



JainMatrix Investments

A quality report by JainMatrix Investments

Relaxo Footwears – Slippery Products, Solid Business

- Date: 12th Nov 2020
- CMP: ₹ 692

- Industry: Footwear
- P/E: 79 times and P/B: 12.4 times
- Mid Cap: 17,200 cr. mkt cap
- Advice: BUY with a target price of ₹ 1091 by May 2023



Why buy now: Relaxo Footwear is a leader in the mass market of Indian non leather footwear.

- It has built its own brands, and these are gathering strength.
- Its financials are solid as Revenues, EBITDA and PAT have grown at 19%, 24% and 31% CAGR from FY09-FY18.
- It manufactures all products in-house, thus controlling quality and costs.
- Started 44 years ago by the Dua brothers, by now the next generation is in senior management positions, thus ensuring business solidity. At the same time many professionals are also in leadership roles.
- The Covid impact is a good jump in volumes in value segments of footwear.
- Business is getting a boost from exports and eCommerce.
- Margins and volumes are likely to improve due to new value added products and premiumization, deeper penetration helping gain access to new geographies and a favorable macro environment.

Risks: 1) Rise in raw material prices, particularly imports could impact margins 2) Relaxo may find it difficult to succeed in premium segments due to the value perceptions 3) competition including MNCs

Advice: Investors can **BUY** this share with a May 2023 target price of ₹ 1,091/share. This will allow their investment to appreciate 58% absolute or 23% annualized.

Here is the report on Relaxo Footwears Ltd. (RXO)

Relaxo Footwear - Description and Profile

- Relaxo Footwears is the #2 footwear firm in India after Bata. It is the leader in volumes, and the “Value segment”, with a portfolio of renowned brands like Relaxo, Sparx, Flite and Bahamas.
- RXO revenue in FY20 was ₹2,410 cr. and profits ₹ 226 cr. It had 7,852 employees in FY20.
- RXO started in the footwear industry in 1976 when brothers Mukund Lal Dua and Ramesh Kumar Dua started the mfg. of Hawaii slippers and later diversified into casuals, joggers, kidswear and school and leather shoes. RXO has capacity of 7.5 L pairs per day with capacity utilization of 70%. This touches 90% during peak demand.
- RXO has stayed away from leather footwear where the prices may be higher but the market size is much smaller.
- RXO expanded its store footprint to 390 exclusive brand COCO outlets (company owned, company operated), adding 47 new ones in FY20, reached new territories in both domestic and export markets, and has a vision to become India’s top non-leather exporter. It has set up 8 FOFO (Franchise) stores in East on an experimental basis.
- However, majority of RXO business comes from general trade, with 700 distributors and 50,000+ retailers across the country. 75% of the COCO stores are located in north India particularly in UP, Delhi, Haryana and Punjab.
- Around 80% of RXO’s revenue comes from multi-brand outlets, which are part of the distribution network.
- RXO has its HO in Delhi and has 8 ‘state of art’ mfg facilities at Bahadurgarh, Bhiwadi and Haridwar. In FY20, a capacity add project started at Bhiwadi (Rajasthan) for 1 lakh pairs p.a. which will take 3 years to complete. Fig 1a.
- Products include rubber/EVA slippers, canvas shoes, sport shoes, sandals, school shoes, etc. See Fig 1b - brands.



Fig 1a – RXO Geographical presence; Fig 1b - Brands of RXO

- RXO brands are promoted by India's youth icon Ranveer Singh for Flite, Sparx by Akshay Kumar, Salman Khan, Shahid Kapoor, Katrina Kaif and Shruti Hassan from the Indian film industry.
- Key Executives are: Ramesh Dua (MD), Mukund Lal Dua, Deval Ganguly and Nikhil Dua (Whole Time Directors); Sushil Batra (CFO), Gaurav Dua (VP Marketing) and Ritesh Dua (VP Finance).
- Shareholding pattern % is: Promoters 70.98, FII/FPI 3.39, MF 6.96, Others DII 12.11, Others 6.57%.

