

Bata India

3 June 2019

Reuters: BATA.BO; Bloomberg: BATA IN

Weak 4QFY19: Impact Of Consumption Slowdown And One-offs

We recently met the management of Bata India (BIL) to comprehend the lower expected financial performance in 4QFY19 and its future outlook. As can be seen in Exhibit 3, 4QFY19 was below our estimates both on revenue and EBITDA margin. The deviation from our revenue estimate has been explained by: (1) Decelerating retail sales growth from 18% YoY in 3QFY19 to 11% YoY in 4QFY19. We believe this is likely driven by the general consumption slowdown observed across companies rather than anything company or industry-specific (2) Non recurrence of an institutional order of Rs210mn from a state government which was part of the 4QFY18 revenues (3) Loss of revenue in March on the e-commerce side with the change in e-commerce rules – likely a cap on sourcing from a particular supplier (around Rs120mn). On the margin front, we were expecting a gross margin expansion which was larger than the actual. We expected the sourcing benefits in 3QFY19 would continue in 4QFY19 and 1QFY20 (see our notes [Margin Surprises, PE Expansion Likely](#) and [Initiatives To Drive Robust Revenue Growth And Margin Expansion](#)). However, only a part of that was seen. Considering the shift in revenue mix towards retail during the quarter, the gross margin gain ought to have been better. We understand that the gross margin in the institutional business is in the low teens while in the retail side it is ~55%-60%. EBITDA level margin also got impacted as fixed costs were spread over a lower than expected revenue base. Without stating any explicit guidance, Bata management indicated resilient demand and growth in the ensuing quarters. It also indicates margin expansion without indicating the extent. We understand that e-commerce issues are resolved. On the institutional side, Bata is confident on getting a couple of state government orders in FY20, albeit uncertain about the timelines. On the wholesale front (sales through multi-brand outlets – MBOs) we understand there is an uptick of growth to low teen level after a period of subdued to negative growth. We have toned down our estimates a tad (see Exhibit 2) and lower our target price on BIL to Rs1,410 based on 42x March 2021E EPS and retain our Accumulate rating. The 42x represents +0.5SD higher than its five-year 12-month forward mean P/E multiple. We expect BIL to clock revenue/EBITDA/PAT CAGR of around 15%/19%/15%, respectively, over FY19-FY21E with pre-tax RoIC expanding from ~ 63% to ~ 69% during the period. The PAT CAGR looks lower as FY19 PAT is inclusive of tax refunds and interest income on that. We believe the Indian consumer story with the kind of financial profile depicts above deserves to trade at a premium to its five-year historical average.

More details on 4QFY19: Retail sales (largely from company-owned company-operated stores – COCO stores – formed about 88% of revenue) grew by 11% YoY. Same-store sales growth (SSG) stands at 7.5%, while the SSG for FY19 was 8.8%. Apart from the institutional order which did not persist, **volume growth was indicated to be at 3% both in 4Q and FY19.**

Higher other income was driven by one-off: While the EBITDA for the quarter was below our estimates by around 18%, PAT beat our estimates by 22% owing to the higher than expected other income and lower tax rate. The 16% tax rate versus expectation of 35% was due to the tax refunds. The interest on these refunds helped inflate the other income number.

Margin improvement to continue: While there was no specific guidance on margin improvement, BIL indicated that premiumisation, better sourcing of raw material and finished products, better throughput from its upgraded manufacturing facility, and keeping a tight lid on other operating costs will be led to further margin expansion. This is despite likely higher spending on advertising by about 40-50% in FY20.

Store expansion continues, Franchisee expansion expected to gather steam in FY20: On a gross basis, 103 stores were opened in FY19, while on a net basis the expansion was only for 53 stores. It was indicated that on a net basis the store addition would likely to be to the tune of 70 in FY20. On top of the COCO store addition, franchising sees an uptick in FY20 with a net addition of 60 stores to the existing number of 140. Franchising apparently contributed to 2.5% of revenue in FY19. Franchising is being attempted in tier-2 and tier-3 cities where the franchisee buys inventory on cash and carry basis from BIL.

Steady working capital: While there was a drop in debtors' days there was a small rise in inventory days. BIL indicated that there is unlikely to be a material improvement in the inventory days until the IT project on customer conversion/inventory management goes live across the company.

