INDIA

CENTRUM

10 December 2008

Initiating Coverage

Bata India

BUY

Revamped

CMP: Rs84*

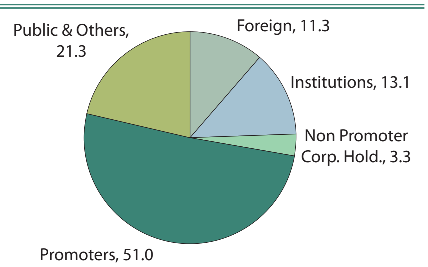
Target Price: Rs132

Key Data	
Bloomberg Code	BATA IN
Reuters Code	BATA.BO
O/S Shares (mn)	64.3
Diluted Shares (mn)	64.3
Market Cap (Rs bn/US$ mn)	5.4/108.7
52 Wk H / L (Rs)	295/76
Daily Vol. (3M NSE Avg.)	102,077
Face Value (Rs)	10

1 US$ = Rs49.6

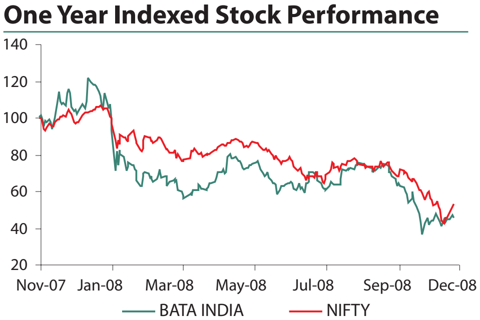
Source: Bloomberg

Shareholding Pattern (%)



As on 30th September 2008

One Year Indexed Stock Performance



Source: Bloomberg, Centrum Research

Price Performance (%)	1M	6 M	1 Yr
Bata India	(21.2)	(44.5)	(68.6)
Nifty	(6.9)	(40.4)	(53.1)

Source: Bloomberg, Centrum Research

*As on 8 December 2008

Bata is on the transformation curve and has aligned itself towards addressing a larger pie with newer product lines and a resurgent brand. We estimate the company to post 15.9% revenue CAGR over CY08E-CY10E, fuelled by new retail stores, remodeling of old stores and addition of new growth category of industrial shoes. Moreover, rationalization through raw material and manpower cost reduction will aid in improving margins going forward. We initiate coverage on the stock with a target price of Rs132, valued on one year forward multiple of Bata relative to Nifty.

Sporting a new look through new strategy

Bata's revamped business strategy is aligned towards addressing a larger pie, introducing newer product lines and a resurgent brand. Its front-end strategy involves focusing on higher footfalls, value retailing and driven by its new-look stores. We estimate Bata to post 15.9% revenue CAGR over CY08E-CY10E, fuelled by new retail stores, re-modeling of old stores and addition of new growth category of industrial shoes. The company plans to add 210 stores over the next three years and has revamped and consolidated its old stores. With new product lines skewed towards high-end variants, volume growth from new stores and new category of institutional sales, we expect Bata to enlarge its market share to 7.6% in CY10E from 6.5% currently.

Cost control to improve efficiency

We expect Bata to post 10.8% EBITDA margin in CY10E vs 7.9% in CY07, on the back of rationalization through raw material and manpower cost reduction. Bata's staff cost as percentage of sales is estimated to fall to 18.6% by CY10E from 21.2% in CY07, as the company has opted for outsourcing model. Cost saving through outsourcing, staff reduction and push of high end variants product line will help improve its EBITDA margin by 200bp to 10.8% in CY10E. By increasing its proportion of outsourcing, Bata will be able to concentrate on marketing and manufacture only in-house footwear profitably.

Fully funded for the next level of growth

Bata is expected to finance its expansion plans, additional working capital and dividend payout through internal accruals from its existing business. Strong internal cash flows will help Bata in maintaining its growth trajectory without depending on external finance. We also expect the company to reduce its existing debt, resulting in its debt-equity ratio falling to 0.1x inCY10E from 0.21x in CY07.

Valuation: relatively less cyclical but with good growth prospects

Bata has been trading at 30% premium to Nifty over last three years and we have valued the stock on PE multiple relative to Nifty. While consensus estimates (Bloomberg) Nifty to grow at 11% in FY10E and ROE to shrink to 19.9%, Bata, on the other hand, is expected to sustain its profit growth and also improve its ROE. To reflect its higher growth with an almost non-leveraged balance sheet and improving return ratios, we value Bata at a PE of 13.1 x CY09E (provided additional 10% premium to Bata over historical premium, which the company has been commanding over Nifty) and arrive at a target price of Rs132, implying a potential upside of 57.1%. However, we have not built additional contribution from Bata's JV in real estate, which we estimate to contribute Rs19/share to Bata.

Key Financials

Y/E Dec (Rs mn)	CY06	CY07	CY08E	CY09E	CY10E
Net Sales	7,702	8,675	9,954	11,545	13,374
Growth (%)	8.7	12.6	14.7	16.0	15.8
EBITDA	462	687	875	1,163	1,445
Margin (%)	6.0	7.9	8.8	10.1	10.8
PAT (adjusted)	222	446	541	648	831
Growth (%)	99.8	101.1	21.2	19.8	28.3
ROE (%)	9.4	19.2	20.1	21.2	23.6
EPS (diluted) (Rs)	3.5	6.9	8.4	10.1	12.9
P/E (diluted) (x)	24.3	12.1	10.0	8.3	6.5
EV/EBITDA (x)	12.5	8.1	6.4	4.7	3.5
EV/Sales (x)	0.8	0.6	0.6	0.5	0.4
Price/BV (x)	2.5	2.1	1.9	1.7	1.4

Source: Company, Centrum Research

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Sporting a new look through new strategies

Bata's revamped business strategy is aligned towards addressing a larger pie, introducing newer product lines and a resurgent brand on the front-end and curtailing costs at the back-end. The company has attacked these challenges through the following measures: 1) a front-end strategy focused on higher footfalls, higher value retailing, driven by a new-look store layout and a resurgent brand and 2) back-end strategy of process rationalization in form of raw material cost and manpower cost reduction, leading to superior margins. Under the stewardship of Mr P M Sinha, who joined Bata India (earlier served as the South Asia CEO of Pepsi Foods International) as the Chairman in 2004, the company changed its overall business strategy and has been functioning as an FMCG player rather than a conventional footwear manufacturer. The new team has brought about a significant turnaround in the company's operations.

Exhibit 1: Traditional and Enhanced Value Proposition

Measures		Qualitative effect	Quantitative effect
Focused on sales			
-Ramp-up of new stores - Extension of shopping hours - Modernization/relocation of old stores	Plans to add 70 stores per year for next 3 yrs Extended store hours till late evening Consolidation of small stores and relocation to better area	Led to presence of Bata Stores near the consumer both in terms of location and time, Swanky international looks will attract higher footfalls	1)This has started showing signs of turnaround, with the company clocking 7.7% sales CAGR over CY04-07 2) We believe the new strategy will aid the company's sales at 15.5% CAGR over CY07-10E
- Reposition brand 'Bata'	Fading brand to Super Brand	High brand recall for consumer led to higher footfalls and better conversions	
- Target new market (ladies and kids)	Filling the missing 45% pie of footwear market	Catering to key decision maker to attract higher footfalls, this category in itself sees the highest churn	
- Improving shoe line	Launching international brands, focus on style	Attracting new young customer class .. But maintaining value for money preposition	
- Addition of new segment of industrial sales	Cater to industrial segment incl. Armed forces, mining, etc	Bata International's 20% global market share in this segment will help the company gain significant market share in India as well	
Driven by cost control			
- Focus on outsourcing - Global sourcing of raw material	Outsourcing of production in stylist and low shelf life shoe-lines	Outsourcing saved high variable overhead costs and inefficiencies at Bata's factory; global sourcing from East Asian nations improves the look and feel of shoe-line to convert footfalls into sales	1) This led to improvement in EBITDA margin from -6.3% in CY04 to 7.9% in CY07. 2) EBITDA margin is expected to increase further to 10.8% in CY10E
- Manpower rationalisation	Rationisation of manpower across production facilities by providing VRS	Reduced its high-cost labour and improved staff to sales ratio	
- Reduce time to market	Created a logistic team to provide timely inputs to purchase and production team to cater to changing demand of consumer	Decrease in inventory of slow-moving items by reducing its production and purchases on time	
- Reduce collection days	Set maximum limit of collection of dues to 45 days	Reduced sales to non-core wholesellers and in turn reduced low-margin wholesale sales	Overall collection days reduced to about 9 in CY07 from 24 in CY04; expected to further reduce to about 7 days in CY10E
Bata Nagar Project			
Development of Bata Nagar Project	Developing its 262 acre land near Kolkatta		Will provide cash flows after CY11E

Source: Bata Annual Report, Centrum Research

Transformation and transition of Bata stores

Sensing diminishing interest in its type of format and a rapidly evolving retail landscape, Bata decided to launch its new stores and revamp its old stores aligning with international look. It successfully created brand 'Bata' over a period of time. However, aging stores and fading product lines had impacted its brand to an extent. To support its new smarter look, the company embarked on a high-spend campaign to drive recall and store sales.

