Bata India

2 May 2012

Reuters: BATA.BO; Bloomberg: BATA IN

Focus on Premium Portfolio

To increase market penetration, Bata India (BIL) opened 146 outlets in CY11 versus 108 in CY10. BIL decided to move up the value chain and gave priority to premium products in each category rather than volume growth. As a result, total volume grew by only 1.1% to 48.8mn pairs in CY11 but witnessed a robust 20.2% improvement in bended realisation at Rs308/pair. Following better realisation, net revenue grew 22.6% to Rs15,421mn in CY11. Fall in staff costs by 200bps, coupled with lower other expenses, improved operating margin by 214bps to 15.5%, as a result of which net profit grew 49% to Rs1,421mn. Higher capex, aggressive expansion and higher inventory levels exerted pressure on working capital and free cash flow in CY11. However, with stabilisation of new outlets, the working capital requirement should decline in CY12/13 and BIL should be able to generate free cash flow of Rs3,682mn over CY12-13E.

Focus on value rather than volume: BIL sold 48.8mn pairs in CY11, up by a mere 1.1%, as strategically it decided to focus on premium products, the effect of which is reflected via its product mix and average realisation. Bended realisation increased by a robust 20.2% to Rs308 per pair. Share of low-value items like plastic footwear fell from 18.2%/8.3% to 16.5%/7.4% in volume/value terms, respectively, over CY10-11.

Aggressive expansion plan: BIL opened 146 stores in CY11, much higher than 69/108 stores opened in CY09/10, respectively. It has already opened 61 stores in 1QCY12, and plans to open over 200 stores in CY12 compared to 146 stores in CY11. Hush Puppies brand also witnessed expansion with the opening of four exclusive new stores and two shop-in-shops at leading department stores in 1QCY12.

Aggressive expansion exerts pressure on working capital, free cash flow: BIL opened 35 stores in 4QCY11 alone, which contributed to inventory but not to revenue in CY11. On the back of aggressive expansion, inventory increased to 108 days in CY11 from 99 days in CY10. On getting better cash discount from its suppliers for prompt payment, its creditor days reduced from 71 days in CY10 to 65 days in CY11, following which ex-cash working capital requirement increased to Rs2,046mn (13.3% of sales) in CY11 from Rs747mn (5.9% of sales) in CY10. BIL improved its EBIT by 46% to Rs1,977mn in CY11, but due to higher working capital and higher capex at Rs905mn, BIL reported negative free cash flow of Rs1,144mn for CY11.

Valuation: We expect BIL, which is trading at CY13E P/E of 23.1x and EV/EBITDA of 14.0x, to witness a further re-rating. On the back of strong revenue/net profit CAGR of 18.8%/31.2%, respectively, over CY11-13E, BIL would continue to trade at premium multiples. It is attractively priced, with a PEG ratio of 0.9x in CY12. **Based on 16x CY13 EV/EBITDA, we retain our Buy rating on the stock with a TP of Rs1,008.**

BUY

Sector: Retail

CMP: Rs878

Target Price: Rs1,008

Upside: 15%

Jignesh Kamani, CFA
jignesh.kamani@nirmalbang.com
+91-22-3926 8239

Saiprasad Prabhu
saiprasad.prabhu@nirmalbang.com
+91-22-3926 8172

Key Data

Current Shares O/S (mn)	64.3
Mkt Cap (Rsbn/US$bn)	56.4/1.1
52 Wk H / L (Rs)	887/375
Daily Vol. (3M NSE Avg.)	565,446

Price Performance (%)

	1 M	6 M	1 Yr
Bata India	8.7	22.1	106.3
Nifty Index	(0.5)	0.2	(8.4)

Source: Bloomberg

Y/E Dec (Rsmn)	CY09	CY10	CY11	CY12E	CY13E
Revenue	10,917	12,582	15,421	18,459	21,773
YoY (%)	*10.6*	*15.3*	*22.6*	*19.7*	*18.0*
EBITDA	1,295	1,679	2,388	3,085	3,681
EBITDA margin (%)	*11.9*	*13.3*	*15.5*	*16.7*	*16.9*
Reported PAT	672	954	2,258	2,011	2,445
Adj PAT	672	954	1,421	2,011	2,445
EPS (Rs)	10.5	14.8	22.1	31.3	38.1
YoY (%)	*10.7*	*41.8*	*49.0*	*41.5*	*21.6*
RoE (%)	*21.5*	*26.0*	*29.2*	*31.0*	*30.0*
RoCE (%)	*21.2*	*26.0*	*30.9*	*30.7*	*29.8*
RoIC (%)	*21.1*	*28.3*	*31.8*	*32.1*	*38.7*
P/E (x)	84.0	59.2	39.7	28.1	23.1
Price/sales (x)	5.2	4.5	3.7	3.1	2.6
EV/ EBITDA (x)	43.2	32.8	23.2	17.4	14.0