ACCUMULATE

Sector: Retail

CMP: Rs1,325

Target Price: Rs1,410

Upside: 6%

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Key Data

Current Shares O/S (mn)	128.5
Mkt Cap (Rsbn/US\$bn)	170.3/2.4
52 Wk H / L (Rs)	1,480/739
Daily Vol. (3M NSE Avg.)	861,036

Price Performance (%)

	1 M	6 M	1 Yr
Bata India	(8.1)	24.5	73.1
Nifty Index	1.8	9.5	11.5

Source: Bloomberg

Exhibit 1: Key financials

Y/E March (Rsmn)	FY16	FY17	FY18	FY19	FY20E	FY21E
Revenue (Rsmn)	24,227	24,743	26,293	29,284	33,438	38,454
YoY Growth %	(10.1)	2.1	6.3	11.4	14.2	15.0
EBITDA (Rsmn)	2,758	2,786	3,538	4,761	5,659	6,791
% of sales	11.4	11.3	13.5	16.3	16.9	17.7
Adj PAT (Rsmn)	1,534	1,774	2,236	3,284	3,603	4,305
YoY Growth %	(24.9)	15.6	26.1	46.9	9.7	19.5
FDEPS (Rs)	11.9	13.8	17.4	25.6	28.0	33.5
ROE (%)	13.9	14.1	16.0	20.4	19.3	20.2
ROCE (%)	17.9	17.0	20.9	25.6	26.7	28.2
Pre Tax ROIC (%)	29.3	36.7	51.5	63.4	64.6	69.1
P/E (x)	111.0	96.0	76.2	51.9	47.3	39.6
P/BV (x)	14.4	12.9	11.5	9.8	8.6	7.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in our estimates

	New			Old			Change (%)		
	FY19A	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue (Rsmn)	29,284	33,438	38,454	29,825	34,747	39,959	(1.8)	(3.8)	(3.8)
EBITDA (Rsmn)	4,761	5,659	6,791	4,973	6,035	7,114	(4.3)	(6.2)	(4.5)
EBITDA Margin (%)	16.3	16.9	17.7	16.7	17.4	17.8	-	-	-
PAT (Rsmn)	3,284	3,603	4,305	3,133	3,848	4,517	4.8	(6.4)	(4.7)
FDEPS (Rs)	25.6	28.0	33.5	24.4	29.9	35.1	4.8	(6.4)	(4.7)