Exhibit 2: Lay out of old stores

Source: Centrum Research

Exhibit 3: Lay out of new super stores

Big format store in Vadodra

Super store in New Delhi

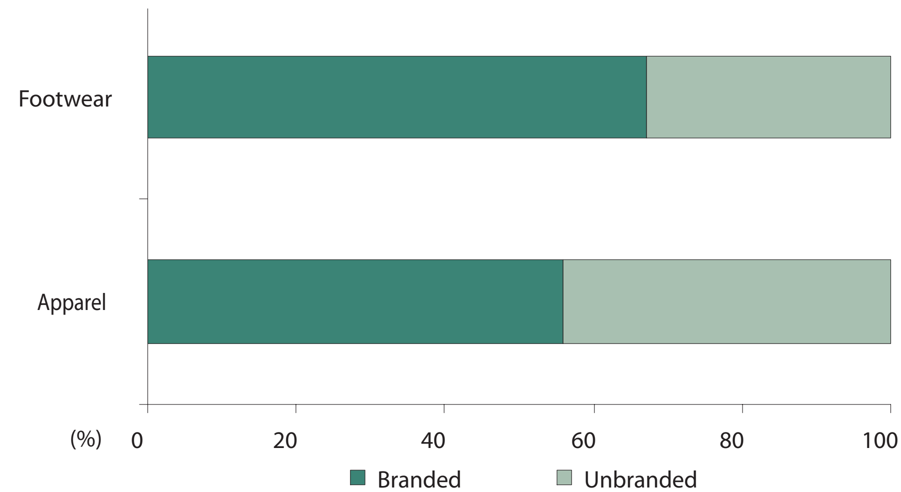
Super Store- Dehradun

Exclusive Hush Puppies store- Ahmedabad

Source: Bata website, Centrum Research

Inherent to this strategy is that over two-thirds of consumers prefer branded footwear over un branded ones (Source: The Knowledge Company).

Exhibit 4: Proportion of branded products is higher in footwear



Source: India Consumer Trends '06-07' - The knowledge company

Recent wins in various brand categories imply that Bata's brand strategy is in the right direction.

Exhibit 5: Bata: Brand recognition awards

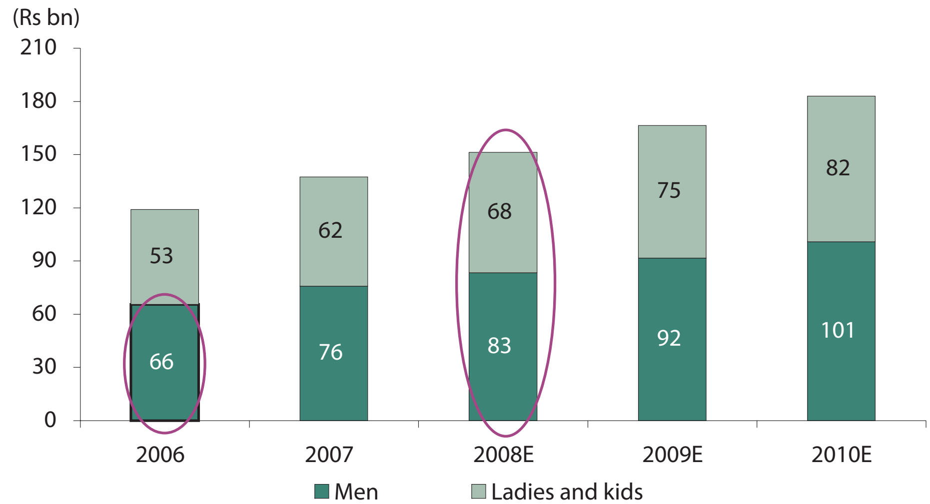
Award	Year	Agency	Description
Images Retail Award	2007	Images Retail	This is country's most coveted retail award
Outstanding Sales Award	2007	Wolverine Word Wide	This was given for increase in sales by 21% in the Hush Puppies brand
Lycra Images Fashion Award	2007	Images Retail	Bata was honoured with most the admired brand for footwear category in 2007
Super Brand	2006	Superbrands	Bata has been rated as one of the top ten super brands in India. Super brand signifies the recognition that the consumer is giving to the brand image, brand value and brand delivery

Source: Bata Annual Report

Addressing a larger pie and driving footfalls

Footwear for men account for nearly 55% of the total Indian footwear market of Rs1,51.3bn, whilst that of ladies and kids contribute the balance (ladies footwear accounts for 36% and the balance 9% is contributed by kids footwear). Bata was long known for its strong presence in the men's footwear range. However, the global and Indian experience shows that ladies and kids are the driving factors for larger footfalls and the company needed to address this market. To back-up this strategy, the company set up an in-house design team to service and innovate a new business line. It also roped in Rani Mukherjee (Indian actor) for its ladies brand, *Marie Claire*, which saw increased sales subsequent to the campaign. This improved the cross-sell opportunities at its stores, driving higher store sales.

Exhibit 6: Catering to a larger market



Source: Images Retail , Centrum Research

Aggressive value retailing continues

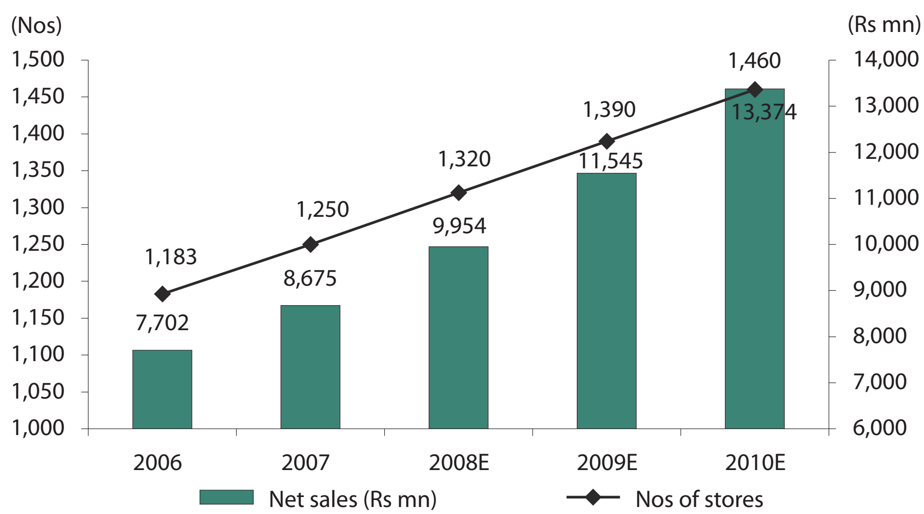
The brand 'Bata' essentially had a feel and appeal for the 'value-for-money' class of consumers. We believe a variety in product offerings is key to the success and survival of any brand. The company's strategy to replace its older and slow-moving footwear lines with newer designs and styles would help it attract higher footfalls and result in higher conversion ratio. The company caters to a wide consumer base that includes footwear and accessories for men, ladies and kids at different price points (the company's footwear in different categories are priced in the Rs35- Rs5,000 range). This coupled with its newly launched range of accessories (school bags, socks, fashion bags, etc) would help the company in cutting across customer classes.

Aggressive retail expansion…

Bata's aggressive retail expansion strategy makes us believe that it will likely add another 210 stores by 2010. The company is also set to capitalize its existing retail and wholesale network to tap opportunities in India's retail footwear segment. We estimate its retail expansions (including new segment of industrial sales and part of wholesale operations) to witness immense growth, going forward. Rising per capita income and increased spending, change in consumer preferences and styles along with emergence of competitive players in the organized segment has prompted the company to revamp and restructure its existing retail operations. The company is on a major drive to consolidate its small format stores and re-model its old stores to compete with other organized players. These measures will drive the company's revenue growth from its existing stores going forward.

Under its retail operations, the company operates through a chain of retail stores spread across the country. In 2007, the company was estimated to posses a wide retail network of 1,250 stores spread across India, providing it an edge over other footwear retailers in terms of wider coverage and higher penetration in footwear retailing.

Exhibit 7: Addition in stores and growth in total sales



Source: Bata Annual Report, Centrum Research

…and big push from institutional sales

We estimate Bata India to register 87.1% revenue CAGR from industrial sales over CY08E-10E on the back of support from parent, Bata Shoe Organization (BSO) and expected tie-ups with defense forces and manufacturing companies. We believe that Bata is targeting defense forces and the mining companies whose footwear requirement are largely being met by the unorganized sector. Considering the huge opportunity in these sectors, Bata has forayed into industrial sales, whereby it manufactures footwear under the division, Bata Industrial (an integral part of the company's wholesale business). Bata Industrial (a division of BSO) enjoys about 20% market share in the industrial segment worldwide. Bata Shoe Organization (BSO), the parent company is expected to provide technical expertise to Bata India.

