps y-o-y to 16.8%. On a comparable basis, OPM improved by ~150 bps to 15% (ahead of our expectation) as a result of operating efficiencies. Comparable operating profit rose by 26.8% y-o-y to Rs. 93.3 crore. Post Ind-AS 116, reported depreciation and finance costs rose significantly to Rs. 27.8 crore and 4.3 crore in Q2FY2020, respectively as against Rs. 15.6 crore and Rs. 1.2 crore in Q2FY2019. Comparable PBT increased by 14.6% y-o-y at Rs. 72.2 crore and the net effect of the shift to Ind-AS 116 on PBT was Rs. 2.1 crore. Reduction in the corporate tax rate to 25.17% and strong operating performance drove up reported profit after tax (PAT) by ~79% y-o-y to 70.5 crore.

Other conference call highlights:

- The volume growth stood at 8% for H1FY2020, Q2 being slightly lower than Q1. However, high value items performed well in the quarter. New products contributed ~20% to the revenue in Q2.
- Products like Sparx, Flite and Flite PU registered higher growth during the quarter; new products are gaining good traction.
- E-commerce channel is growing at a faster pace and grew by ~37% y-o-y in H1; it is currently contributing 4-5% to the total revenue.
- North is the highest contributing region for Relaxo; however, the new territories added in south and west are growing faster.
- The company has expanded its distribution reach to 650 distributors and 35,000 retailers. It also added 27 stores during the quarter taking the total EBO count to 370.
- The total cash generation in H1 was around Rs. 160 crore which was utilised for capex of Rs. 74 crore and repayment of borrowings to some extent.
- The company has planned to incur capex of ~Rs. 100 crore in FY2020 (~Rs. 30 crore to be incurred in H2), which also includes expenditure on the new plant in Rajasthan. The new plant will be built with a capacity of 1,00,000 pairs per day and would become operational in three years.
- Working capital cycle has improved in H1FY2020 as the company has exercised controls and has a no credit beyond certain period policy. The management expects the working capital to remain stable.

Result Snapshot (Standalone) — Rs cr

Particulars	Q2FY20	Q2FY19	Y-o-Y (%)	Q1FY20	Q-o-Q (%)
Net Revenue	621.8	543.1	14.5	648.3	-4.1
Raw-material cost	271.6	254.0	6.9	297.5	-8.7
Staff cost	72.2	62.1	16.3	72.4	-0.3
Other expenses	173.3	153.5	12.9	171.9	0.8
Total expenses	517.1	469.6	10.1	541.9	-4.6
Operating profit	104.7	73.6	42.4	106.4	-1.6
Other Income	1.7	6.3	-73.6	1.2	33.1
Interest expenses	4.3	1.2	-	4.7	-7.5
Depreciation & Amortization	27.8	15.6	78.1	26.6	4.6
PBT	74.3	63.0	17.9	76.4	-2.8
Tax	3.8	23.6	-84.0	26.7	-85.9
Reported PAT	70.5	39.5	78.8	49.7	41.8
EPS	2.8	1.6	73.4	2.0	41.8
			BPS		BPS
GPM (%)	56.3	53.2	309	54.1	221
OPM (%)	16.8	13.5	330	16.4	43