Source: Company, Nirmal Bang Institutional Equities Research

Focus on value rather than volume

The company has decided to move up in value chain and give priority to premium products in each category rather than volume growth. It increased the share of high-value leather products to 50.3%/72.5% in CY11 from 49.1%/72.3% in CY10, in volume/value terms, respectively. Share of low-value items like plastic footwear declined from 18.2%/8.3% to 16.5%/7.4%, in volume/value terms, over the same period. Following the priority given to premiumisation, volume growth was lower at 1.1%, at 48.8mn pairs, in CY11. Volume in leather footwear grew 3.6% to 24.6mn pairs, that of rubber footwear grew 2.5% to 16.2mn pairs while low-value plastic footwear volume declined 8.2% to 8.1mn pairs. **On account of a better product mix, the company was able to improve bended realisation by a robust 20.2% to Rs308 per pair. Per pair realisation of leather footwear increased 17.7% to Rs444, that of rubber footwear increased 22% to Rs186 and that of plastic footwear increased by 19% to Rs138.** BIL increased average realisation by 11% in CY07 and by 14.3% in CY09, which impacted volume growth in those years, but the price hike has been absorbed by the market over a period of time, with volume growth at 8.7% and 6% in CY08 and CY10, respectively. After subdued volume growth of 1.1% in CY11, we expect BIL to report volume growth of 5.1%/5.9% in CY12E/13E, similar to the growth of 8.7%/6% in CY08/CY10, respectively, after subdued growth in CY07/CY09.

Exhibit 1: Focus on premiumisation

Sales (mn pairs)	CY10	CY11	YoY (%)
Leather footwear	23.7	24.6	*3.6*
Rubber footwear	15.8	16.2	*2.5*
Plastic footwear	8.8	8.1	*(8.2)*
Total Volume	**48.3**	**48.8**	***1.1***

Exhibit 2: Sharp increase in realisation

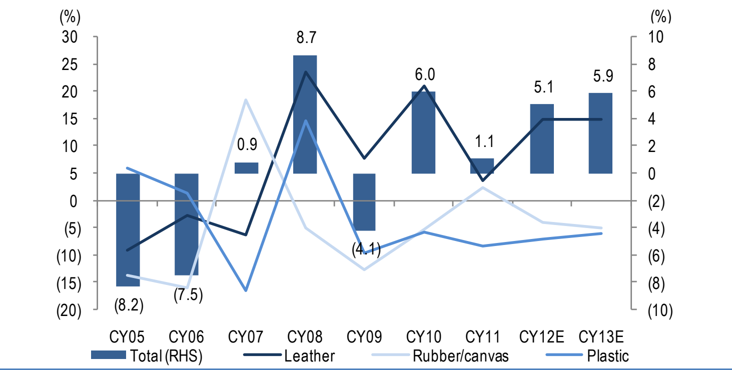
Avg realisation (Rs/pair)	CY10	CY11	YoY (%)
Leather footwear	377	444	*17.7*
Rubber footwear	153	186	*22.0*
Plastic footwear	116	138	*19.0*
Average	**256**	**308**	*20.2*

Exhibit 3: Revenue mix

Sales (Rsmn)	CY10	CY11	YoY (%)
Leather footwear	8,933	10,891	*21.9*
Rubber footwear	2,406	3,008	*25.0*
Plastic footwear	1,023	1,117	*9.2*
Accessories	409	619	*51.3*
Total	**12,771**	**15,634**	***22.4***

