Relaxo Footwear

Reco: Buy

Stock Update

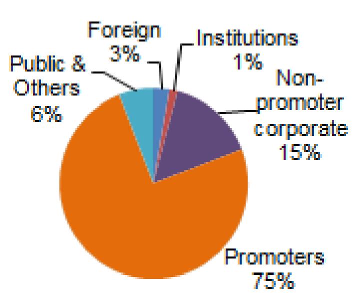
Healthy performance; maintain Buy

CMP: Rs523

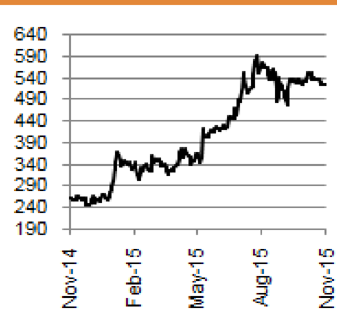
Company details

Price target:	Rs635
Market cap:	Rs6,289 cr
52-week high/low:	Rs615/224
NSE volume: (no. of shares)	26,091
BSE code:	530517
NSE code:	RELAXO
Sharekhan code:	RELAXO
Free float: (no. of shares)	3.0 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.9	-7.7	42.9	102.6
Relative to Sensex	-3.9	-2.9	43.1	108.8

Key points

- **Healthy operating performance; adjusted earnings grew by 39.2% YoY:** In Q2FY2016, Relaxo Footwear (Relaxo)'s revenue growth of 15.7% YoY was driven by both volume and premiumisation improvement in the product mix. In a muted demand environment, this double-digit growth in revenue on an increasingly higher base (Q2FY2015 revenue grew at 25.7% YoY) is commendable and signifies the strong on-ground execution and brand salience efforts of the company. The growth in the revenue along with falling prices of raw materials (EVA and other chemicals that are crude derivatives) boosted the OPM by 170BPS in Q2FY2016. Driven by a healthy operating performance and increase in the other income, the reported net earnings grew by a strong 56.2% YoY. Adjusting for the one-off gain (reported in other income) on account of sale of investment in an associate company, the adjusted earnings grew by 39.2% on a Y-o-Y basis.
- **Favourable industry dynamics coupled with enduring brands to keep financials strong:** With its economical price points (averaging at Rs115-120), the company is well placed to cash in on the transition towards branded shoes from the unorganised segment. We, thus, expect the company to post 21.3% revenue CAGR over FY2015-17. Further, the initiatives to improve efficiency and rationalise cost along with low raw material prices are likely to culminate into a healthy 30.5% earnings growth (CAGR) over FY2015-17.
- **Strong brands, focused management; maintain Buy:** Relaxo's strong presence in the lucrative mid-priced footwear segment (through its top-of-the-mind recall brands like *Hawaii*, *Flite* and *Sparx*) along with its integrated manufacturing set-up, lean working capital requirement and vigilant management puts it in a sweet spot to cash in on the strong growth opportunity unfolding in the footwear category due to a shift from unbranded to branded products. Thus, we remain positive on the stock at an unchanged price target of Rs635 and maintain our Buy rating.

Results Rs cr

Particulars	Q2FY16	Q2FY15	YoY %	Q1FY16	QoQ %
Net revenues	**386.3**	**333.8**	**15.7**	**453.6**	**-14.8**
COGs	158.9	146.1	8.8	184.4	-13.9
Sales (%)	40.8	43.8		40.7	
Staff cost	36.4	31.4	16.1	40.8	-10.7
Sales (%)	9.4	9.4		9.0%	4.8
Other expenses	139.9	117.8	18.7	159.5	-12.2
Sales (%)	36.2	35.3	92BPS	35.2%	
Total expenses	**335.2**	**295.3**	**13.5**	**384.7**	**-12.9**
Operating profit	**51.1**	**38.5**	**32.8**	**68.9**	**-25.8**
OPM (%)	13.2	11.5	170BPS	15.2%	-196BPS
Interest expenses	5.8	4.2	39.6	5.3	9.3
Depreciation & amortisation	11.4	9.9	15.2	10.2	11.7
PBT	39.1	24.5	59.2	53.4	-26.8
Tax	12.0	7.2	66.4	17.5	-31.3
Reported PAT	**27.1**	**17.3**	**56.2**	**35.9**	**-24.6**
Exceptional/one-off (net of taxes)	2.9				
Adjusted PAT	**24.1**	**17.3**	**39.2**	**35.9**	**-32.8**