Market share to sustain

Bata's position as a market leader in the Indian footwear market cannot be doubted, except over the last few years when the company's market share fell to 6.5% in 2007 from 7.2% in 2004. We attribute this to the major restructuring exercise in the company and management's focus on reducing costs than sales. Moreover, severe competition from imports too contributed to the fall in market share.

The company has now almost completed its cost control and restructuring exercise and intends to focus on increasing its revenue to drive the second level of growth, going forward. The strategy includes expansion of new stores across the country and re-modeling of decade old stores to generate footfalls. With this, we expect Bata's market share to increase to 7.6% in CY10E from 6.5% in CY07 on the back of newly devised strategy of volumes and price growth.

Exhibit 8: Bata: Improving market share

Source: Images Retail, Centrum Research

Exhibit 9: Retail space of footwear retailers

Brand	Retail presence (nos. of stores) in 2007
Bata	**1,250**
Liberty	381
Khadim's	300
Reebok	240
Woodland	230
Adidas	220
Action	210
Nike	100
Metro	72
M&B (Lee Cooper)	50
Red Tape	50
Puma	42
Shreeleathers	29
ID	19

Source: Images Retail, Centrum Research

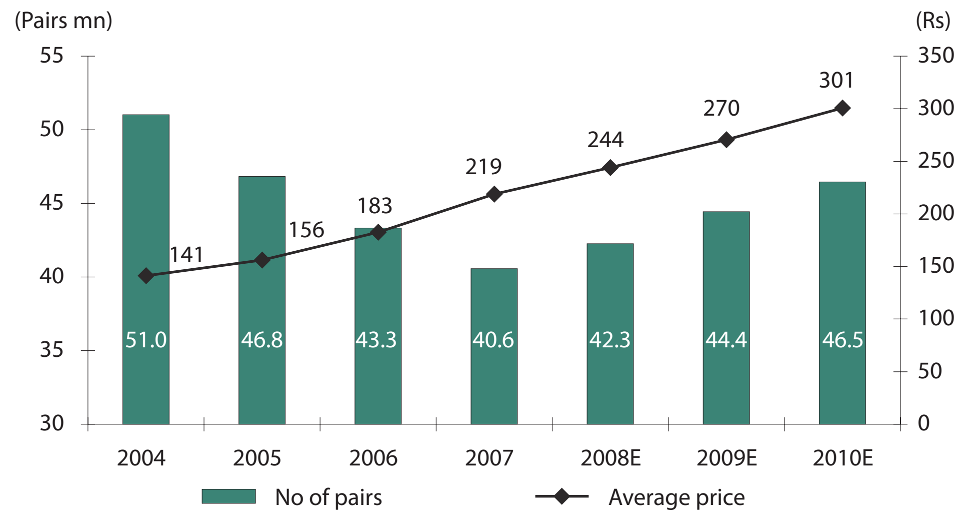
The company enjoys the highest market share and this is evident from the fact that the total retail presence of the company currently is more than thrice that of its closest competitor. We believe this wide gap will provide an edge to Bata to sustain its leadership status, going forward.

Higher avg footwear prices and volumes to boost revenue

Fuelled by the new retail stores, re-modeling of old stores and addition of new growth category of industrial shoes, we estimate Bata's revenues to register 15.9% CAGR over CY08E-CY10E. To achieve next level of growth trajectory, the company expects to focus on volume growth apart from increasing the average sales price of footwear. We believe the retail expansion and industrial segment would push volume growth, going forward. We estimate footwear volumes to register 4.8% CAGR over CY08-10E. Bata has a presence in leather, rubber and plastic footwear and since leather is a high value and better margin product, we expect the company to focus on leather, going forward. We thus estimate the proportion of leather to increase to 67% in CY10E from 63% in CY08E. This coupled with introduction of high end variants in all categories would improve average sale price of footwear at 11.0% CAGR over CY08E-10E to Rs 301 in CY10E.

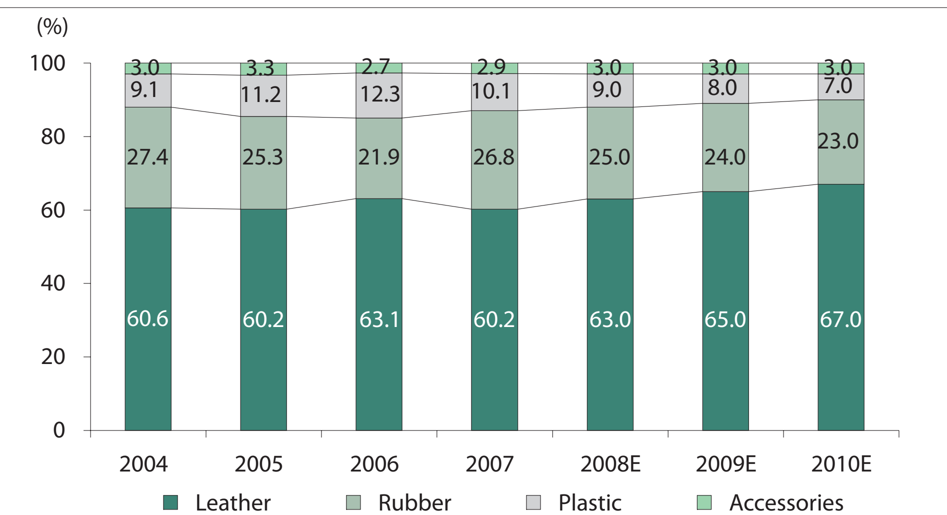
Until CY07, the company had planned restructuring to increase the average sale price of footwear by introducing high end variants in different categories and phasing out the low value items. It has successfully implemented its re-structuring plan and has been able to phase out its low cost variants. The increase in average sales price at 15.7% CAGR helped the company to clock sales CAGR of 7.2% over CY04-CY07 despite 7.4% fall in volumes.

Exhibit 10: Continued improvement in average selling price



Source: Bata Annual Report, Centrum Research

Exhibit 11: Increasing proportion of leather footwear sales



Source: Bata Annual Report, Centrum Research

Cost control to improve efficiency

Bata being an eight decade old company was carrying its own legacy cost structure. We cite its old manufacturing processes and plants, high manpower and overheads costs as reasons for its high costs structure. During the restructuring exercise implemented during CY04-07, the company successfully achieved efficiency in its manufacturing processes, high manpower and overhead costs. This resulted in its gross margins improving by 13.8 percentage point (ppt) during this period. Process rationalization and controlling man power and raw material costs primarily contributed to this improvement.

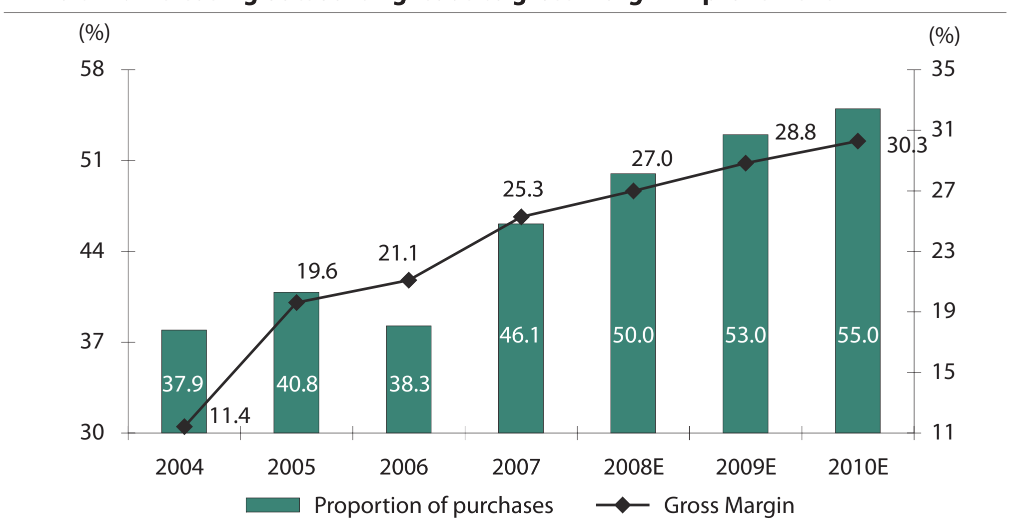
Outsourced manufacturing process

To improve its operational efficiency, the company outsourced part of its production along with certain manufacturing processes. In addition, proportion of third party footwear purchases too increased from 37.9% in CY04 to 46.1% in CY07. We estimate this proportion to increase further to 55% in CY10E. By increasing its proportion of outsourcing model, the company would be able to concentrate only on marketing push and manufacture only those footwear in-house which are profitable in nature.

Moreover, the company is also outsourcing part of its manufacturing processes (the complete production process involves sole manufacturing, leather manufacturing, upper manufacturing, stitching of upper with sole, cutting and finishing) to reduce overhead costs. The company recently began outsourcing to less critical and more labour-intensive process like stitching, cutting and finishing; earlier it was involved in the full cycle of manufacturing from sole to finishing. In order to utilize its existing manufacturing capacities and maintain quality control, core manufacturing operations viz, manufacturing of sole and uppers has been retained by the company.