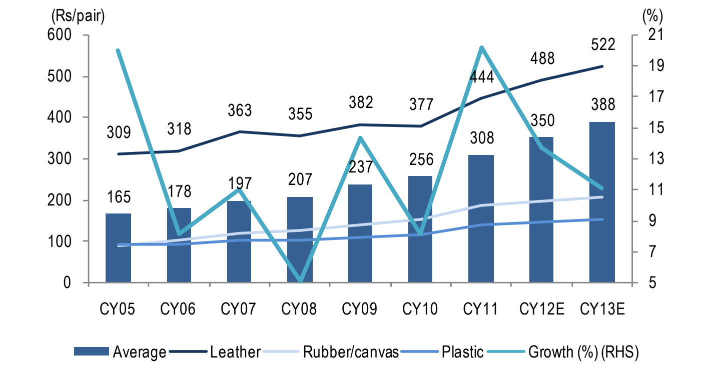
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Sales volume growth



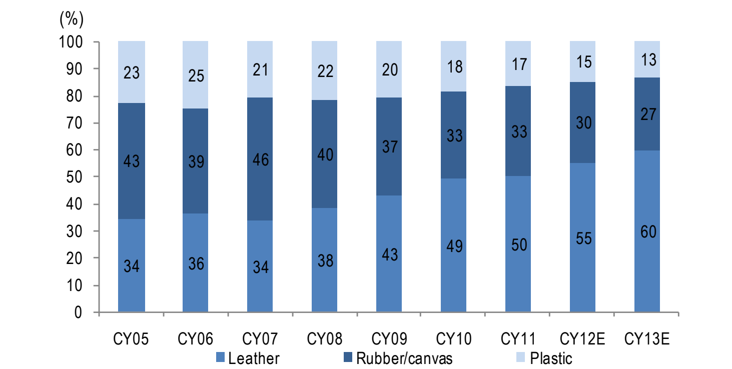
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Improving average realisation



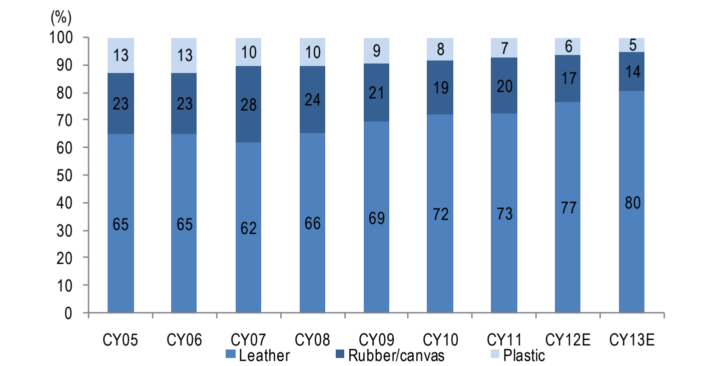
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Sales volume break-up