Business Notes, Strategies and Events

- E-commerce contributes 10% of revenue, which may rise to 15 % in five years. Sparx products are popular online.
- SBI MF, the country's biggest fund manager by assets, held 3.98% stake of RXO in FY20.
- Long-term growth drivers are low presence and penetration in the south market, lower per-capita consumption in India at 1.66 pairs pa compared with 6-7 pairs for developing markets, and low exports contribution of 4%.
- In FY20, PAT was ₹226 cr. with a margin of 9.4%, grew by 29% YoY mainly due to cost control initiatives in mfg. and lower tax rates. RXO generated a CF of ₹319 cr. from operations and spent 208 cr. in capex & repayments.
- In Q2 FY21, RXO booked operating revenue of 575 cr. down by 7% yoy. EBITDA margin for the quarter was 22.9% vs. 17.1% in Q2FY20. PAT was 75.1 cr., up by 6.5% YoY and a new high. The PAT margin was 13%.
- In a conference call, the footwear major said raw material (RM) costs are likely to remain benign in Q1FY21 and gross margins may sustain at the FY20 levels of 57-58%. Major RMs are polymers like natural rubber (locally available), ethylene-vinyl acetate (EVA) and polyurethane (PU) which are imported. RM is not disrupted, per MD.
- COVID Strategies – The stores were closed during the Apr-May lockdown, affecting revenues. Thereafter revival was quick. Cost cutting in advertisement and travel expenses, linking contractual labor costs to production. Currently, fixed cost per month is ₹35-40 Cr. Margins have improved in Q1-Q2.
- Even during challenging times of lockdown, RXO gained market share due to its capital efficient business model with strong in-house mfg. capability & robust distribution network. Consumer demand shifted to RXO's slippers segments. While the volume growth momentum may slow down, it is still expected to grow 8% CAGR in FY21-22.
- **Relations:** Amongst Directors, ML Dua (70) and RK Dua (66) MD are brothers, promoters & founders. Nikhil Dua (44), director is related to ML Dua. Amongst Executive VPs, Ritesh Dua & Nitin Dua are sons of ML Dua while Gaurav Dua and Rahul Dua are sons of RK Dua.
- The FY20 remuneration of Mukund Dua and Ramesh Dua is high at ₹ 14.92 Cr. each.
- Capex Strategy – RXO invested 90 cr. for new plant in Bhiwadi, Rajasthan, which will take 3 years, for capacity addition of 1 lakh pairs per day. The project will be funded through internal accruals.

- Exports contribute about Rs 100 cr., or about 4%, to RXO sales.
- RK Dua was declared as one of the Top 100 CEO's of India in a study by Business Today partnering with PWC.
- CSR activities - provided comprehensive healthcare for 14 villages, established a vision center to treat preventable blindness in Tijara, Raj., government schools are adopted and transformed into modern schools, supports vocational training centers by supplying them with android tablets.

Industry Outlook

- India is the #2 footwear producer of the world after China, with 9% of the world market making 220 cr. pairs. But India exports only 10% of footwear produced as the domestic market absorbs the rest 90%.
- About 86% of the footwear consumed worldwide comprises non-leather. RXO is thus well placed for exports.
- Branded products will continue to grow faster than unbranded footwear.
- Gol push: In Budget 2020, Gol hiked import duty on footwear from 25% to 35% and on footwear components from 15% to 20%. This move, combined with recent Gol announcements on promoting 'Made-in-India' footwear, is expected to provide a boost to domestic mfg. A 2,600 Cr. special package has been announced over next 3 years for development of footwear sector.
- Post Covid, in Sept 2020, a 25-member development council was formed by Gol to build a robust supply chain for the footwear industry, to make the sector competitive in domestic and exports, and support it with schemes and trade policies. FM also announced hikes in customs duty on footwear to protect from imports from China.