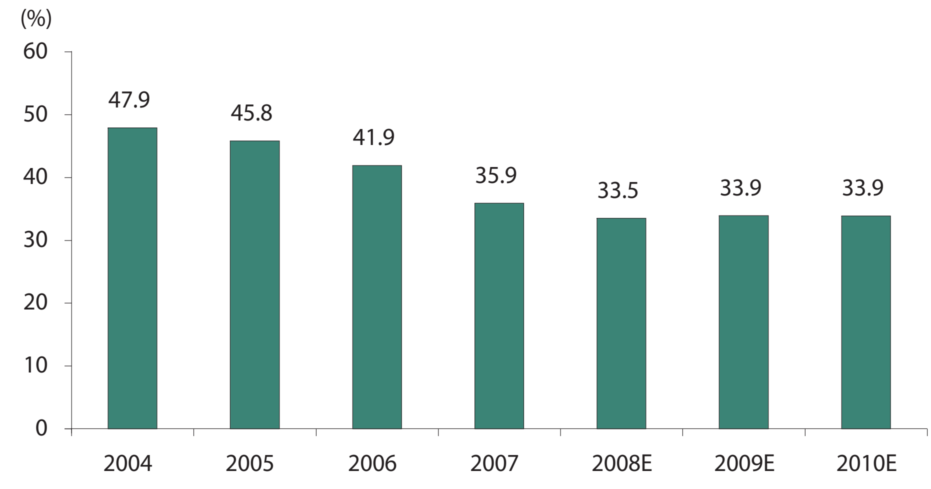
Under the current retail strategy, the company is focused towards providing a variety in terms of styles and product offerings. It therefore provides products with shorter shelf life, because of which the production volumes of different shoe-lines are low. Low production volumes of particular design imply high manpower and overhead costs. In order to reduce higher costs attached to low volumes and at the same time utilize its existing capacities and manpower, the company will concentrate on manufacturing bulk shoe-line and industrial footwear. The capacity utilization during the restructuring period shrunk to 35.9% in CY07 from 47.9% in CY04. Thus, the proportion of bulk shoes has seen a continuous reduction, which will likely lead to a declining trend in capacity utilization. However, part of the reduction would be offset by the industrial segment.

Exhibit 12: Increasing outsourcing leads to gross margin improvement



Source: Bata Annual Report, Centrum Research

Exhibit 13: Moderate decline in capacity utilization

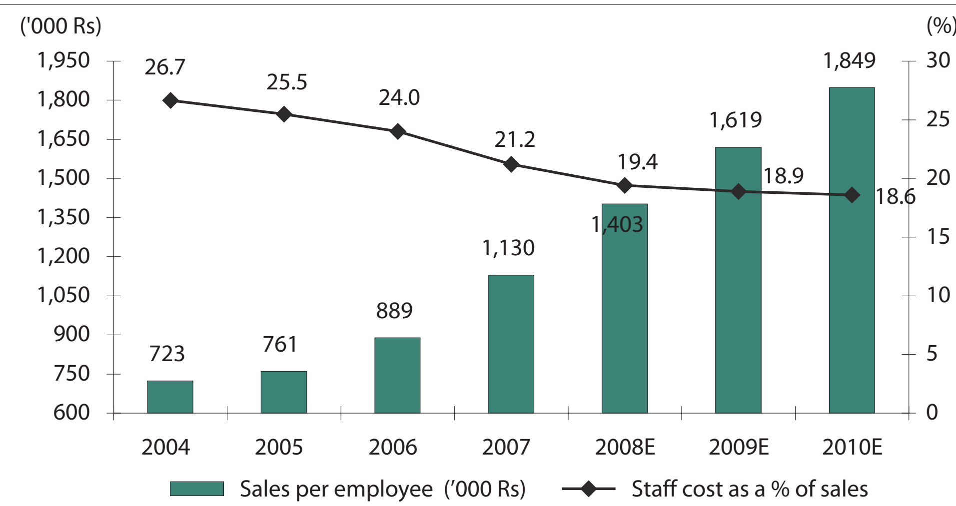


Source: Bata Annual Report, Centrum Research

Reducing manpower costs and increasing efficiency

We estimate Bata's staff cost as a percentage of sales to fall to 18.6% by CY10E from 21.2% in CY07, given that the company has opted for an outsourcing model, leading to further reduction in staff strength at its manufacturing units. Despite addition of marketing personnel due to aggressive retail expansion, Bata's total staff strength is expected to increase at a relatively slow pace owing to expected VRS at its manufacturing unit. Bata has drastically cut its legacy work force through VRS and related manpower expenses over last four years. This led to staff cost as percentage of sales falling to 21.2% in CY07 from 26.7% in CY04 (interestingly, absolute staff cost has not changed over CY04-07).

Exhibit 14: Improvement in manpower efficiency



Source: Company Annual Report, Centrum Research

Bata's overall manpower efficiency has been increasing exponentially and we estimate sales per employee to increase 1.6x during CY07-10E to Rs1.9mn. The major steps taken by the company to rationalize the staff costs include:

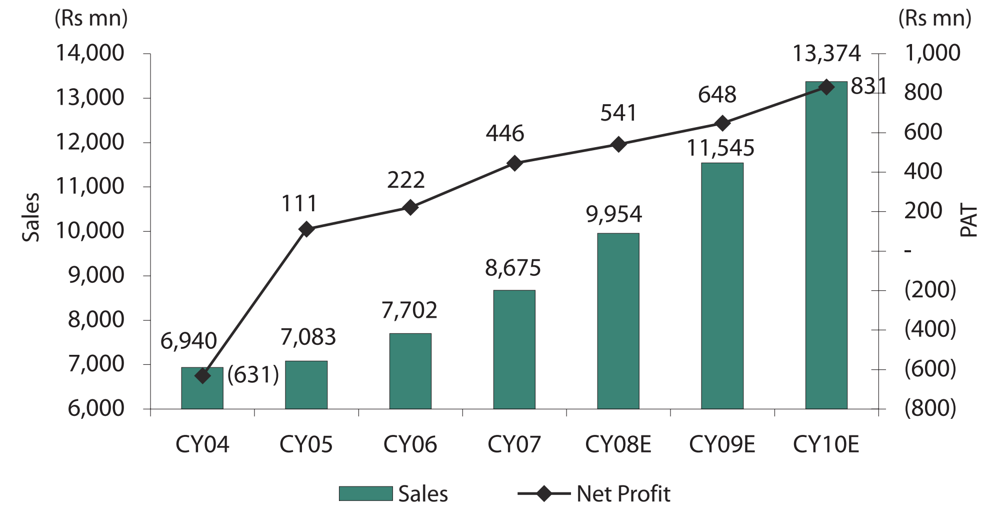
- The management has split the retail employee union
- Absence of employee union has helped the company keep its store open for 365 days, with permission from the local authority
- Has extended the shopping hours in stores
- Installed new automotive plants, where requirement of man power is low

The financial turnaround

Efforts on the front end and cost control at the back end aided the complete transformation of the company from a loss-making to profit-making company in CY05. In CY06, the company paid dividends after a gap of five years as well.

We expect the company to continue its growth phase with continuous improvement in product line and launch of new stores. We expect the Company to register 15.9% net sales CAGR over CY08E-10E.

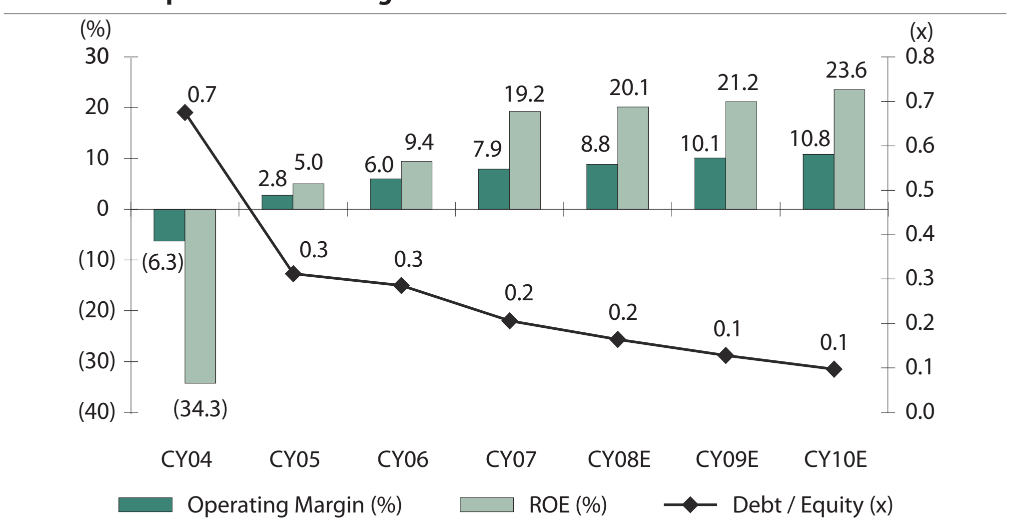
Exhibit 15: Sales and profit growth



Source: Bata Annual Report, Centrum Research

During the re-structuring exercise implemented during CY04-07, the company achieved efficiency in its high manufacturing processes, high manpower and overhead costs. Improvement in process rationalization in form of raw material cost and cost reduction in manpower cost resulted in 13.8 Percentage Point improvement in gross margin during the period. Bata had its own legacy cost structure, given that it is an eight decade old company. Increased proportion of high margin business and continued savings from on-going cost reduction exercise would help EBITDA margin to improve by 200bps to 10.8% during CY08E-10E. This along with reduction in interest cost would help the company's PAT to grow at a CAGR of 24.0% during CY08E-10E. ROE is expected to improve from 20.1% in CY08E to 23.6% in CY10E on the back of superior net profit margins and asset turnover.

