Stock Update

Management Meet

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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. 25,288 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	7.1
Others	18.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.9	3.7	-9.4	-13.3
Relative to Sensex	4.4	-3.2	-3.1	-9.9

Sharekhan Research, Bloomberg

Relaxo Footwear

Corrective measures to revive volumes

Consumer Discretionary	Sharekhan code: RELAXO

Reco/View: Buy	⇔	CMP: **Rs. 1,016**	Price Target: **Rs. 1,185**	↑

↑ Upgrade ⇔ Maintain ↓ Downgrade

Summary

- We maintain a Buy on Relaxo Footwear (Relaxo) with revised price target of Rs. 1,185. Stock trades at 80.6x and 59.6x its FY2024E and FY2025E, earnings. Drivers are in place to achieve consistent earnings growth and improving return profile.
- Company undertook timely price cuts of 13-15% in key value-for-money brands and increased focus on close-ended footwears to revive growth in the quarters ahead.
- Key input prices corrected from highs (EVA prices fell by 45% from highs) and the benefits of same would start flowing in the quarters ahead.
- Scale-up in contribution of close-ended footwear, better penetration through EBOs, renewal of 40% of portfolio every year and increased contribution from e-commerce channel would help volumes grow consistently in high single digit to low double digit.

We interacted with Mr. Sushil Batra – CFO and Mr. Vikas Tak – Company Secretary, of Relaxo Footwear (Relaxo) to understand the current business environment and future growth prospects of the company. The company has undertaken corrective pricing actions to help revive sales volumes, which were affected by raw material inflation, consumer demand slowdown and a hike in the footwear GST rate to 12% from 5%. After key input prices corrected, Relaxo undertook a price cut of 12-15% in key value-for-money brands such as Relaxo, Bahamas and Flite to reduce the prices and make it competitive with unorganised players. The company expects sales volumes to gradually recover and margin pressures to ease as key input prices fall further, from Q3FY2023. Thus, FY2023 is expected to be a muted year while a strong recovery is anticipated in FY2024. The company is focusing on 4-5 key growth levers to achieve consistent volume growth of high single to low double digit in the medium term.

- **Implemented corrective pricing actions to revive sales volumes:** The company took cumulative price hikes of 25-30% (in four tranches) in H2FY2022 to pass on the impact of commodity inflation and GST rate hike in footwear products from 5% to 12%. This hit sales volumes in Q4FY2022 and Q1FY2023 due to increased pricing gap vis-à-vis unorganised players. To arrest the sales volume drop, the company took price reduction of 12-15% in its key value for money brands such as Relaxo, Flite and Bahamas to recover the lost volumes. Further, the company is also focusing on scaling up the contribution of close-ended footwear products to improve sales volume in the coming quarters.
- **Q2 to be yet another muted quarter; good recovery expected from Q3:** The price corrections undertaken will take some time to come in the market and hence Q2FY2023 sales volume are expected to be muted due to weak consumer sentiments affected by inflationary pressures. We expect Relaxo Q2FY2023 revenues to be down by 7-9% while EBIDTA margins to lower by 200-230 bps y-o-y to 14% affected by higher inventory of high-priced raw materials. Management expects gradual recovery from Q3FY2023. Also, if raw material prices continue to correct, it will release pressure on the margins. Overall, margins are expected to be lower in FY23 and are expected to improve from FY24.
- **Key levers in place to drive consistent earnings growth in medium term:** The management has identified 4-5 levers which are expected to drive growth 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 open footwear. The company recently has started experimenting with the EBO model wherein the company has opened 50-100 stores which will contain all the in-house brands of Relaxo. Through this strategy, the company will focus on improving the sales as well as profitability per store.

Our Call

View: Retain Buy with revised price target of Rs. 1,185: Relaxo is well poised to achieve revenue and earnings CAGR of 14% and 22%, respectively, over FY2022-FY2025E, with key levers expected to drive consistent growth. The company has a strong, debt-free balance sheet with good cash generation ability. The stock currently trades at 80.6x/59.6x its FY2024E/FY2025E earnings. We have introduced FY2025E earnings through this note. We maintain a Buy recommendation on the stock with a revised price target (PT) of Rs. 1,185 (rolling it forward to October 2024 earnings).