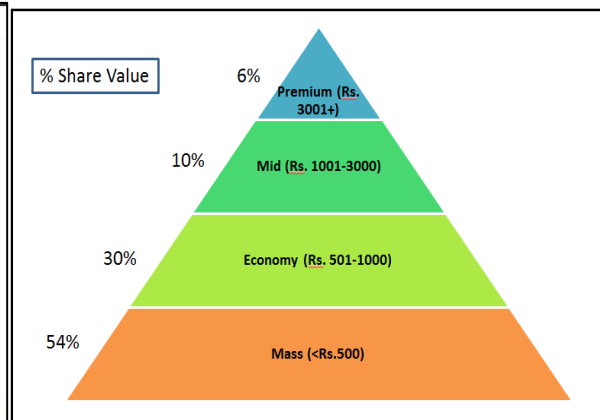
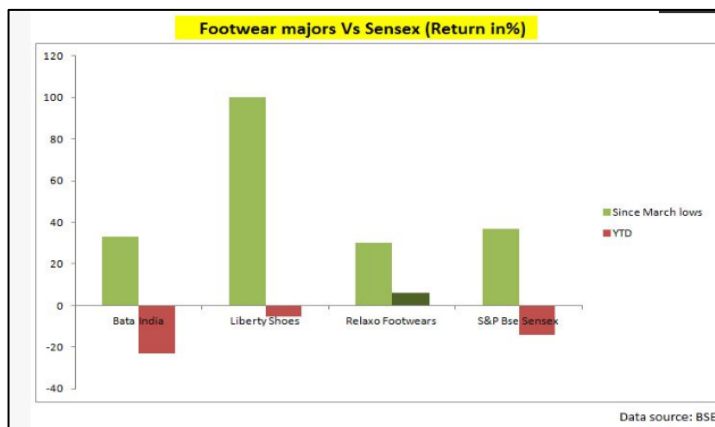
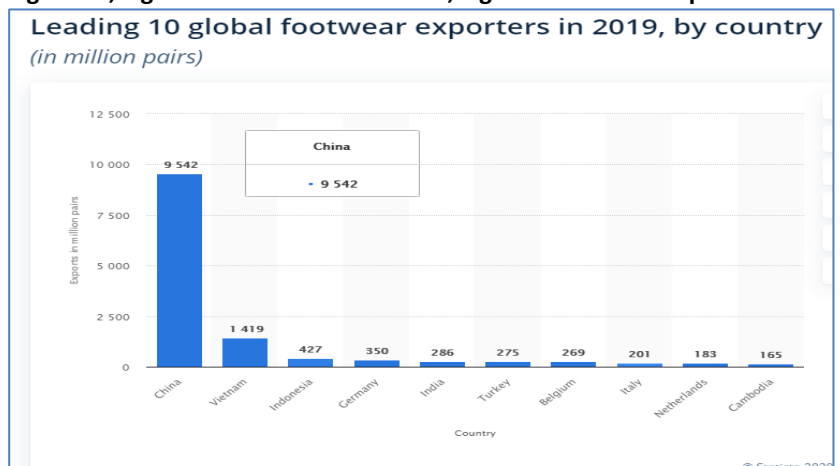
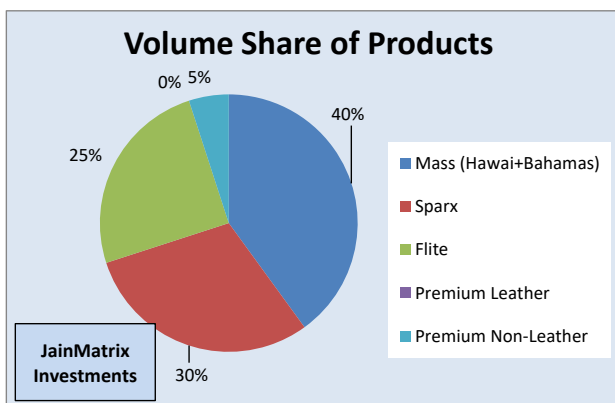


Fig 2a – Peers compared to Sensex; Fig 2b – Market Segments; Fig 2c – Volume Share of RXO; Fig 2d – Footwear Exporters



- In Fig 2a we see how the listed footwear players were affected by the Covid news in March 2020. Only Relaxo was positive YTD, while others fell sharply, then recovered partially. RXO is more stable on the bourses.
- In Fig 2b we can see the footwear industry segments. In contrast we can see RXO's volumes breakup in Fig 2c.