Exhibit 16: Improvement in margins and return ratios



Source: Bata Annual Report, Centrum Research

Fully funded for the next level of growth

Bata India is expected to generate sufficient internal accruals from its existing business to finance its expansion plan including requirement for additional working capital and to maintain dividend payout. Strong internal cash flows would help Bata in maintaining its growth trajectory without depending on external financing (equity as well as debt).

Exhibit 17: Fund requirement vs. generation

(Rs mn)	CY08E	CY09E	CY10E
Fund requirements			
Total capex	507	452	328
Net working capital	32	269	584
Dividend	190	227	292
Total fund required	**729**	**948**	**1,204**
Fund generation			
Internal accrual	779	998	1,254
Debt	(50)	(50)	(50)
Total fund generation	**729**	**948**	**1,204**

Source: Centrum Research

Apart from financing its expansion plans, the company would be able to reduce its existing debt. The debt equity of the company is expected to reduce to 0.1x in CY10E from 0.21x in CY07.

Share buyback and/or higher dividend payout

The company is expected to generate sufficient cash flows to fund its expansion plan and maintain its dividend pay out ratio at 30% for next three years. We believe after CY10, majority of its free cash flow, which includes cash flow from the business and expected Rs6.9bn from its real estate JV in CY11 -12E would not be utilized in the business. We estimate surplus cash post CY11E to be used either for higher dividend pay out and/or equity buyback. This would help improve the company's return ratios.

Improving consumption pattern

Burgeoning middle class, higher per capita income and media penetration has led to higher consumer aspirations with consumer graduating towards better consumer lifestyle products. This has resulted in jump in discretionary expenditure specifically directed towards lifestyle and personal care segment viz. apparel, accessories and footwear segments. Exposure to global trends has led to the development of the 'fashion consumer' who is much more open-minded and experimental in nature. The initial price conscious consumer psyche is now driven by functionality (comfort and durability) along with attractiveness of the overall package.

The Rs151bn Indian footwear market comprises of 1.57bn pairs spread over a population of over 1.1bn *(source: Images retail)* .This translates into a footwear consumption of 1.38 pairs per person. We expect the industry to clock 10% CAGR during CY08-09 on the back of population growth, especially the middle class segment, together with penetration from organized footwear retail.

Per capita footwear consumption to rise

We expect per capita footwear consumption to grow at 3.3% CAGR over CY07-10E to 1.47 pairs per person and average price of footwear at 5.0% CAGR over the same period. This would result in overall 10% CAGR in total footwear market during the same period.

Exhibit 18: Footwear consumption

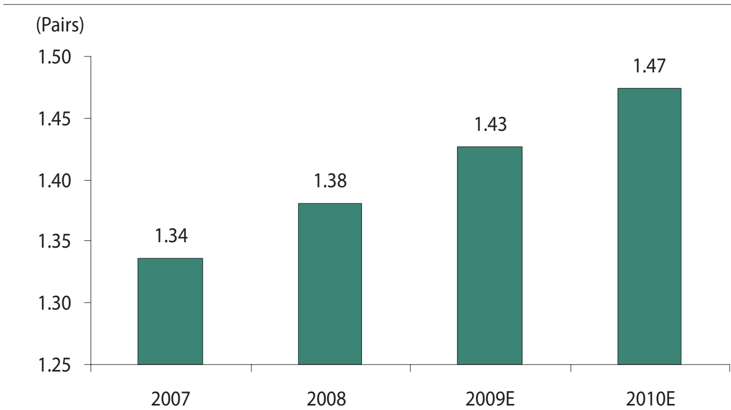
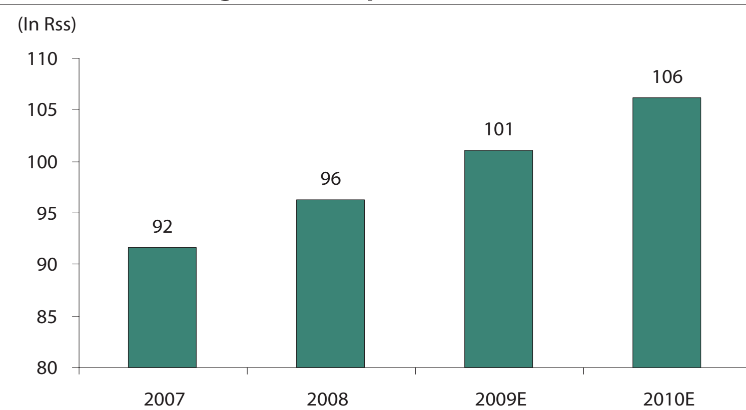


Exhibit 19: Average footwear price



Source: India Retail Report 2007, Centrum Research

India has among the lowest per capita footwear consumption of 1.34 pairs per person (CY08) and average footwear price of Rs96 (CY08). This coincides with lower discretionary expenditure, given the lower per capita income. Growth in per capita income would result in consumers demanding value offerings in basic consumer goods and make room for discretionary spends, thereby increasing per capita consumption as well as per pair price.

Exhibit 20: Lower per capita income......

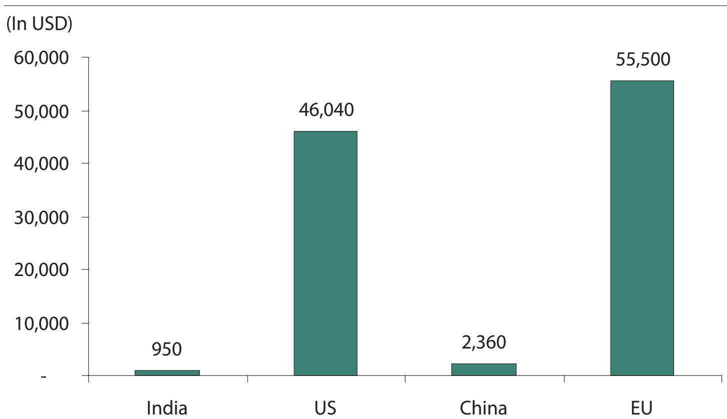
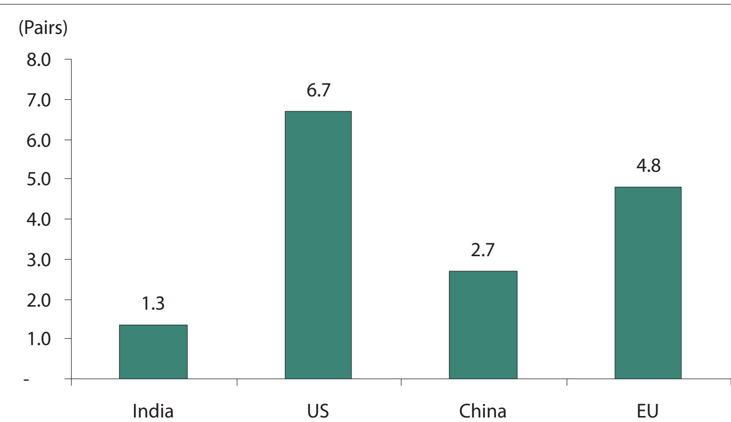


Exhibit 21: ... Coincides with lower footwear consumption

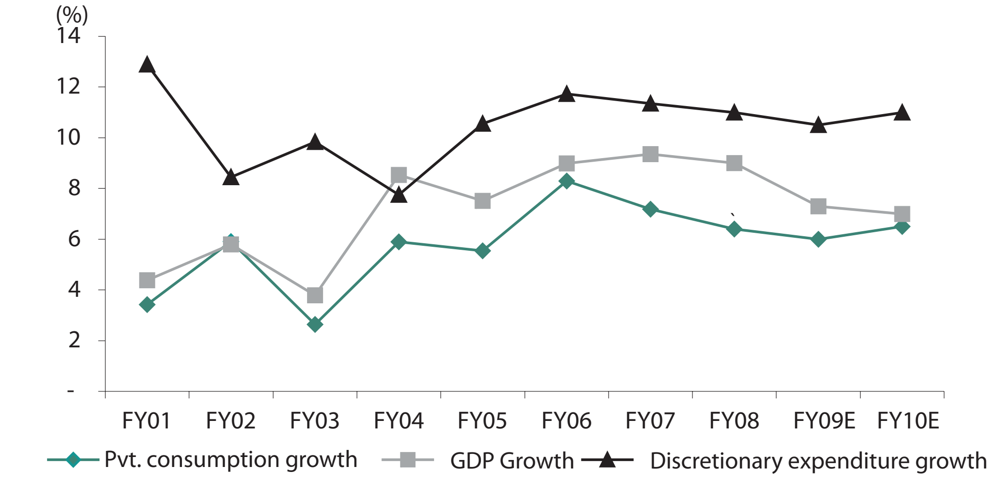


Source: India Retail Report 2007, Centrum Research

Discretionary spending to bounce back

An expected decline in GDP growth to 7.3% and 7% in FY09E and FY10E, respectively (Centrum estimates) is likely to impact the per capita disposable income, leading to a decline in private consumption and discretionary spending. Although discretionary spending may see a dip from 11% in FY08 to 10.5% in FY09E, consumption is expected to bounce back to 11% in FY10E owing to the expected various liquidity measures implemented by the Central Bank.

