Raymond RYMD.NS RW IN

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Supply Chain focus, positive impact in FY14

Quick Note

September 18, 2012

Rating Remains	**Buy**
Target price Remains	INR 525
Closing price September 17, 2012	INR 370

Raymond's supply chain presentation to investors by the Raymonds Strategy Office Vice President Mr. B Madhukumar highlighted the importance of the supply chain in the apparel business and the tangible benefits that it will likely derive from its initiatives on this front. Key takeaways from this investor interaction:

Foresee incremental margin benefit of ~3% in apparel business on the back its supply chain initiative

Raymond supply chain initiative with Accenture is focussed on optimising inventory with minimal impact of its market share or brand perception. The company expects an incremental margin of ~3% in its apparel business, the full benefit of which will likely be visible in FY14. This will, on our forecasts, translate to an annual savings of ~INR290mn (applying the incremental margin to FY14F sales estimate) and a payback period of less than 12 months. Important to note that part of the payment to Accenture is performance linked

Apparel business supply chain – a critical but a very complex component of the business

The apparel business supply chain is fairly complex and a critical component of the business. Generally it takes 220-275 days between ideation and first delivery which will be potentially reduced by ~ 40 days for Raymond post exercise with Accenture. For example, the idea generation to predict fashion and design for next year autumn will start now. Once design & type of fabric is frozen, other decisions pertaining to source of fabric, trims (including threads & buttons), vendors to manufacture, warehousing, packaging and logistics need to taken. The presentation highlighted the unique challenges that exist with respect to identifying a reliable vendor.

Segmentation of product portfolio

Apparel products can be segmented into three categories:

- Seasonal products: Apparel which are targeted towards a particular season (either Feb-June or Aug-Dec) in a particular year. Life of these products is very short (5 months) as it goes out of fashion after a season. These are products in which a lot of effort time goes in the ideation phase and are critical from a brand recall perspective
- Never-out-of-stock (NOS) product: Apparels that are purchased by consumers across seasons, like white shirts. These products are never out of stock as consumer demands it continuously and company needs to be very efficient (low cost of production & close to source).
- Flash Products: Apparel products which are used to cater to an immediate or opportunistic demand seen in the market. Flash products can also be used by apparel players for risk mitigation say in case if their exiting designs in market are not selling, then they can tweak that range to launch a different category in the same season. This category is normally not more than 10-15% of product portfolio for an apparel manufacturer

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Composition of product across these three categories is an important determinant of margin profile for an apparel player. Seasonal products have higher margin but given that this involves introducing a new product range in the market, it also can result in higher inventory write downs – something that the industry witnessed in CY12.

On the other hand, NOS products have a more predictable demand but a relatively low margin. Company plans to increase share of NOS in product portfolio over next 3-4 years, which will reduce volatility in earnings as the prospects of inventory write-downs go down.

Raymond and Accenture have rationalized the supply chain with scientific forecasting technique, making supply chain more flexible and responsive based on market signals (lead metrics like advance booking and sales velocity, lag metrics like fulfilment rate in warehouse and customer demand fulfilment). It has also done more formal product segmentation even as vendor base rationalization to increase predictability of suppliers is currently in progress.

Q2FY13 – mixed quarter even though Onam festival season was good, optimistic around rebound in H2 on account of strong festival & marriage season and weak base effect

Festival season has started positively for Raymond. As per company, sales during Onam were good in Q2 although general consumer sentiment (as was guided previously in Q1) continues to be weak and the company is still in the process of clearing up the old inventory.

They remain very optimistic and expect strong demand in Q3 backed by festival season (Diwali & Dasara) and strong marriage season. Since these festival dates are late in Q3FY13 vs Q3FY12 as shown below, we expect strong growth in H2 which will also benefit from a low base effect.

Fig. 1: Festivals Date – Dasara and Diwali late in Q3FY13 vs Q3FY12

Festival	FY12	FY13
Dasara	6-Oct-11	24-Oct-12
Diwali	27-Oct-12	14-Nov-12

Source: Nomura research

It is important to note that H2FY12 was also market by poor consumer sentiment which is expected to rebound H2FY13. We are currently building in a margin rebound along with strong growth in 2H FY13.