- The size of the Indian footwear market is ₹70K Cr. with leather footwear (30K) & non-leather (40K Cr.). The PU footwear is part of this at ₹10K Cr. (Source ET). Thus Relaxo has a 6% share in non-leather footwear.
- India's share in global exports is just 2% compared to China's 40%, thus there are opportunities to grow. Fig 2d.
- India is still an underpenetrated market – a per capita consumption of only 1.66 pairs p.a. against a global average of 3 pairs. Developed countries average 6-7 pair p.a. (Source - RXO documents)
- Discretionary consumption presents a huge opportunity in India. Segments like retail, footwear and allied sectors which cater to lifestyle consumption for the middle and upper middle class have a strong runway in the country.
- GST is propelling the shift from unorganized to organized segment. Organized segment today caters to 45% of the market. Uniform tax rates pan-India for all footwear ensuring a level playing field. GST rate on footwear worth up to ₹ 1,000 is 5%, while those above ₹ 1,000 possess a GST rate of 18%.
- With changing consumer tastes and preferences, footwear is evolving from being a necessity to a fashion accessory. Buying behavior of the Indian consumer is changing rapidly with growing urbanization and affluence. Consumers are becoming more brand-centric in tier II, tier III cities and rural markets as well.

Stock Evaluation, Performance and Returns

- The share price has grown at 29.97% CAGR over 5 years and at 35.6% over 2 years. See Fig 3.
- Revenues, EBITDA and PAT have grown at 17.5%, 22.68% and 28.62% CAGR from FY09-FY20. See Fig 4. Margins have continued to improve over the last few years.

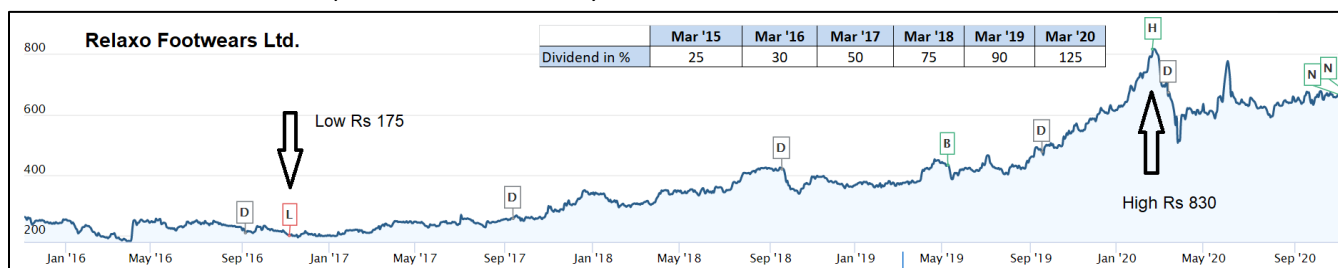
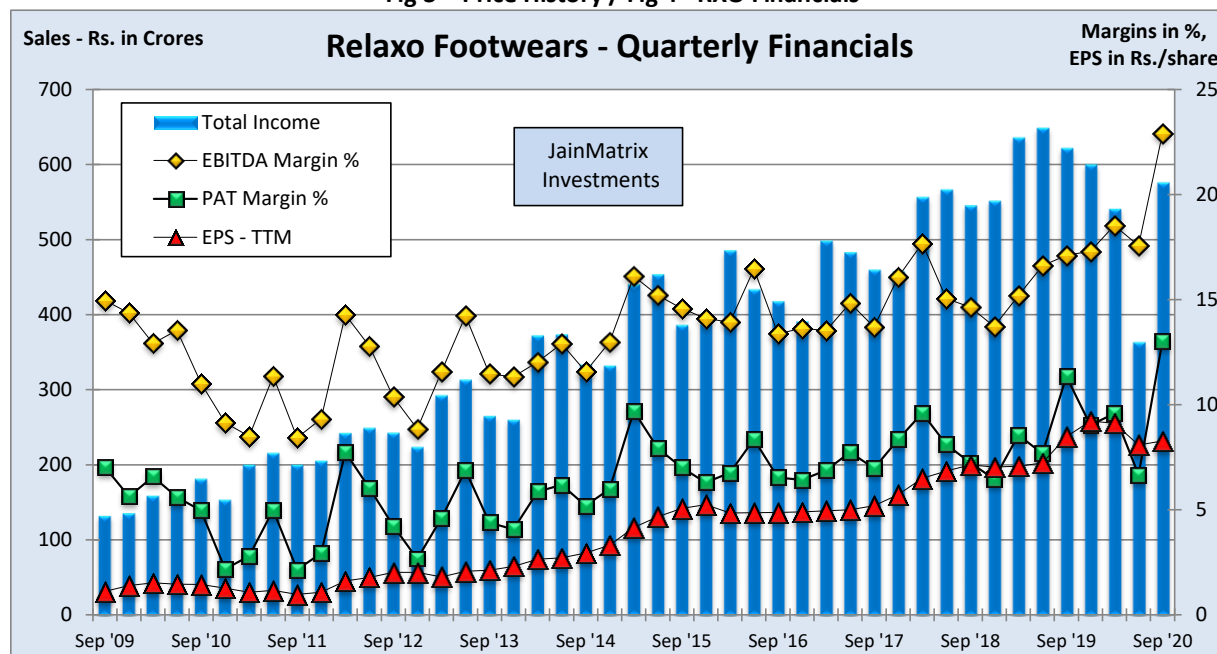