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Sales value break-up

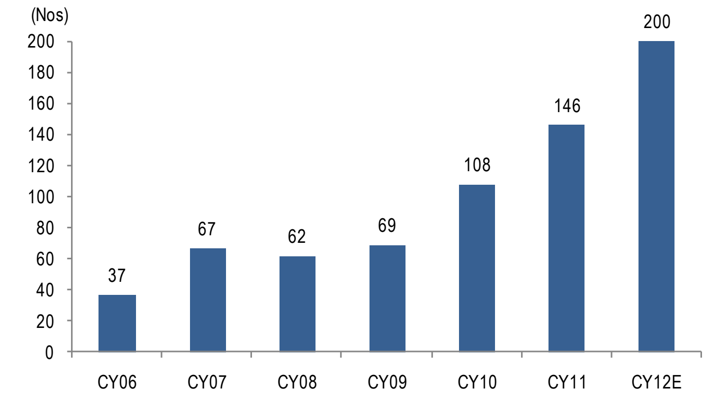


Source: Company, Nirmal Bang Institutional Equities Research

Aggressive expansion plan

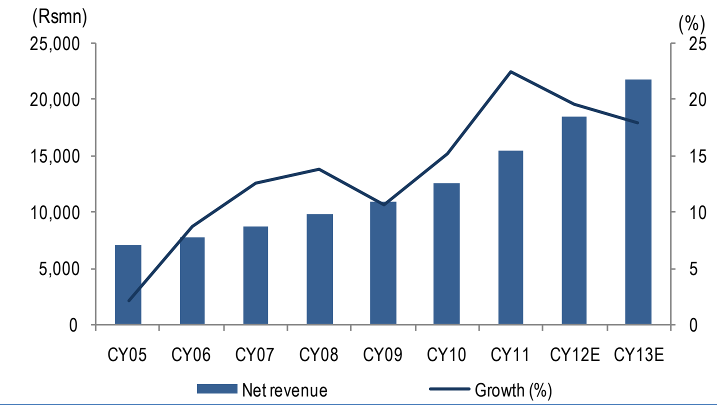
BIL has an aggressive plan to increase its retail reach and enhance market penetration. Big format stores would be at the heart of its break-neck expansion plan. Over the past five years, BIL has completely repositioned its stores by opening large format stores, renovating all existing stores and closing down small and unviable stores. The company has shut down nearly 400 small stores in the past five years. It has been very aggressive in setting up new stores, which is already visible from the fact that number of new stores opened each year is higher than that of the previous year. The company opened 69 and 108 stores in CY09 and CY10, respectively, while it opened 146 stores in CY11, much higher than 108 stores opened in CY10. **The company has already opened 61 stores in 1QCY12, and based on the current aggression there is a good chance that it would open over 200 stores in CY12 compared to 146 stores in CY11. We expect BIL to open 100 outlets only in CY12, which may pose upside risk to our revenue estimate for CY12/13.** BIL continues to open new stores across metros like Delhi, Mumbai, Chennai, Hyderabad and Bangalore. It has also increased brand penetration in mini metros/tier-II cities such as Ambala, Anand, Bilaspur, Hissar, Bhopal, Kannur, Indore, Bareilly and Gaya among others. Hush Puppies brand also witnessed expansion with the opening of four exclusive new stores and two shop-in-shops at leading department stores in the same period.

Exhibit 8: Number of stores added



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Strong revenue growth



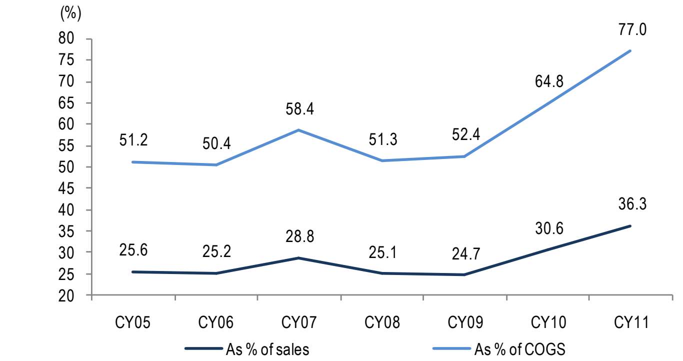
Source: Company, Nirmal Bang Institutional Equities Research

Higher share of outsourcing to reduce cost of goods sold

BIL was predominantly producing low-value products like rubber and canvas footwear during CY02-04. This was partially because of the need to utilise excess staff during that period. As employee costs were high, it resorted to outsourcing low-value items like rubber, canvas and plastic footwear and utilised the capacity to produce high-value leather footwear. The company reduced its footwear production by 9.9% to 20.2mn pairs in CY11. As the company chose to outsource low-value footwear, the production of rubber footwear declined at a sharper pace of 17.4%, while that of leather footwear declined at a slower pace of 5.7% in CY11.

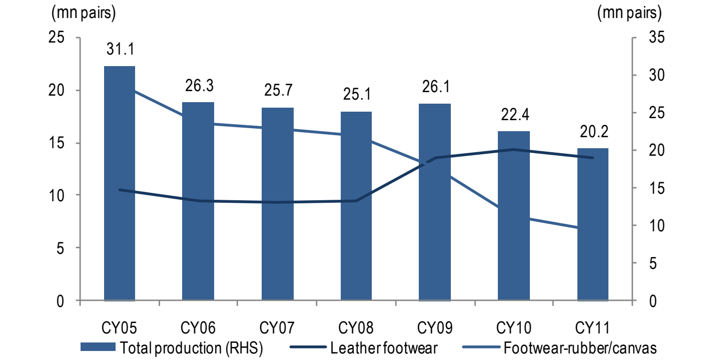
Share of outsourced products increased from 30.6%/64.8% of sales/cost of goods sold in CY10 to 36.3%/77.0% in CY11, respectively. Similarly, of the total pairs sold, outsourced volume accounted for 58.6% in CY11 from 53.5% in CY10. Following higher outsourcing and a better product mix, gross margin improved by 20bps to 52.9% in CY11. We expect this trend to continue over CY12-13 also, thereby reducing the cost of goods sold. Past performance of the company was impacted on account of unionisation by its workforce and excess staff at its factories. With a higher share of outsourced products, the company would be able to tackle these issues much more effectively. As compared to the production-led model during CY02-08, the company is now more focused on branding, distribution and working capital management.