Source: Nirmal Bang Institutional Equities Research

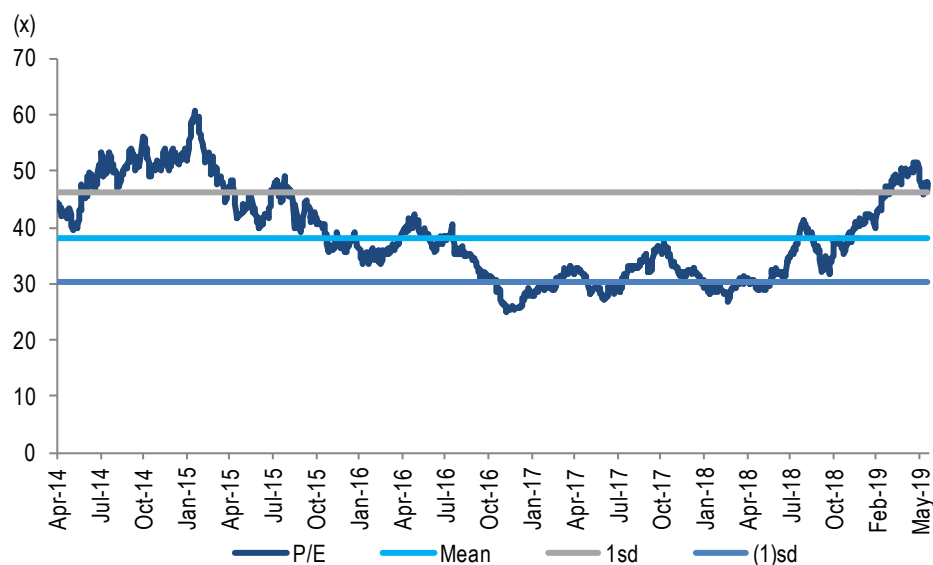
Why we like Bata India: We believe the Indian footwear opportunity is a large one (we expect it to be Rs0.6trn-Rs0.7trn as of FY19E). We consider it to grow in mid-teens in the foreseeable future. Per capita consumption currently stands at 1.7 pairs annually. Chinese and Indonesian consumers average three pairs. We believe that the ASP of the entire market is Rs300 per pair. We expect both volume and ASP expansion (the latter more so) as fashion consciousness rises. We also believe the organised part of this industry is around 30%. Of this organised part, we believe BIL - the largest player – commands only around 15% share. The market is extremely fragmented with the presence of both domestic and foreign players (the latter more in the premium end). Bulk of the market (80%) is in the value segment (less than Rs1,000 per pair price point). We see scope to grow at both ends of the spectrum (value and premium). BIL has the largest range of footwear in the Indian market (straddling various price points, types of consumers and brands). Bata as a brand has been very well known to the Indian consumer because of its long association with the country - around 90 years. BIL is trying to reposition its brand to appeal to the young generation. Despite being an Indian household name in footwear, the brand always had a problem of being considered as staid, local and meant for the old generation. The focus of BIL is to appeal to the new generation (moving it to 'cooler' and closer to 'international' positioning) and make it more willing to pay a premium for BIL products. This has been happening through various means including: (1) Stepped-up spending on advertisements with celebrity endorsers. BIL is embarking on celebrity endorsements after many years. (2) Launch of internationally designed Red Label collection of shoes in India. Bringing in new designs to the market is part of the attempt to cater to young consumers. (3) Improving customer experience by bringing to India 'Red-concept' stores and better visual merchandising. The change in management at the global level – with CEO Mr. Alexis Nasard (ex-Heineken and ex-P&G) from 2016 and in India where a new CEO Mr. Sandeep Kataria (ex-Vodafone, Yum Brands, and Hindustan Unilever) joined from August 2017, seems to have resulted in greater aggression and a shift in strategy. The prolonged underinvestment in branding is being corrected and this number is pushed to 2.5% of sales in FY19. This is funded through better gross margin and also through a tighter control on non-direct costs like rent. This could potentially create a virtuous cycle wherein greater advertisement spending could push up footfalls and premiumisation and thus drive revenue growth at a mid-teen rate. BIL also decided to focus on franchising after a 20-year gap. This two-year old initiative has added 140 plus stores by FY19 end.

Exhibit 3: 4QFY19 performance

Y/E Mar (Rsmn)	4QFY18	3QFY19	4QFY19	YoY(%)	QoQ (%)	4QFY19E	Deviation (%)
Net Sales	6,323	7,787	6,794	7.4	(12.8)	7,335	(7.4)
Net RM & Purchase of finished goods	2,789	3,226	2,915	4.5	(9.6)	3,089	(5.6)
% of Sales	44.1	41.4	42.9	-	-	42.1	-
Gross Margin (%)	55.9	58.6	57.1	-	-	57.9	-
Rental Expenses	896	970	969	8.1	(0.1)	1,004	(3.5)
% of Sales	14.2	12.5	14.3	-	-	13.7	-
Other expenses	1,006	1,124	1,117	11.0	(0.6)	1,167	(4.3)
% of Sales	15.9	14.4	16.4	-	-	15.9	-
Employee Cost	809	831	849	4.9	2.2	930	(8.7)
% of Sales	12.8	10.7	12.5	-	-	12.7	-
EBITDA	823	1,636	945	14.8	(42.3)	1,145	(17.5)
EBITDA Margin (%)	13.0	21.0	13.9	-	-	15.6	-
Other Income	137	137	279	103.9	103.3	147	90.4
Depreciation	169	170	166	-	-	176	(5.5)
Interest	5	9	6	-	-	11	(46.5)
PBT	771	1,594	1,052	36.4	(34.0)	1,105	(4.8)
Provision for Tax	250	562	169	(32.2)	(69.9)	386	(56.1)
Effective Tax Rate	32	35	16	-	-	35	-
Minority share in Profit / Loss	0	0	0	-	-	0	-
PAT (Reported)	521	1,032	882	69.4	(14.5)	719	22.8
NPM (%)	10.1	8.3	13.3	-	-	9.3	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: P/E multiple chart