Key Risks

Any slowdown in consumer demand or significant increase in raw material prices would affect earnings estimate.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenues	2,653	2,830	3,275	3,870
EBITDA margin (%)	15.7	14.8	16.8	18.0
Adjusted PAT	233	221	313	423
Adjusted diluted EPS (Rs.)	9.4	8.9	12.6	17.0
P/E (x)	-	-	80.6	59.6
P/B (x)	14.4	13.2	11.7	10.0
EV/EBITDA (x)	61.0	60.7	46.0	35.9
RoNW (%)	14.0	12.0	15.3	18.0
RoCE (%)	17.5	16.7	22.1	23.7

Source: Company; Sharekhan estimates

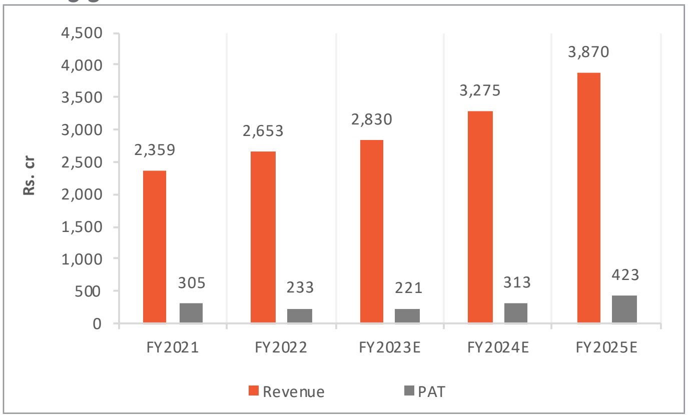
Key highlights of the management meet

- **Q4FY2022 and H1FY2023 revenues affected by multiple factors:** H2FY2022 witnessed sharp increase in the key input prices (including Ethylene-Vinyl Acetate [EVA]). This along with increase 7% increase in GST rate triggered significant price hike in Relaxo's footwear products by 25-30% in key brands such as Relaxo, Bahamas and flite in December 2021. It took price 3-4 price hikes in short span. A 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 Q4FY2022 and Q1FY2023. The company expects Q2FY2023 to be yet another muted quarter.
- **Fall in RM prices to provide relief from Q3FY2023:** Ethylene-Vinyl Acetate (EVA) comprises ~30% of the raw material while Polyurethane (PU) is 15% and rubber comprises 7-8% of the raw material mix. Prices of EVA had risen to Rs. 300/kg from Rs. 100/kg and currently saw a drop to Rs160/kg in-line with fall in the global commodity prices. The company maintains a three-months raw material inventory so even though prices have come down, the advantage of the same is expected to start flowing in from Q3FY2023.
- **Benefit of price cuts to be visible from Q3FY2023:** With stabilization in raw material prices, the company undertook a combined price correction of 10-12% in two tranches, one in May 2022 and the next in August 2022. In terms of brands, Hawaii, Bahamas and Flite saw aggressive price cuts, while there was only a minor price cut in Sparx brand. The benefit from the price cut will be visible from Q3FY2022 once the new inventory with revised prices is available with the channel partners.
- **Growth drivers in place:** 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 exclusive brand outlet (EBO) model and steady growth momentum maintained in the open footwear category.
- **Maintenance capex to continue:** The capacity utilization is currently at 60-65% and the company expects to maintain the utilization level at current level. It will improve with overall improvement in the demand in the coming quarters. Capacity utilisation in FY2024 will improve and compared to last two utilisation of ~60%. The company is adding capacities in the shoes category and expects the closed footwear to be one of the growth drivers going ahead. The company does not plan to undertake any major capex in the near term and will continue with its annual maintenance capex of Rs. 80-100 crore.
- **Higher contribution eyed from closed footwear:** The company's mix consists of 85% open footwear and 15% closed footwear. With capacity additions and improving demand in the shoes category, the company expects the contribution from closed footwear to increase upto 20% in the medium term.
- **Balanced region-wise and brand-wise distribution:** In terms of the region-wise distribution, the north to north-east belt together contributes ~55% to the company's revenues while remaining 45% is through West, South and Central regions. In terms of the brand mix, Hawaii and Bahamas together contribute ~25% to topline while Sparx and Flite contribute 37% each to the revenue.
- **EBO model to aid profitability:** The company recently has started experimenting with the EBO model wherein the company has opened 50-100 stores which will contain all the in-house brands of Relaxo. Through this strategy, the company will focus on improving the sales as well as profitability per store.
- **High churning rate to help Relaxo stay consumer-focused:** Customers expect fresh designs to be available at frequent intervals leading to a high churning rate. The company aims to maintain a churning rate of ~40% which is aided by its own manufacturing.