Fig 3 – Price History / Fig 4 - RXO Financials



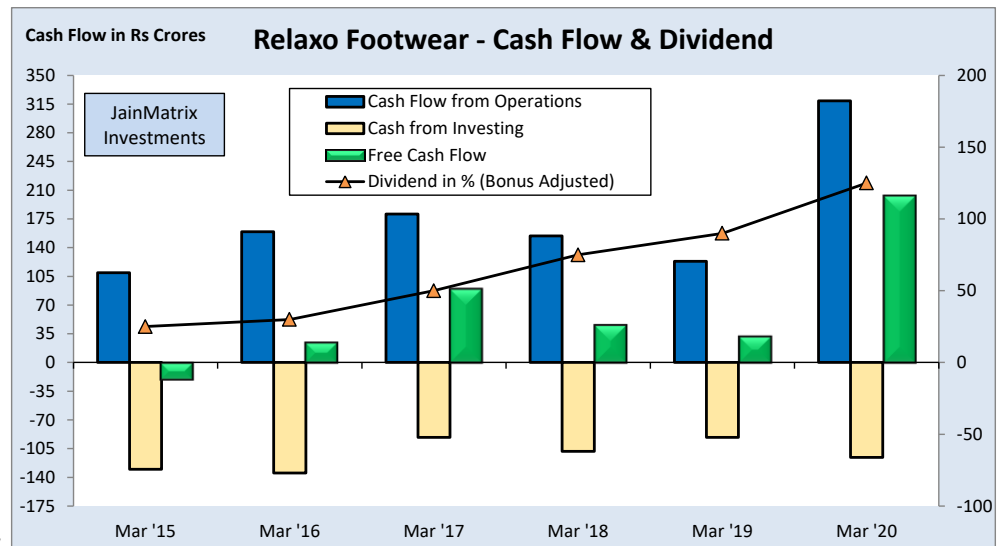


Fig 5a – Cash Flow

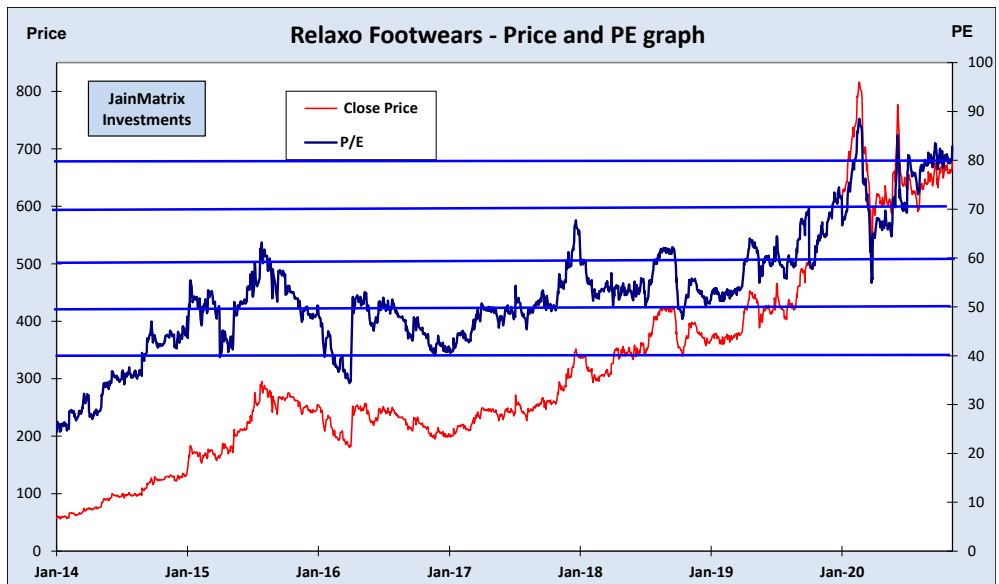


Fig 5b – Price and PE Chart

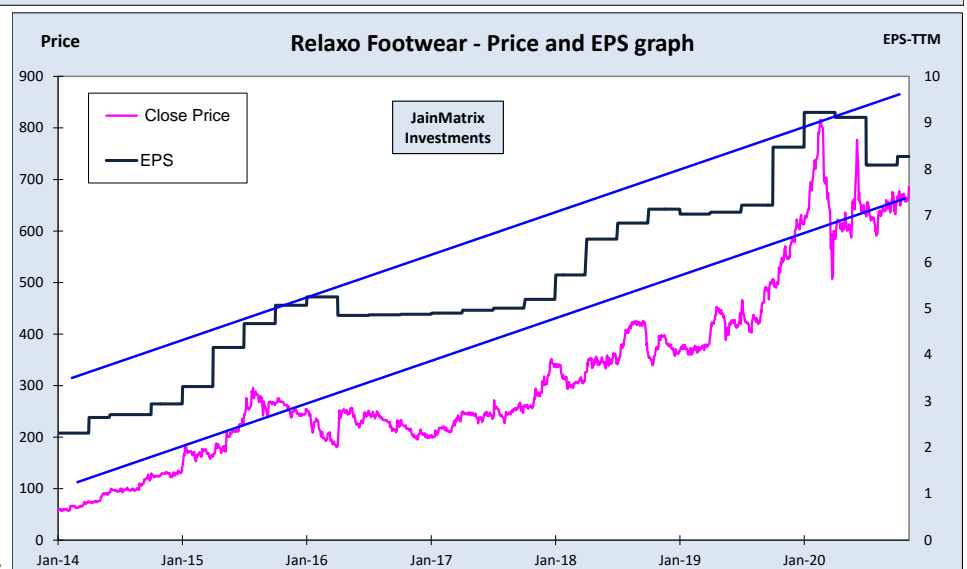


Fig 5c – Price EPS Chart

- The Cash Flow chart Fig 5a indicates positive cash flow from operations every year. Capex or Investments were less than this so there was positive and rising FCF. Dividend growth has been excellent.
- The 10 year PE average is 60 times and the range has been 40-80 times. In the last 2 years, PE has risen to average 64.44 times, implying that the firm has undergone a re-rating. Currently RXO is trading at a PE of 78.8 times and is in the top quadrant of PE levels. See Fig 5b.
- EPS growth has been stable over last 7 years, Fig 5c. The earnings of RXO grew 3.43x from FY14-20. However they flattened out in FY17 on account of demonetization and a surge in costs. Then earnings revived from 2018 onwards due to GST benefits, fall in interest costs, adds to product portfolio and adoption of the franchise model.
- ROCE and ROE for FY20 are 21.61% and 19.03% respectively which is robust.