Source: Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

(Y/E March)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	24,743	26,293	29,284	33,438	38,454
-Growth (%)	2.1	6.3	11.4	14.2	15.0
Raw material and Finished Goods purchase	11,529	11,959	12,843	14,424	16,492
Gross Margin	13,214	14,334	16,441	19,014	21,962
% of sales	53.4	54.5	56.1	56.9	57.1
Employee Expenses	2,732	2,954	3,311	3,708	4,153
% of sales	11.0	11.2	11.3	11.1	10.8
Rent Expense	3,564	3,622	3,793	4,249	4,758
% of sales	14.4	13.8	13.0	12.7	12.4
Other Expenses	4,132	4,220	4,576	5,398	6,260
% of sales	16.7	16.0	15.6	16.1	16.3
EBITDA	2,786	3,538	4,761	5,659	6,791
EBITDA Margin (% of sales)	11.3	13.5	16.3	16.9	17.7
Other income (net)	460	508	685	602	654
PBT	2,555	3,400	4,770	5,550	6,632
-PBT margin (% of sales)	10.3	12.9	16.3	16.6	17.2
Provision for tax	782	1,164	1,486	1,947	2,327
Effective tax rate (%)	30.6	34.2	31.2	35.1	35.1
Net profit	1,774	2,236	3,284	3,603	4,305
-Growth (%)	15.6	26.1	46.9	9.7	19.5
-Net profit margin (%)	7.2	8.5	11.2	10.8	11.2
Shares outstanding- Basic	129	129	129	129	129

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
Equity capital	643	643	643	643	643
Reserves & surplus	12,601	14,145	16,823	19,262	22,171
Net worth	13,243	14,787	17,465	19,904	22,813
Other liabilities	(1,004)	(1,054)	(73)	(1,098)	(1,098)
Total liabilities	12,240	13,733	17,393	18,807	21,716
Net block (incl. CWIP)	2,735	2,945	3,146	3,905	3,805
Investments	1,630	1,853	1,996	1,996	1,996
Deferred tax asset - net	890	1,054	1,098	1,098	1,098
Other current assets (Mainly Inventories)	7,410	8,335	8,853	10,096	11,516
Debtors	694	886	653	929	1,068
Cash & bank balance	5,220	5,885	8,390	8,371	10,735
Loans and Advances	294	370	479	468	538
Total current assets	13,619	15,476	18,375	19,863	23,857
Total current liabilities	5,988	6,662	6,296	6,958	7,942
Net current assets	7,631	8,814	12,079	12,906	15,915
Total assets	12,239	13,733	17,393	18,807	21,716

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19	FY20E	FY21E
EBIT	2,135	2,934	4,120	4,990	6,021
(Inc.)/dec. in working capital	620	(519)	(759)	(846)	(645)
Cash flow from operations	2,755	2,415	3,361	4,144	5,377
Other income	460	508	685	602	654
Depreciation & amortisation	650	604	640	669	769
Financial expenses	(40)	(42)	(35)	(42)	(43)
Tax paid	(782)	(1,164)	(1,486)	(1,947)	(2,327)
Dividends paid	(582)	(621)	(803)	(964)	(1,157)
Extraordinary item	250	-	-	-	-
Net cash from operations	2,711	1,701	2,362	2,461	3,273
Capital expenditure	(396)	(692)	(893)	(1,256)	(1,256)
Net cash after capex	2,315	1,009	1,469	1,205	2,017
Inc./(dec.) in debt	-	-	-	-	-
(Inc.)/dec. in investments	2	(223)	(143)	-	-
Equity issue/(Share Buyback)	-	-	-	-	-
Cash from financial activities	2	(223)	(143)	-	-
Others	-	-	-	-	-
Opening cash	3,425	5,220	5,885	8,390	8,371
Closing cash	5,220	5,885	8,390	8,371	10,735
Change in cash	1,796	665	2,505	(19)	2,364