- **Steady realisation growth expected:** Realisation is expected to grow by 8-10% with improvement in product mix contributing to 5-6% while price increases will lead to a 3-4% growth in the realisation.
- **Reduction in inventory working capital:** The working capital pressure on inventory side will ease with the liquidation of old stock and due to benefit from declining raw material prices.
- **E-commerce gaining momentum:** The e-Commerce channel currently contributes to 8-10% of the company's revenues and the company aims to increase the contribution going ahead. The management has guided that there is good potential in the closed footwear on the e-commerce channel which the company is planning to tap.
- **Exports to be a key growth driver:** The revenue from exports came in at ~Rs. 100 crore in FY2022 and the company plans to grow its exports by 20-25% on the low base.

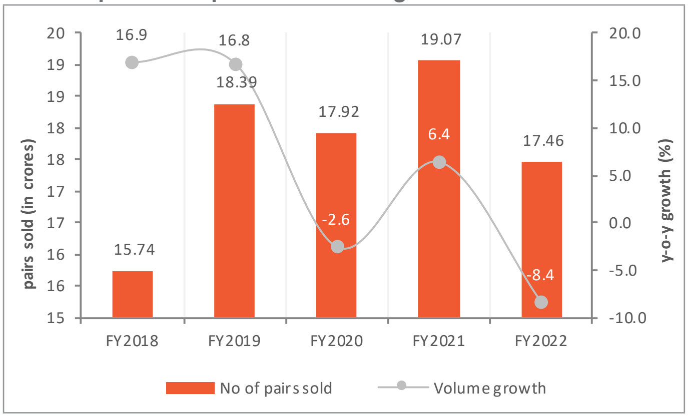
Financials in charts

Steady growth in revenue and PAT



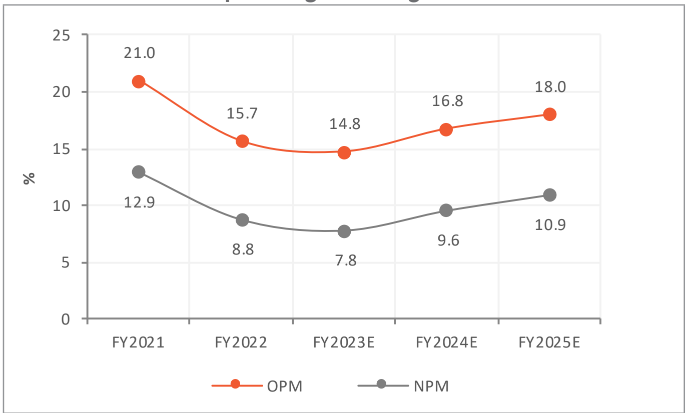
Source: Company; Sharekhan Research

Trend in pairs sold p.a. and volume growth



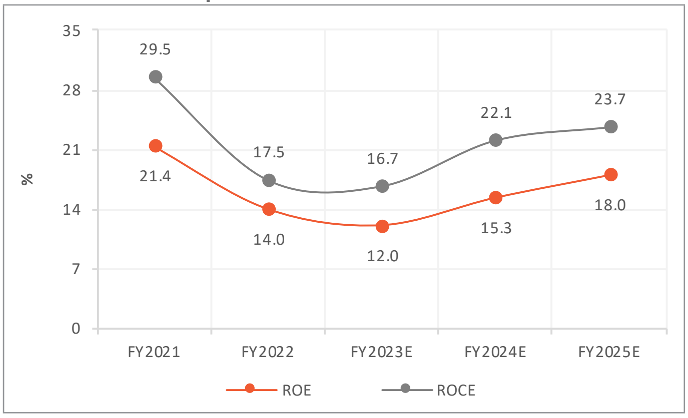
Source: Company; Sharekhan Research

OPM and NPM to expand significantly



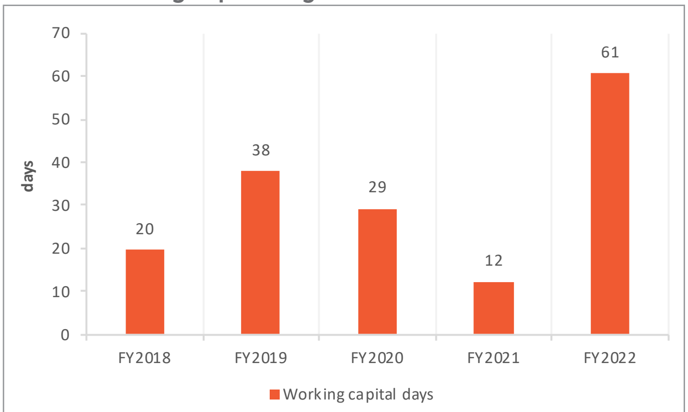
Source: Company; Sharekhan Research

Return ratios to improve



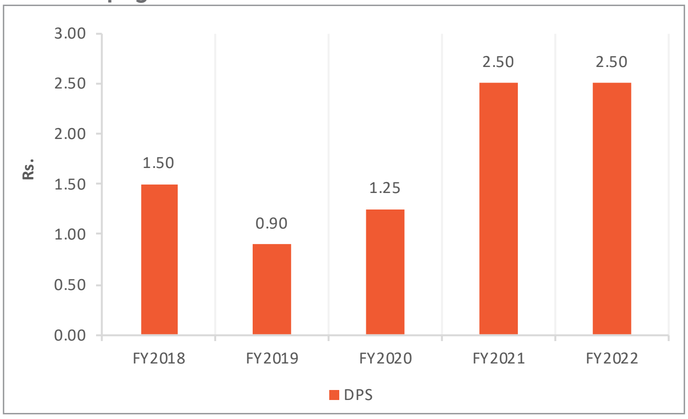
Source: Company; Sharekhan Research