Valuations

Particulars	FY14	FY15	FY16E	FY17E	FY18E
Net sales (Rs cr)	1,205.8	1,472.8	1,765.4	2,153.5	2,626.8
Change (%)	20.0	22.1	19.9	22.0	22.0
Operating profit (Rs cr)	146.6	200.4	254.2	325.2	399.3
Change (%)	33.5	36.7	26.8	27.9	22.8
OPM (%)	12.2	13.6	14.4	15.1	15.2
Net earnings	65.6	103.1	133.3	179.9	229.3
Change (%)	46.5	57.0	29.3	35.0	27.4
Diluted EPS	5.5	8.6	11.1	15.0	19.1
PER (x)	98.0	62.4	48.3	35.8	28.1
EV/EBITDA	44.4	33.1	26.0	19.9	15.9
RoCE (%)	23.3	25.1	26.0	27.7	27.9
RoE (%)	20.4	23.4	22.1	22.3	24.9

Earnings highlights

Revenue growth aided by volume and realisation growth: In Q2FY2016, Relaxo posted a healthy revenue growth of 15.7% on a year-on-year (Y-o-Y) basis, aided by both volume and realisation growth. This double-digit growth coming in an environment of muted consumer demand is commendable and signifies the growing brand salience of its brands along with its strong on-ground execution.

The company would remain focused on consumers with the introduction of value-added and premium products under each of its brands. The newly launched flip flop range, *Bahamas*, has received a decent response from the market.

Soft raw material pricing led to robust margin expansion: Product mix premiumisation along with falling prices of raw materials (EVA and other chemicals that are crude derivatives) was reflected as a reduction in the raw material cost, which declined by 300 basis points (BPS) year on year (YoY). The effect of these benefits was visible in strong improvement in the operating profit margin (OPM). Despite the increase in the fixed overheads (viz employee cost [+16.1%] YoY and other expenses [+18.7%] YoY), the sharp improvement in the gross profit margin (GPM) percolated down at the operating level, resulting in a healthy 32.8% Y-o-Y growth in the operating profit for the quarter, consequently, the operating profit margin expanded by 170BPS YoY and was at 13.2% for the quarter.

Reported net earnings included one-offs; adjusted earnings grew healthy by 39.2% YoY: Led by a strong operational performance and higher other income (which came at Rs5 crore for the quarter are one-offs in nature; owing to sale of long-term investment in the associate company), the reported net earnings grew by a strong 56.2% YoY. Adjusting for the one-offs other income (on a post-tax basis), the adjusted earnings grew by 39.2% on a Y-o-Y basis.

Key developments

- The company's foray into modern trade through institutional sales and online shopping access to customers to boost sales and have a presence in all trade options are yielding positive results.
- The company has already amicably settled the long drawn litigation on its brand *Sparx* with Bata India, adding further momentum to the growth as *Sparx* is one of the most promising brands in its portfolio with strong revenue and margin growth potential ahead.
- To keep pace with the strong growth momentum, the company is looking to augment its capacity for which plans are on the drawing board stage. The company has purchased a land parcel in Rajasthan (Bhilwara) at a cost of Rs48 crore for the project.
- Its key raw materials, ethylene vinyl acetate (EVA) and other chemicals, are crude derivatives and hence follow crude cycle with a lag effect. Prices of EVA have been ruling at 15-17% lower on a Y-o-Y basis and are currently trading at around Rs120 per kg as against Rs140-145 a kg a year ago. The management believes that apart from crude, the demand supply dynamics for EVA play an important role in determining the prices, and the prices have largely bottomed with minimal scope for further downside.

We expect revenues to grow at 21.3% over FY2015-17: Relaxo's product presence in the economy category and mid-priced category along with its integrated manufacturing set-up puts it in a sweet spot to cash in on the emerging consumer transition from the unorganised to the organised segment, capturing the benefits at all levels. We expect Relaxo to significantly outperform the industry growth rates led by both volume and realisation growth. We, thus, expect Relaxo to grow its revenues at a compounded annual growth rate (CAGR) of 21.7% over FY2015-17.

Net earnings to grow at 30.5% CAGR over FY2015-17: A robust revenue growth, low prices of raw materials (rubber, EVA), the management's stiff eye on cost rationalisation and efficiency improvement along with efforts to weed out the loss-making stores are likely to have a positive effect on the margins of the company. We expect Relaxo's OPM to further expand hereon and reach 15.2% by FY2017. The net earnings are expected to grow at a 30.5% CAGR over FY2015-17. We have retained our positive stance on the stock due to its structural growth story. We have retained our Buy rating on it with an unchanged price target of Rs635.