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

Y/E March	FY17	FY18	FY19	FY20E	FY21E
Per Share (Rs)					
EPS	13.8	17.4	25.6	28.0	33.5
FDEPS	13.8	17.4	25.6	28.0	33.5
Dividend Per Share	4.5	4.8	6.3	7.5	9.0
Book Value	103	115	136	155	177
Dividend Related (%)					
Dividend Yield	0.3	0.4	0.5	0.6	0.7
Dividend Payout Ratio (incl DT)	38.4	32.5	29.5	32.3	32.4
Growth (%)					
Revenue	2.1	6.3	11.4	14.2	15.0
EBITDA	1.0	27.0	34.5	18.9	20.0
PAT	15.6	26.1	46.9	9.7	19.5
Margins (%)					
Gross Margin	53.4	54.5	56.1	56.9	57.1
EBITDA Margin	11.3	13.5	16.3	16.9	17.7
PAT Margin	7.2	8.5	11.2	10.8	11.2
Return ratios (%)					
RoE	14.1	16.0	20.4	19.3	20.2
RoCE	17.0	20.9	25.6	26.7	28.2
Pre Tax ROIC	36.7	51.5	63.4	64.6	69.1
Turnover Ratios					
Asset Turnover Ratio	2.0	1.9	1.7	1.8	1.8
Debtor Days	10	11	10	9	9
Inventory Days	117	121	123	120	120
Valuation ratios (x)					
PER	96.0	76.2	51.9	47.3	39.6
P/BV	13	12	10	9	7
EV/EBTDA	58.7	45.9	33.6	28.3	23.2
EV/Sales	6.6	6.2	5.5	4.8	4.1

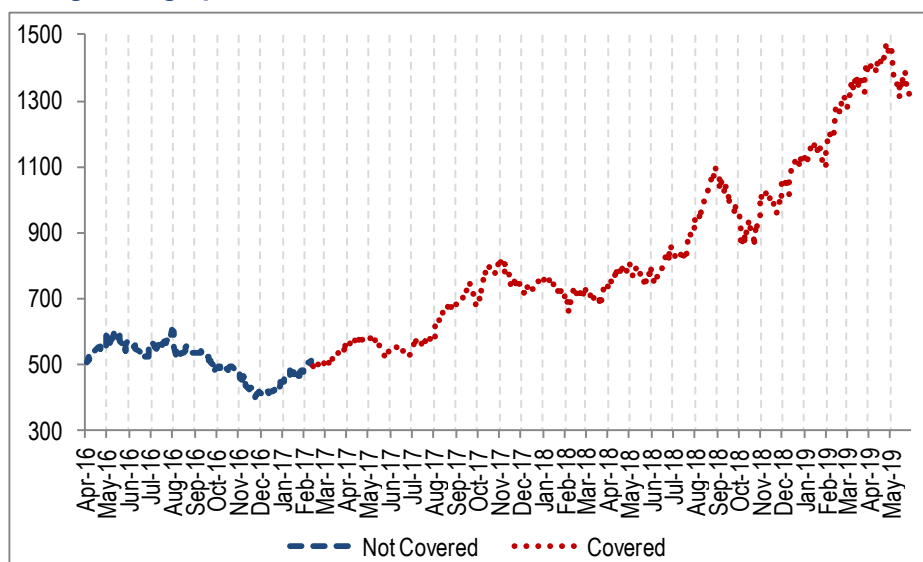
Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
12 April 2016	Buy	415	547
16 May 2016	Buy	468	589
1 August 2016	Accumulate	548	589
3 November 2016	Accumulate	604	655
7 February 2017	Accumulate	759	720
16 May 2017	Accumulate	576	600
3 August 2017	Accumulate	584	610
8 September 2017	Accumulate	692	696
15 November 2017	Accumulate	783	755
2 January 2018*	Accumulate	757	755
14 February 2018	Buy	713	821
25 June 2018	Buy	830	952
23 July 2018	Buy	842	970
9 November 2018	Accumulate	1,012	1,055
14 February 2019	Buy	1,272	1,479
7 March 2019	Accumulate	1,344	1,479
3 June 2019	Accumulate	1,325	1,410

*Coverage shifted to Girish Pai with effect from 2 January 2018

Rating track graph



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BUY > 15%

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