Trend in working capital days



Source: Company; Sharekhan Research

Dividend payout trend



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 lockdown during the pandemic 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 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.

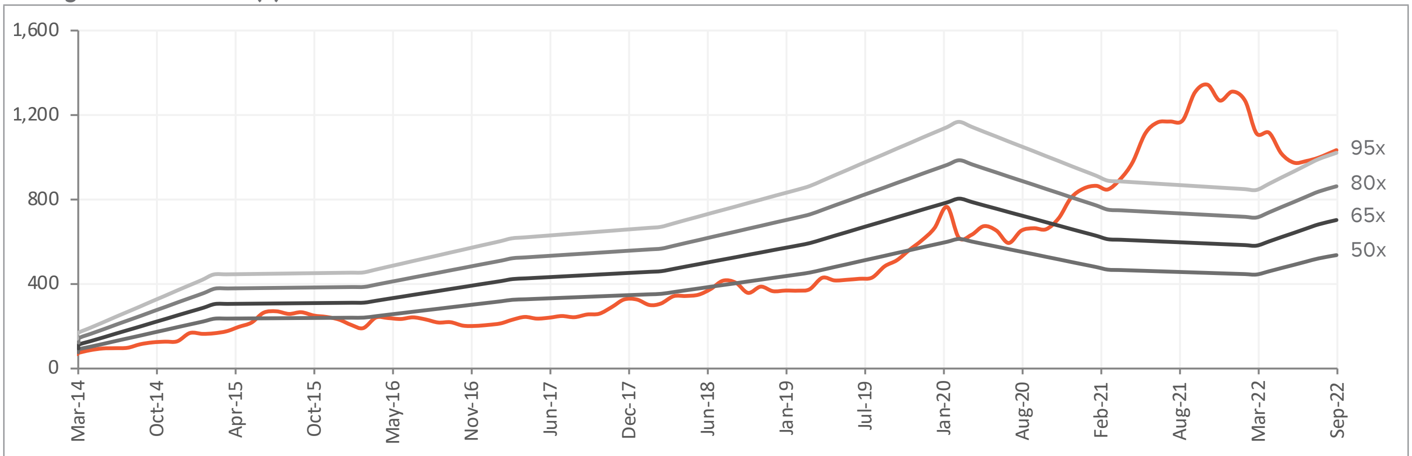
■ Company Outlook – Margins under pressure in the near term; Long-term outlook intact

With lower sales volumes and sustained margin pressure, 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 a revised PT of Rs. 1,185

Relaxo is well poised to achieve revenue and earnings CAGR of 14% and 22%, 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. The stock currently trades at 80.6x/59.6x its FY2024E/FY2025E earnings. We have introduced FY2025E earnings through this note. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,185 (rolling it forward to October 2024 earnings).

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	-	56.3	39.6	48.8	25.3	19.6	5.3	13.2	16.7
Relaxo Footwears	-	-	80.6	61.0	60.7	46.0	17.5	16.7	22.1

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. 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 Website

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	Sundaram AMC Ltd	0.14
10	Norges Bank	0.13

Source: Bloomberg (old data)

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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