Exhibit 10: Rising share of outsourced items



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Decreasing output of low-value rubber footwear

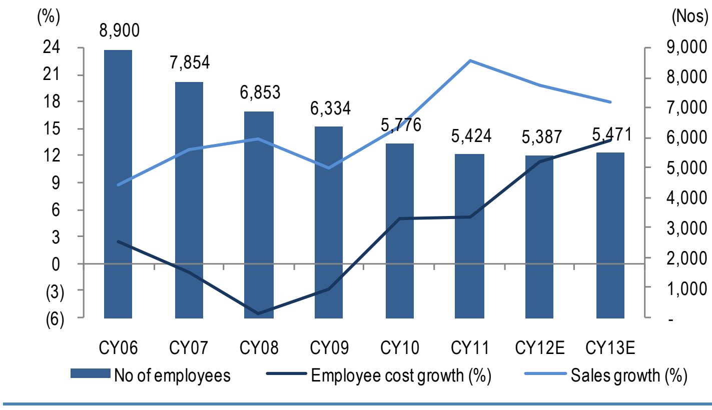


Source: Company, Nirmal Bang Institutional Equities Research

Employee costs under control

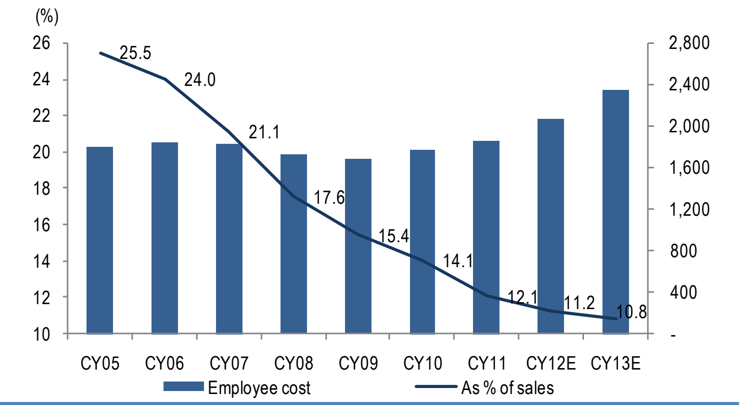
One of the main reasons for losses incurred during CY02-04 was excess staff at its factories and unionisation by employees, resulting in employee costs touching a decade-high level of 28.5% of sales in CY03. BIL aggressively started focusing on reducing its employee base as well as costs. The number of employees in absolute terms declined 6.1% to 5,424 in CY11 as a result of which employee costs increased by a mere 5.1% against a revenue growth of 22.6% in CY11. **Employee costs as a percentage of sales declined from 14.1% in CY10 to 12.1% in CY11, and lower employee costs by 200bps was the main reason behind the 214bps expansion in operating margin to 15.5% in CY11.** The company opened 254 outlets over CY10-11 and 61 outlets in 1QCY12. **As it takes 1.5-2.0 years to stabilise any outlet, we expect majority of these outlets to witness ramp-up in revenue in CY12/13, but costs like employee expenses, lease rent and other costs would remain almost the same resulting in higher profitability in CY12/13 from these outlets. The company is opening new outlets in form of K stores (commission stores) where employee costs are lower and as a result, we expect employee costs as a percentage of sales to decline further by 125bps to 10.8% of sales over CY11-13 and operating margin to improve by 142bps to 16.9% over the same period.**

Exhibit 12: Growth in employee costs to lag sales growth



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Declining employee costs as a percentage of sales



