INSTITUTIONAL SECURITIES

INDIA RESEARCH | RETAIL | MANAGEMENT MEETING NOTE | SENSEX: 16968 | 27JUNE 2012

UNRATED

Bata India

Transformation delivering results!

Rs846

Mkt Cap: Rs54bn; US$971m

We interacted with the senior management of Bata India (Bata). The company is the largest footwear retailer in India with 1340 stores across the country. From being a predominantly lower-end/ men's footwear retailer, Bata has transformed itself to cater to a wider consumer set in terms of gender (increasing revenue share of women and children's footwear) and income group (expanding the premium range). This shift in strategy has led to accelerated growth and sharp improvement in profitability (margins doubled in the past four years). Bata's increasing scale, focus on enhancing the premium portfolio and aggressive store expansion as also refurbishment plans point to a promising growth outlook. Over 60% of the Rs200bn Indian footwear market is unorganized, with rural India accounting for 75% of the consumption. This implies huge potential in terms of conversion from unorganized to organized segment and premiumisation. With its unmatched scale and reach, Bata is likely to be the biggest beneficiary of this opportunity provided it remains relevant to an increasingly younger consumer profile. The stock trades at 23x CY11 earnings.

Key takeaways from the meeting

A large market… and an even larger opportunity

The Indian footwear industry has a market size of Rs200bn, with the unorganized segment constituting over 60%. Moreover, about 75% of the total consumer base lies in rural India. An urban customer spends an average Rs240 pa for footwear as against Rs100 pa in rural India, which implies a huge scope for premiumisation across rural and urban markets. Though men's footwear accounts for 50% of the market, its share has been gradually decreasing as women and children's segments are now growing at faster. With an unmatched reach (1340 stores, the largest footwear retailer), strong brand equity and a wide product portfolio across segments, Bata stands to be a big beneficiary.

Adapting to changing consumer needs bearing fruit

Bata has, in the past few years, strived to become more relevant to the increasingly demanding modern consumer. The company now changes 70% of its merchandise every 7-8 months to keep in step with the latest trends. It has renewed its product lines, introduced new brands, refurbished or shut down old stores while expanding its portfolio across the consumer chain (men, women and kids). As a result, only 50-55% of the company's sales now come from men's footwear, as against ~75% three years back. The ladies segment now contributes 20-22% and children's 8-10%. Focus on improving the mix has significantly boosted margins, albeit at the cost of volume growth. These factors have driven ahead-of-industry growth levels and doubled EBITDA margins from 7.5% in CY07 to 15% in CY11.

Demand momentum to continue; volume growth back on track

Focus on improving the product mix resulted in muted volume growth in CY11. However, volumes have improved in CY12, with a 14% volume growth in Q1 as compared to low single-digit volumes in the corresponding quarter. Though the management expects the momentum to continue, we believe a large part of incremental volumes will come from new stores (75 in Q1). The company is not seeing any signs of a slowdown and believes the demand momentum seen in Q1 (31% revenue growth) should translate into a healthy 20%+ revenue expansion this year.

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Aggressive expansion plans; focus on larger format stores

Bata operates 1340 stores, of which 250 are owned by dealers. The company opened 100 stores this year and shut 20. The strategy is to remodel the old stores (~500; area, 500-600 sqft) into larger format stores (2500-3000 sqft) and shut down redundant ones. The company plans to open 150 stores this year and is investing Rs750m as retail capex. The expansion target is in line with what the company achieved in CY11 (opened 146 stores and remodeled 30 unviable stores to large format). The large format stores showcase the complete range of products besides offering far higher margins than the smaller stores. The company expects all new stores to break even in the first year.

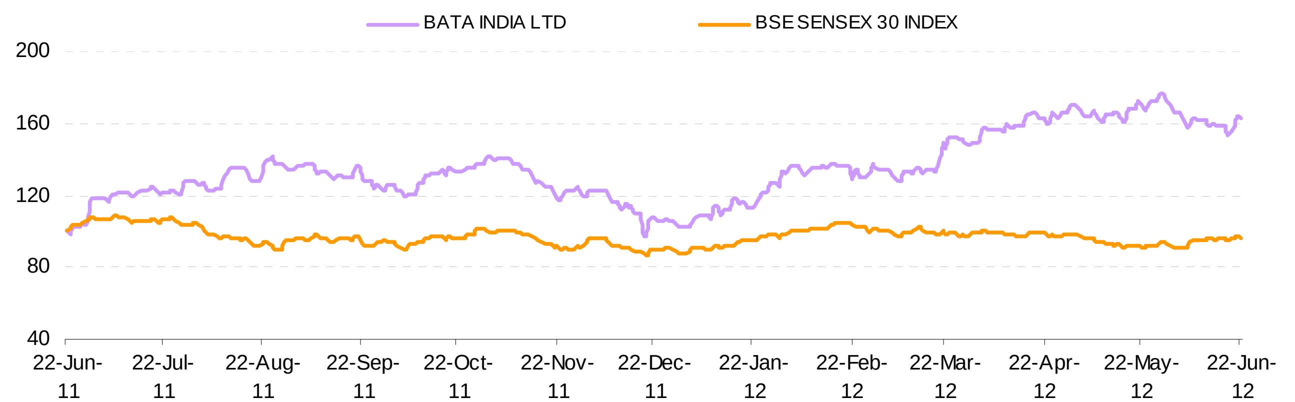
Margins to be stable despite front-ended costs for new stores

Adding premium products and large format stores have been providing higher margins and improving profitability. Accordingly, the company expects to sustain ~15% EBITDA margins despite incurring higher costs for new stores (rentals, staff costs, etc) helped by improved volume growth and continued premiumisation.

New product lines and formats to support growth

Bata is planning to open exclusive outlets for its premium range of footwear, Hush Puppies. The company is exploring a new format called FOOTIN to sell affordable but stylish footwear to youth in tier 2 and tier 3 cities. It has launched "BATA HOME Delivery" service and is also exploring the online retail channel to spur growth.

Relative price performance



Source: Bloomberg

Key financials

As on 31 March	CY07	CY08	CY09	CY10	CY11
Net sales (Rs m)	8,675	9,869	10,917	12,582	15,421
Adj. net profit (Rs m)	474	607	672	954	2,258
Shares in issue (m)	64.3	64.3	64.3	64.3	64.3
Adj. EPS (Rs)	7.4	9.5	10.5	14.8	35.1
% change	-	*28.0*	*10.7*	*41.8*	*136.8*
PE (x)	108.8	85.0	76.8	54.1	22.9
Price/ Book (x)	20.5	17.7	15.4	13.0	9.0
EV/ EBITDA (x)	75.4	53.4	39.2	29.8	21.2
RoE (%)	20.5	22.4	21.5	26.0	46.4
RoCE (%)	17.6	18.6	18.5	23.8	44.8

Source: Bloomberg

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Explanation of Ratings:

1. Outperformer	:	More than 5% to Index
2. Neutral	:	Within 0-5% (upside or downside) to Index
3. Underperformer	:	Less than 5% to Index

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