Exhibit 22: Short term blip in discretionary spending



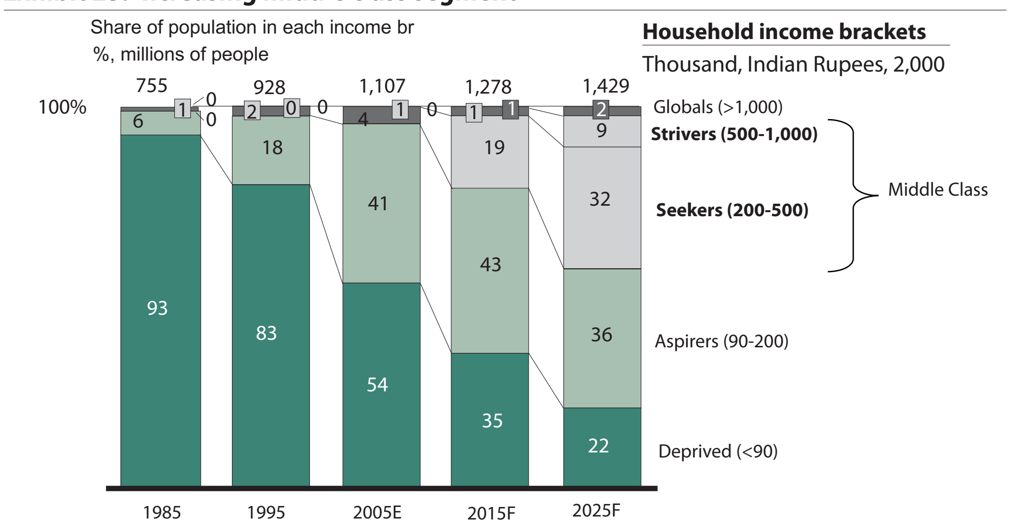
Source: RBI, Centrum Research

Middle class consumption to boom

Bata's products and pricing strategy is aimed at the middle class segment. The company believes the segment offers immense potential and has the ability to drive consumption growth. By FY15E, the segment is expected to account for 43% of the consumption basket. With development and economic growth, we expect the 'Aspirers' (Rs90,000-Rs 200,000) and 'Seekers' (Rs200,000-500,000) to bulge, , working their way up the income ladder by CY15E (currently these do not form a part of the middle class). This would increase the middle class population bracket to 255mn people accounting for 20% of the total population. Thus, by CY15E, the middle class segment is expected to contribute 43% of the total consumption basket.

India's 1.1bn population is expected to register 1.4% CAGR over CY08-09 (Source: NCEAR). Of the total population, the middle class comprising of 'Strivers' (Rs500,000-Rs1mn) and 'Seekers' (Rs200,000-Rs 500,000) accounts for 4.6% of the total population and contributes 20% to the total consumption basket.

Exhibit 23: Increasing middle class segment



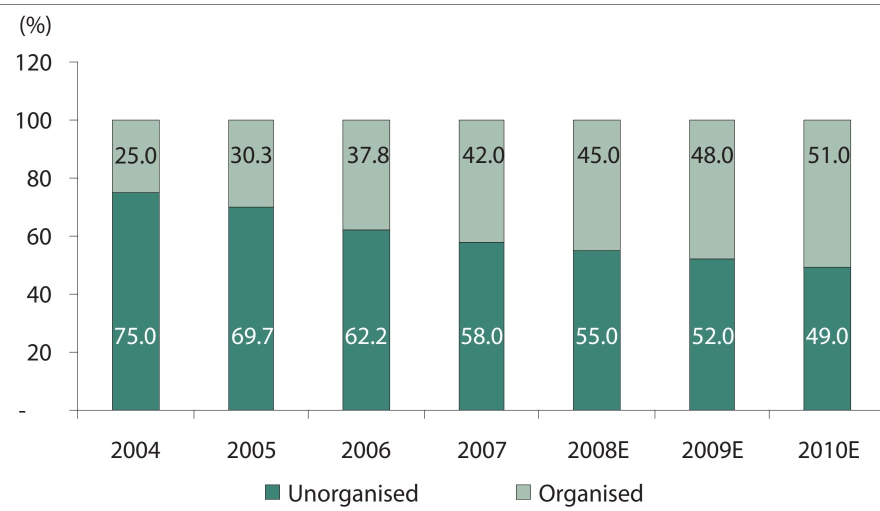
Source: Mckinsey Global Institute

Changing perception of footwear

Footwear is being perceived as a performance-enhancing product vis-à-vis the earlier image of it being a basic necessity item. Footwear retailing is currently dominated by unorganized players who account for 58% of the total footwear market. In India, the organized retailers provide a wide array of products in the men's footwear range, which accounts for 52% in value terms. The ladies footwear segment still remains largely untapped, as 80-90% of purchases take place in the unorganized market largely due to the dressing habits of the women who prioritize style over comfort and durability. Thus, there is a huge potential for organized retailers to expand in the ladies footwear segment.

Bata has revamped its collection under various brands and has launched new brands (e.g. Marie Claire, Bubble gummers) to attract footfalls from untapped segment i.e. ladies and kids.

Exhibit 24: Increasing penetration of organized footwear retailing



Source: Images Retail Report 2007, Centrum Research

A very unique aspect of modern lifestyle tastes is that though consumers are becoming more and more price conscious whilst purchasing footwear, comfort tops priority. With the influx of media, average consumer has become more brand conscious along with realization that branded goods are superior to unbranded in terms of quality, comfort, finishing and style. This has led to the emergence of branded and organized retailers dominating the footwear market. Average Indian consumer psyche is now tilted towards branded footwear which seen to provide 'value for money'. All these factors have contributed to higher penetration by organized retail at 42.0% in CY07 , which is further expected to reach to 51% by CY10E.

Valuation

Relatively less cyclical but with good growth prospects

We have valued Bata using relative PE multiples. However, to reflect the change in economic scenario and overall contraction in earnings multiple, rather than using standalone Bata PE multiple, we have used Bata's one year forward multiple relative to one year forward multiple of Nifty. On an average, the stock has been trading at 30% premium to Nifty over last three years. While consensus estimates (Bloomberg) suggests earnings of Nifty to grow at 11% in FY10E and ROE to shrink to 19.9%, Bata, on the other hand, is expected to sustain its profit growth and also improve its ROE.

Therefore, to reflect its higher growth with almost non-leveraged balance sheet and improving return ratios, we have given an additional 10% premium to Bata over historical premium Bata has commanded over Nifty. We value Bata at a PE of 13.1 x CY09E and arrive at a target price of Rs132, implying a potential upside of 57.1% at current levels. However, we have not built any additional contribution from Bata's JV in real estate. We estimate the real estate venture to contribute Rs19 per share to Bata.

Exhibit 25: One year forward PE multiple of Bata vis-à-vis Nifty

Source: Bloomberg, Centrum Research

Comparison with peer, Titan

Among peers, we have compared Bata to Titan on a longer horizon and expect the company to capitalize on its brand value. As brand is the key driving force for both companies, we believe Titan is a good proxy and we have valued Bata at 20% discount to Titan's one-year forward PE multiple. The discount reflects Bata's presence in a single business segment vs Titan's presence in two profitable segments, apart from the difference in their RoEs. Hence, Bata is valued at a PE of 12.5x CY09E, on which we arrive at a value of Rs125.