Raymond continue to remains a solid proxy for the Indian consumption story

Raymond remains a solid proxy for the Indian consumption story where we expect consumers will upgrade to branded and higher-value products driven by rising income and increased discretionary spending. This trend should improve the current relatively low per capita apparel consumption and low penetration of retail in India. Raymond, with its range of brands, high brand recall and a solid distribution network, should be very well positioned to benefit from rising demand, especially in tier 3/4/5 cities and towns.

We maintain our Buy rating on the stock and target price of INR525. We continue to value the core business at 6x EV/EBITDA multiple and land parcel at INR100/share. Stock is currently trading at P/E multiple of 8.8x FY14 EPS and EV/EBITDA multiple of 5.3x FY14 EBITDA. Adjusted for land value of INR 100, stock currently trades at P/E multiple of 6.5x FY14 EPS and EV/EBITDA multiple of 4.6x FY14 EBITDA.

Appendix A-1

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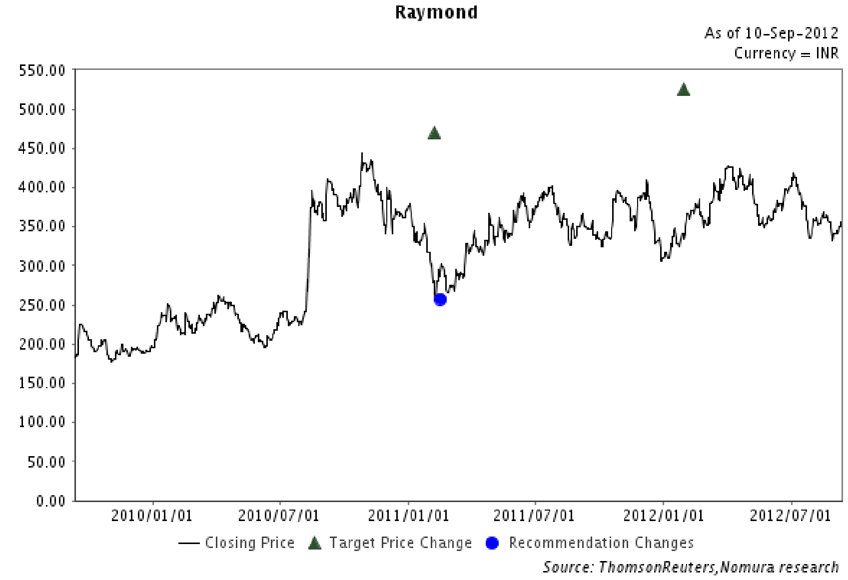
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Raymond	RW IN	INR 370	17-Sep-2012	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Raymond	Not Rated	08-Feb-2011

Raymond (RW IN) **INR 370 (17-Sep-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
30-Jan-12		525.00	333.25
08-Feb-11	Buy		264.85
08-Feb-11		470.00	264.85

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value the core business at 13x one-year forward P/E, based on a target EV/EBITDA of 6x, a ~45% discount to its average EV/EBITDA of the past five years to derive our core business value of INR425 per share. Reflecting our conservative approach, we assign this discount given the company's recent loss-making years. Since the company was loss making at the net level for the past two years, comparisons with historical P/E are not possible. We have valued the real estate business conservatively at INR100 per share (INR6.2bn). This is based on almost a 55% discount to the current post tax realisable value (INR14bn) of this land parcel.

Risks that may impede the achievement of the target price • Romania denim plant: The denim manufacturing plant in Romania is loss-making as demand in Europe is still weak. If economic conditions in Europe remain subdued for a long time, management may have to make a decision on the future of this plant, or simply tough out continued losses there. • Unexpected economic downturn: As Raymond is a play on discretionary consumer consumption, any economic downturn would likely lead consumers to reduce or postpone discretionary spending. Also, a drop in demand in smaller cities and towns may not justify further company expansion. In that case, we expect the company would halt its expansion plans. Any such decline in consumer spending poses a risk to our estimates.• Rapid increase in raw material price: Raw material costs equate to around 25% of sales. Any unexpected increase in the price of raw materials like cotton, wool and polyester could impact margins. Although the company has thus far been able to pass on increases in raw material prices with a 3- to 6-month time lag, such increases do impact margins in the short term. Also, in the shirt business, it is difficult to pass on an increase in raw material prices, since as per management, customers are not willing to pay beyond a certain price point for shirts. • Delay in real estate development: A delay in the company's plan to divest its real estate property poses a risk to our target price.

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