- The D/E of the firm has fallen continuously from last 6 years, currently being only 0.02 compared to 0.96 in 2013. This is a positive. This is likely to drive the margins up.

Benchmarking and Financial Estimates

- We present a benchmarking exercise with listed peers in similar product categories. Since Mirza Intl. is focused on exports, it is not strictly comparable. See Exhibit 6.

Particulars	Relaxo	Khadim	Bata	Liberty	Mirza Intl.
Revenues in Rs. cr's (FY20)	2,410	799	3,056	652	1,152
EBITDA in Rs. cr's	421	65	912	66	146
Profits in Rs. cr's	226	21	331	8	48
Market Cap - Rs. Crores	15,923	185	16,723	233	591
PE (x) TTM	78.84	NM	131.23	25.92	38.35
Price to Book Value (x)	12.44	0.79	8.81	1.23	0.91
3 Yr CAGR Sales (%)	13.90	14.35	7.29	9.47	58.58
3 Yr CAGR Profit (%)	23.56	-6.47	23.48	4.18	145.28
Debt to equity ratio (x)	0.12	0.32	0.34	0.64	0.54
EBITDA Margin (%)	17.45	8.19	29.83	10.06	12.66
Net Profit Margin (%)	9.39	2.65	10.76	1.69	4.24
Return on Equity (%)	19.03	7.61	18.10	4.31	8.25
RoCE (%)	23.26	12.76	24.69	7.60	11.82
Dividend Yield (%)	0.20	NA	0.31	NA	1.89