Exhibit 26: PE (FY10E) and EPS CAGR (FY08-10E)

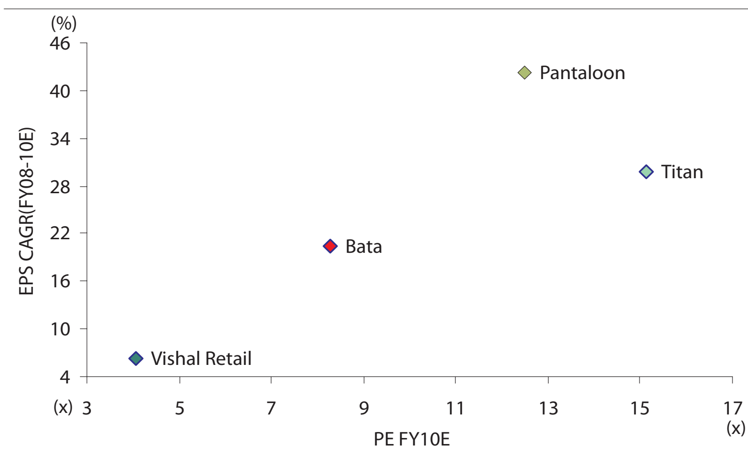
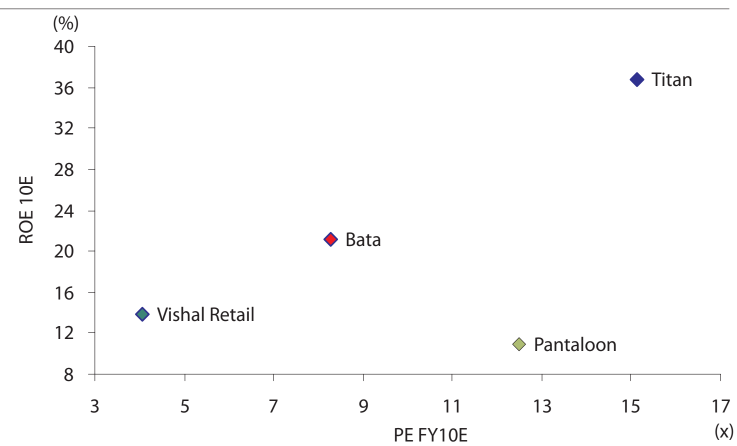


Exhibit 27: PE vs ROE (FY10E)



Source: Bloomberg, Centrum Research

Real estate venture - one time value driver

The company has cumulative 309 acres of land in Batanagar, Kolkata. Of this, apart from the factory area of 47 acres, the balance 262 acres has been transferred to Riverbank Developers Private Limited (RDPL), a special purpose entity, to build an integrated township. The special purpose entity RDPL is 50:50 joint venture between Bata India and Calcutta Metropolitan Group (CMGL). The project construction has already begun in 2007 and is expected to be completed by CY2011. We estimate a value of Rs5.2bn for this integrated township.

Given the present gloomy outlook for real estate in India, we have not ascribed any value from this project to our target price for Bata. However, we would factor this one-time extraordinary gain once the economic scenario gains momentum.

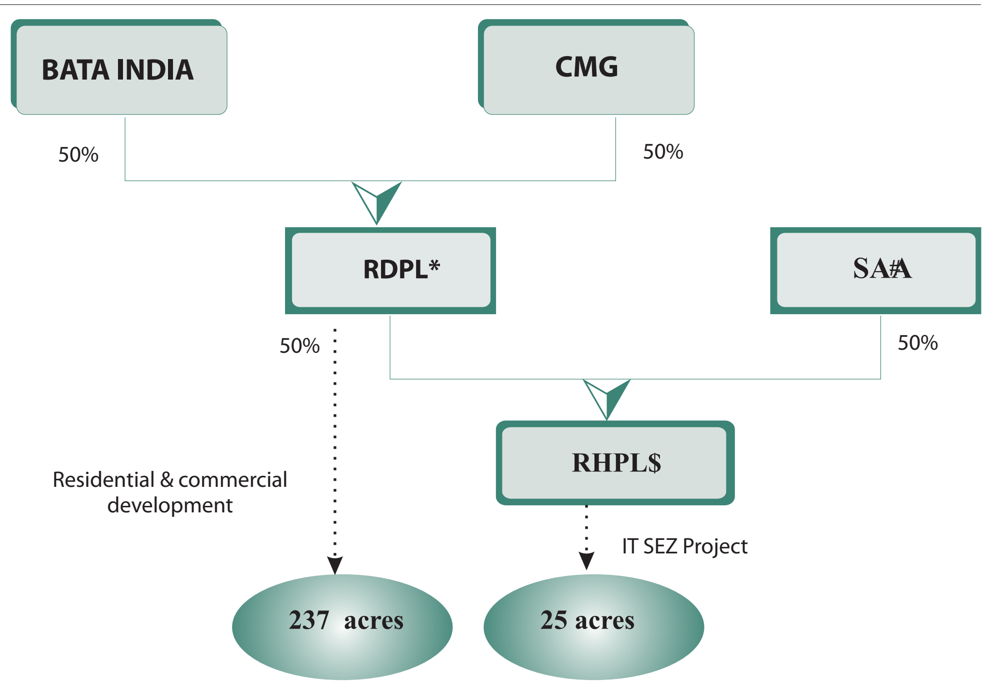
Exhibit 28: Calculation of value of the project

	Acre	Equity Value (Rs mn)	Bata's Stake (%)	Equity Value to Bata (Rs mn)
Residential	89	1,884	50	942
Commercial	60	2,481	50	1,241
SEZ	25	842	25	210
Social purpose	88	0	50	0
Total	**262**			**2,393**
Nos of shares (mn)				64.3
NAV per share to Bata (Rs)				37
Discount to NAV (%)				50.0
Net NAV (Rs)				**19**

Source: Centrum Research

CMGL is a 50:50 Joint Venture between the United Credit Belani Group (UCBG) and the Kolkata Metropolitan Development Authority (KMDA) and has a number of prestigious projects in Kolkata, such as Hiland Park on the EM Bypass. UCBG, which has interests in real estate and financial services, is credited with more then 50 multistoried landmarks adorning the Calcutta skyline. KMDA on the other hand, is a statutory body set up under the West Bengal Town and Country (Planning and Development) Act, 1979.

Exhibit 29: Structure of the development project

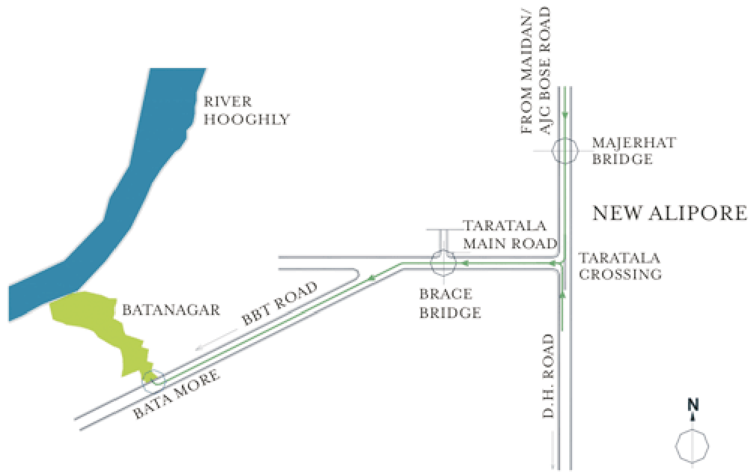


* Riverbank Developers Pvt. Ltd
# Saffron Asset Advisors
$ Riverbank Holdings Private Limited

Source: Bata Annual Report, Centrum Research

In 2007 the company inducted a strategic equity partner (50% stake), Saffron Asset Advisors (SAA), to develop 25 acres of IT SEZ at Rs1,176mn. Under the present arrangement, of the remaining 237 acres, 88 acres will be used for social causes, which include hospital, hotel, school and community centre.

Exhibit 30: Location of the project



Source: Company website

Annexure

Company background

Established in 1931, Bata India had established a strong leadership position in the footwear industry. The company deals in wide range of footwear which include rubber, leather, canvas and plastic.

Through its recent restructuring and re-engineering initiatives, the company has been able to reposition itself as a brand leader in the industry. The company has implemented various restructuring measures that include reducing cash drain stores, retail restructuring, introduction of trendier and better product lines, extending store timings, improved customer service, introduction of franchisee model to improve penetration, controlling staff costs, specializing production in factories, restricting credit days etc.

With over 1,250 exclusive stores and reasonable pricing strategy, the company has been able to garner 15% market share in organized retail.

The company undertakes manufacturing operations through its factories located in the state of West Bengal, Bihar, Haryana, Karnataka and Tamil Nadu. It also procures its additional footwear requirements through imports, viz, Singapore.

The company's wholesale operation can be categorized under urban, branding and industrial divisions.

Its urban division comprises of 16 depots selling over 15mn pairs across the country. Its network includes 150 distributors and over 20,000 dealers. The company's branding division consists of 15 distributors located in major metros selling branded footwear (e.g. Hush Puppies, Dr Scholl's, Power & Bubble gummer) to departmental stores, footwear chains, specialty stores and high street dealers. The company's specialized industrial division primarily caters to footwear requirements of various industries and institutions. The footwear is customized to suit the specific requirements of large industries and private/public institutions and sold through the company's specialized distributors.