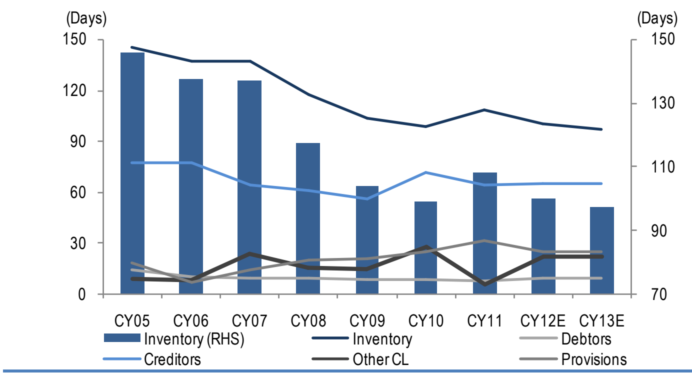
Source: Company, Nirmal Bang Institutional Equities Research

Aggressive expansion exerts pressure on working capital

The company has been very aggressive in retail expansion by opening 108/146 stores in CY10/11. It opened 35 stores in 4QCY11 alone, where necessary inventory has been maintained, but these stores have not contributed to revenue meaningfully in CY11. On the back of aggressive expansion, inventory days increased to 108 days in CY11 from 99 days in CY10. The company is getting better cash discount from its suppliers for prompt payment and as a result its creditor days reduced from 71 days in CY10 to 65 days in CY11. Following higher inventory and lower creditor days, ex-cash working capital requirement increased to Rs2,046mn in CY11 from Rs747mn in CY10 and ex-cash working capital, as a percentage of sales, increased to 13.3% in CY11 from 5.9% in CY10. **The company is planning to do bar-coding of its footwear which would help in reducing dead stoke inventory and also improve inventory turnover at the store level.**

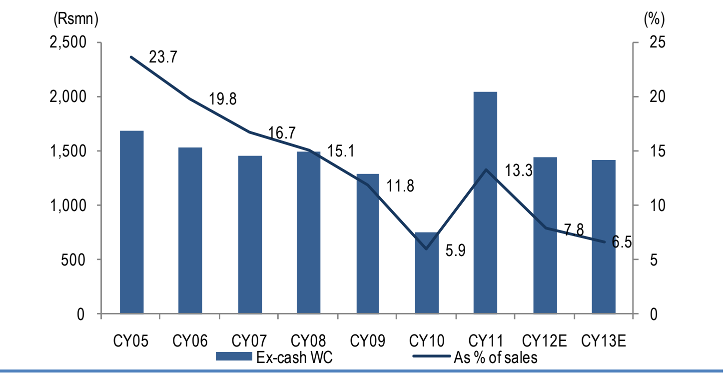
With stabilisation of new outlets and improvement in demand, we expect inventory days to come back to the normal level of 100/97 days in CY12E/13E, respectively, from 108 days in CY11. As a result, ex-cash working capital would reduce to 7.8%/6.5% of sales in CY12E/13E from 13.3% in CY11.

Exhibit 14: Aggressive expansion increased inventory



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Prompt payment to increase working capital need