Exhibit 6 – Benchmarking

- In competitor analysis, we can see from above that RXO has high valuation with PE being at 78.8 times, although lower than its closest and main peer Bata. The PB is highest. DE ratio is continuously decreasing over the years, a positive sign. Sales and profit growth have been high. RXO has leading EBITDA margin and a high NP margin too. Return ratios are excellent for RXO where it takes leadership position. The dividend yield is fair.
- In sum RXO is an all round leader, with low debt, good cash flow and strong market position yielding high returns.

Financial Projections

- We project the financials of RXO for the next 3 years.

	Mar '18	Mar '19	Mar '20	Mar '21	Mar '22	Mar '23
Sales Turnover - crores	1,957	2,299	2,410	2,704	3,234	3,868
EBITDA - crores	307	337	418	433	550	696
Net Profit - crores	161	175	226	243	291	387
Earnings Per Share - Rs/share	6.5	7.1	9.1	9.8	11.7	15.6
PE (at current Price)	-	-	77.0	71.5	59.8	45.0

Exhibit 7 – Financial Projections

- The basis for the projections are 1) a 5% recovery in volumes for FY21 and 15% thereafter 2) A good growth in Revenue/pair over FY21-23, and 3) Flat operating and profit margins in FY21, improvements from FY22

Strengths

- RXO has seen a steady and high growth of revenues and profitability over the last 10 years.

- It is investing in and building its own brands, which is a more profitable business in the long run.
- Footwear mfg. is a labour intensive industry. The good availability of labour helps RXO business.
- The Raw material base for non-leather products is good with strong supply chain.
- RXO focuses on consumer needs with continuous improvement in product quality and refresh of portfolio.
- RXO has good distribution network, and is expanding in under penetrated markets by empowering its sales force and channel partners with innovative digitized solutions. RXO distributors directly service over 85% of the large districts in India, yielding significant gains in their priority markets in West and East India.
- RXO has strong channel partners and presence in new / emerging channels (modern trade, e-commerce).
- RXO has good employee retention and perks like private healthcare, pension, childcare and corporate discounts.

Risks and Challenges

- Import dependence: Currently, 40% of raw materials used are imported (EVA 18%, PU 15% and rubber 7%). Fluctuation in prices of these crude-linked products and currency exchange rates can impact the margins. Furthermore, Govt recently hiked custom duty on footwear (from 25-35%) and parts of footwear (from 15-20%).
- High level of competition may impact margins: Increased level of competition from new entrants, esp MNCs as well as unorganized players can impact the profitability metric for the footwear industry.
- Post Covid, the multi brand outlets (MBO channel) are facing liquidity stress leading to lower off take across product categories. RXO is dependent on the MBO channel as they contribute 80% of revenues.
- Macro-economic factors like a downturn in the economy like current covid situation, unforeseen political and social upheavals, natural calamities and below normal monsoon can affect RXO.
- Changing customer tastes and preferences can also affect business in longer term.
- RXO is a family owned businesses, here there is a risk of breakups and business separation.
- RXO has high promoter compensation compared to that in industry, which could lower the earnings of company.

Overall Opinion, Outlook and Recommendation

- India has a low per capita consumption of footwear which will rise.
- The footwear market has many players but RXO has a leadership in mass Value for Money, and is visible and offers good quality footwear. There is a large unorganized sector in footwear. With GST and other tax initiatives in place, RXO will capture market share from them while growing with premiumization and brand strengthening.
- Margins and volumes are likely to improve due to new value added products, deeper market penetration, new geographies and a favorable macro environment. The new export focus can add to margins.
- RXO has sound financials and uses part of the free cash flow to regularly expand capacities even as it adapts itself to changing consumer needs and preferences. This then results in superior return ratios and good cash flows.
- Valuations are expensive at P/E of 78.8, but this should correct post covid.
- Risks: 1) Rise in raw material prices, particularly imports could impact margins 2) Relaxo may find it difficult to succeed in premium segments due to the value perceptions 3) competition including MNCs
- Investors can **BUY** this share with a May 2023 target price of ₹1091/share. This will allow their investment to appreciate 58% absolute or 23% annualized.

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