Management Strength

Particulars	Current designation	Past credentials
Mr PM Sinha	Chairman	Mr. Sinha (67 years) is the former CEO of Pepsi Cola International South Asia and was the Chairman of Pepsico India Holdings and President of Pepsi Foods Limited.
Mr Marcelo Villagran	Managing Director	Mr. M Villagran, a Bata veteran has over 35 years of experience with the organisation. He was responsible for successfully running Bata Chile, before joining Bata India. He has enormous operating and sales experience.
Mr S Sinha	Director - Finance	Mr S Sinha is a Chartered Accountant (1986) by qualification and was previously working for Reckitt Benckiser in U.K. and India for eight years before finally joining Bata India.
Mr R Rizzo	Non-Executive Director	Mr Rizzo (61 years) has been with the organisation since 1969, posses extensive knowledge in the area of footwear retailing, manufacturing and marketing coupled with international exposure. Prior to this, he was President; Bata International Group Limited, Singapore and was responsible for overlooking Africa, Asia-Pacific and Indian operations.

Source: Bata Annual Report, Centrum Research

Financial Statements

Profit & Loss Account

Y/E Dec (Rs mn)	CY06	CY07	CY08E	CY09E	CY10E
Net Sales	**7,670**	**8,640**	**9,919**	**11,510**	**13,339**
Other operating income	32	35	35	35	35
Total revenue	**7,702**	**8,675**	**9,954**	**11,545**	**13,374**
Growth in total revenue %	*8.7*	*12.6*	*14.7*	*16.0*	*15.8*
Cost of goods sold	6,078	6,482	7,267	8,217	9,325
-% of sales	*78.9*	*74.7*	*73.0*	*71.2*	*69.7*
Gross Profit	**1,624**	**2,193**	**2,686**	**3,328**	**4,049**
-Gross margin (%)	*21.1*	*25.3*	*27.0*	*28.8*	*30.3*
Administrative costs	922	1,177	1,339	1,511	1,725
-% of sales	*12.0*	*13.6*	*13.4*	*13.1*	*12.9*
Selling and distribution expenses	133	178	246	332	440
-% of sales	*1.7*	*2.0*	*2.5*	*2.9*	*3.3*
Advertisement expenses	107	152	226	321	440
-% of sales	*1.4*	*1.7*	*2.3*	*2.8*	*3.3*
EBITDA	**462**	**687**	**875**	**1,163**	**1,445**
-EBITDA margin (%)	*6.0*	*7.9*	*8.8*	*10.1*	*10.8*
Depreciation	136	160	179	214	251
PBIT	**326**	**527**	**696**	**949**	**1,194**
Finance Charge	106	106	79	69	63
PBT from operations	**220**	**421**	**617**	**880**	**1,131**
Other non-operating income	272	94	106	126	156
PBT	**492**	**515**	**723**	**1,005**	**1,287**
-PBT margin (%)	*6.4*	*5.9*	*7.3*	*8.7*	*9.6*
Provision for tax	90	41	182	358	455
-Current tax	*77*	*51*	*123*	*221*	*283*
-Deferred tax	*0*	*(20)*	*46*	*121*	*154*
-Fringe benefit tax	*13*	*10*	*13*	*16*	*18*
-Effective tax rate (%)	*15.7*	*5.9*	*23.4*	*34.0*	*34.0*
Reported net profit after tax	**402**	**474**	**541**	**648**	**831**
Extraordinary items net of tax effect	180	28	0	0	0
Adjusted profit	**222**	**446**	**541**	**648**	**831**
-Growth in adj. net profit (%)	*99.8*	*101.1*	*21.2*	*19.8*	*28.3*
-Adj. net profit margin(%)	*2.9*	*5.1*	*5.4*	*5.6*	*6.2*

Source: Bata Annual Report, Centrum Research

Balance Sheet

Y/E Dec (Rs mn)	CY06	CY07	CY08E	CY09E	CY10E
Share capital	643	643	643	643	643
Reserve and surplus	1,477	1,871	2,211	2,620	3,149
Total shareholder 's fund	**2,120**	**2,514**	**2,853**	**3,262**	**3,791**
Loan fund	605	518	468	418	368
Deferred tax liability	0	(27)	19	140	294
Total capital employed	**2,725**	**3,005**	**3,340**	**3,820**	**4,453**
Gross block	3,066	3,245	3,662	4,124	4,534
Accumulated depreciation	2,101	2,206	2,396	2,621	2,882
Impairment	171	0	0	0	0
Net block	794	1,039	1,266	1,503	1,652
Capital WIP	8	3	93	82	0
Net fixed assets	802	1,042	1,359	1,585	1,652
Investments	172	172	172	172	172
Cash and bank	223	327	300	345	637
Inventories	2,764	3,037	3,252	3,677	4,173
Debtors	216	229	245	268	293
Other current assets and Loans & advances	423	505	508	577	656
Total current assets and loans & advances	3,626	4,098	4,305	4,867	5,759
Current liabilities	1,735	1,984	2,057	2,220	2,409
Provisions	141	337	451	597	733
Net current assets	1,750	1,778	1,797	2,050	2,617
Miscellaneous expenses not w/off	0	12	12	12	12
Total assets	**2,725**	**3,005**	**3,340**	**3,820**	**4,453**

Source: Bata Annual Report, Centrum Research

Cash Flow Statement

Y/E Dec (Rs mn)	CY06	CY07	CY08E	CY09E	CY10E
Cash Flow from Operating Activity:					
Profit before tax	492	552	723	1,005	1,287
Depreciation	136	160	179	214	251
Interest expenses/(interest income)	61	49	59	49	43
Non-cash and other charges	(148)	(68)	0	0	0
Operating profit before change in working capital	**541**	**692**	**961**	**1,268**	**1,580**
Working capital adjustment	25	(56)	(98)	(263)	(356)
Gross cash generated from operations	**566**	**636**	**863**	**1,006**	**1,224**
Direct tax paid	(14)	(116)	(123)	(221)	(283)
Payment under VRS	(108)	(12)	0	0	0
Cash generated from operations	**444**	**508**	**740**	**784**	**941**
Cash Flow from Investing Activity:					
Capex	(151)	(258)	(507)	(452)	(328)
Investment	-	(0)	-	-	-
Interest/dividend income	4	9	-	-	-
Net cash used in investing	**(147)**	**(249)**	**(507)**	**(452)**	**(328)**
Cash Flow from Financing Activity:					
Proceeds from share capital	-	-	-	-	-
Borrowings/(repayment)	(201)	(87)	(50)	(50)	(50)
Interest paid	(77)	(68)	(59)	(49)	(43)
Dividend paid	-	-	(150)	(190)	(227)
Net cash from financing	**(277)**	**(155)**	**(260)**	**(288)**	**(321)**
Net cash increase/(decrease) in cash	**20**	**104**	**(27)**	**44**	**293**

Source: Bata Annual Report, Centrum Research

Ratio Analysis

Y/E Dec	CY06	CY07	CY08E	CY09E	CY10E
Margins Ratios(%)					
EBITDA margin	6.0	7.9	8.8	10.1	10.8
PBIT margin	4.2	6.1	7.0	8.2	8.9
Pre-Tax margin	6.4	6.4	7.3	8.7	9.6
Profit after tax margin	5.2	5.5	5.4	5.6	6.2
Growth Ratios(%)					
Total revenue	8.7	12.6	14.7	16.0	15.8
EBITDA	136.6	48.7	27.4	32.8	24.3
Net profit	99.8	101.1	21.2	19.8	28.3
Returns Ratios(%)					
Return on Capital Employed (RoCE)	8.9	17.4	16.8	17.5	19.1
Return on Invested Capital (RoIC)	10.0	20.6	19.9	20.3	22.7
Return on Equity (RoE)	9.4	19.2	20.1	21.2	23.6
Du-Pont Analysis -ROE Decomposition (X)					
Net profit margin	5.2	5.5	5.4	5.6	6.2
Asset turnover	2.5	3.0	3.1	3.2	3.2
Equity multiplier	1.3	1.2	1.2	1.2	1.2
Working Capital Cycle(Days)					
Average inventory	167	163	163	163	163
Average collection	11	9	9	8	8
Average payable	91	96	95	90	86
Operating cycle	87	77	77	81	85
Per Share (Rs.)					
Adj. earnings	3.5	6.9	8.4	10.1	12.9
Book value	33.0	39.1	44.4	50.8	59.0
Dividend	0.0	2.0	2.5	3.0	3.9
Cash profit	3.5	5.1	4.7	5.4	9.9
Solvency Ratio					
Debt-equity	0.3	0.2	0.2	0.1	0.1
Interest coverage -on EBIT	4.7	7.8	11.8	19.5	27.6
Valuation Parameters					
P/E	24.3	12.1	10.0	8.3	6.5
P/BV	2.5	2.1	1.9	1.7	1.4
EV/EBITDA	12.5	8.1	6.4	4.7	3.5
EV/total revenue	0.8	0.6	0.6	0.5	0.4
M-cap/sales	0.7	0.6	0.5	0.5	0.4

Source: Bata Annual Report, Centrum Research

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