Source: Company, Sharekhan estimates

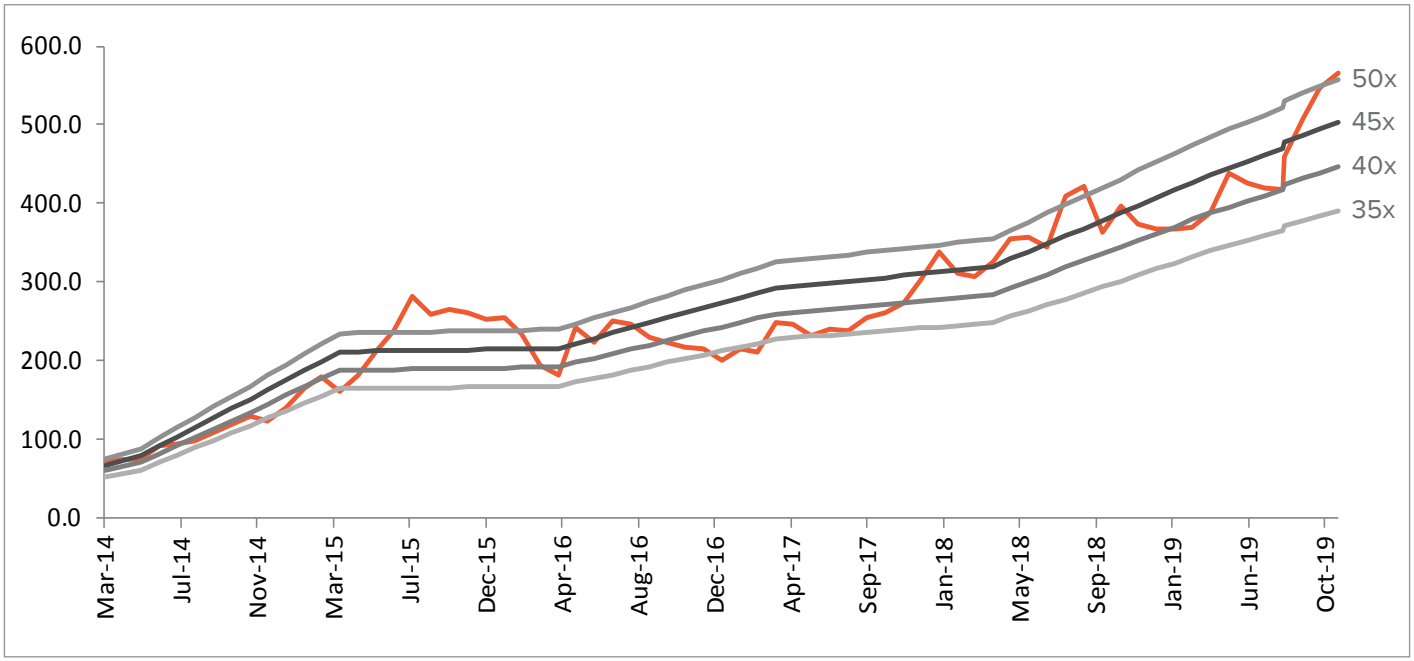
Outlook – Steady growth momentum to sustain

Overall, Relaxo posted a good set of numbers in H1FY2020 with revenue and operating profit growing by 15% and 35%, respectively, while OPM stood at 16.6%. This was despite a slowdown in discretionary demand. We expect volume growth to stay steady in the near term and a gradual pick in the backdrop of festive season would help H2 to be better. An improving product mix and benign input costs and price hikes would help company expand its margins. OPM is expected to sustain at ~16.5% in FY2020. Relaxo has a 5% share in the footwear industry space and thus, has a huge scope for expansion going ahead. Moreover, a shift in consumer preference from unorganised to organised players along with innovation and increasing presence in untapped markets will drive operating performance in the near to medium.

Valuation

We broadly maintain our estimates for FY2020 and FY2021 (we have also introduced FY2022 estimates) as Q2FY2020 performance was better than our expectation in a tough demand environment. The negative impact of Ind-AS 116 on PBT was limited to Rs. 2.1 crore. Capacity expansion will help boost volumes and add to revenue growth. Healthy volume growth and consistent improvement in OPM will help Relaxo clock revenue and earnings CAGR of 17% and 29%, respectively, over FY2019-FY2022. Given the company's strong business prospects and better earnings visibility, we maintain our Buy recommendation on the stock with a revised PT of Rs. 650 (rolling it forward to average of FY2021 and FY2022 earnings).

One-year forward P/E (x)



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Bata	66.4	51.9	44.0	38.6	33.7	28.6	19.4	19.3	19.1
Relaxo Footwears	79.7	58.3	47.3	43.4	32.8	26.9	23.8	28.5	29.2

Source: Company, Sharekhan estimates

About company

New Delhi-based Relaxo is a leading footwear company with a turnover of over Rs. 2,000 crore. It has 10 manufacturing facilities across northern India with a capacity of over 7.5 lakh units per day. It has a wide distribution network of 35,000-40,000 stores. Relaxo produces a wide range of footwear under its brands - Sparx, Bahamas, Flite, Schoolmate and Relaxo Hawaii. 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, sustained volume growth and increasing presence in untapped markets would be key growth drivers in the near to medium term.

Key Risks

- **Slowdown in discretionary demand:** Any slowdown in the demand environment 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
Mukand Lal Dua	Executive Director
Nikhil Dua	Executive Director
Sushil Batra	Chief Financial Officer
Vikas Kumar Tak	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Dua Ramesh Kumar	23.3
2	Dua Mukand Lal	20.4
3	VLS Securities Ltd	6.6
4	VL Finance	5.0
5	SBI Funds Management Pvt Ltd	4.1
6	Dua Lalita	3.8
7	Dua Usha	3.8
8	Dua Nikhil	3.8
9	Dua Nitin	3.8
10	Dua Ritesh	3.8

Source: Bloomberg

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