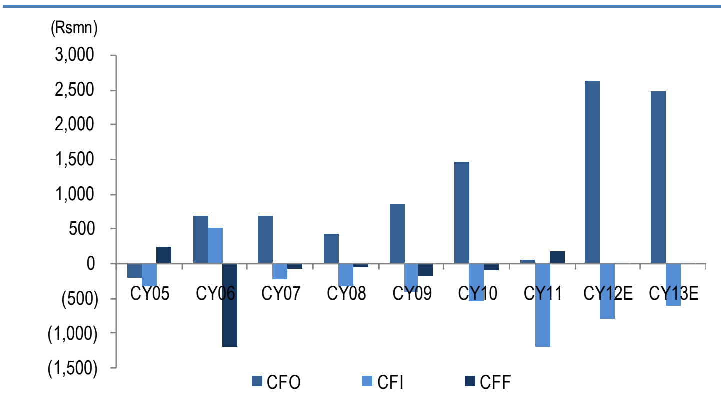


Source: Company, Nirmal Bang Institutional Equities Research

Higher working capital exerts pressure on free cash flow

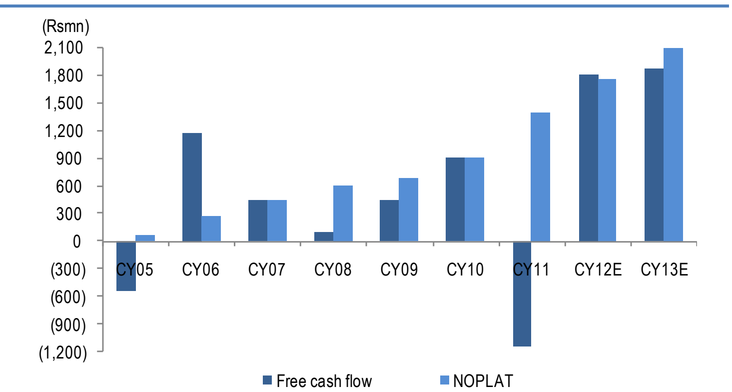
The company improved its EBIT by 46% to Rs1,977mn in CY11 but reported increase in ex-cash working capital by Rs1,300mn, as a result of which the company just broke even at operating cash flow level in CY11 versus operating cash flow of Rs1,456mn in CY10. The company invested Rs905mn, and around 50% of this capex was incurred to open 146 outlets in CY11 while the balance was used to improve manufacturing facilities. Following lower operating cash flow and higher capex, the company reported negative free cash flow of Rs1,144mn for CY11. As the company is expanding its retail reach aggressively and the benefit of the expansion would accrue over time, one should not read negative free cash flow in isolation. **We expect working capital requirement to moderate in CY12/13 post stabilisation of new outlets and capex also to decline to Rs800mn/Rs600mn in CY12E/13E, respectively (mainly for setting up new outlets only). It may be recalled that a part of the capex went to modernise older outlets in CY10/11, which would not be the case in CY13. As a result, BIL should generate operating cash flow of Rs5,096mn and free cash flow of Rs3,682mn over CY12-13E.**

Exhibit 16: Near term pressure on cash flow



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Free cash flow to turn positive again



Source: Company, Nirmal Bang Institutional Equities Research

Ratings track

Date	Rating	Market price (Rs)	Target price (Rs)
26 September 2011	Buy	639	817
1 November 2011	Buy	725	838
10 January 2012	Buy	550	838
1 March 2012	Buy	700	838
20 March 2012	Buy	725	838
20 April 2012	Buy	844	1,008
26 April 2012	Buy	839	1,008
2 May 2012	Buy	878	1,008

Financials (Standalone)

Exhibit 18: Income statement

Y/E Dec (Rsmn)	CY09	CY10	CY11	CY12E	CY13E
Net sales	10,917	12,582	15,421	18,459	21,773
Growth (%)	10.6	15.3	22.6	19.7	18.0
Raw material costs	5,135	5,945	7,265	8,674	10,232
Staff costs	1,683	1,768	1,859	2,067	2,352
Rental costs	1,012	1,155	1,453	1,772	2,156
Freight costs	292	339	405	461	523
Commission	193	266	416	498	588
Others	1,307	1,430	1,635	1,901	2,243
Total expenditure	9,622	10,903	13,033	15,375	18,093
EBITDA	1,295	1,679	2,388	3,085	3,681
Growth (%)	42.5	29.7	42.2	29.2	19.3
EBITDA margin (%)	11.9	13.3	15.5	16.7	16.9
Other income	84	153	220	438	537
Extraordinary items			1,094		
Interest costs	97	76	96	60	58
Gross profit	1,282	1,755	3,605	3,462	4,160
Growth (%)	41.1	36.9	105.4	(4.0)	20.2
Depreciation	279	325	411	447	493
Profit before tax	1,003	1,430	3,194	3,015	3,666
Growth (%)	39.6	42.6	123.4	(5.6)	21.6
Tax	330	476	936	1,004	1,221
Effective tax rate (%)	32.9	33.3	29.3	33.3	33.3
Net profit	672	954	2,258	2,011	2,445
Growth (%)	10.7	41.8	136.8	(11.0)	21.6
Extraordinary items	-	-	838	-	-
Reported net profit	672	954	1,421	2,011	2,445
Growth (%)	10.7	41.8	49.0	41.5	21.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Balance Sheet

Y/E Dec (Rsmn)	CY09	CY10	CY11	CY12E	CY13E
Equity	643	643	643	643	643
Reserves	2,700	3,340	5,100	6,583	8,430
Net worth	3,343	3,982	5,743	7,226	9,072
Short-term loans	104	138	194	178	188
Long-term loans	147	-	-	-	-
Total loans	251	138	194	178	188
Deferred tax liability	(241)	(311)	(342)	(252)	(142)
Liabilities	**3,352**	**3,809**	**5,595**	**7,152**	**9,118**
Gross block	3,744	4,176	5,003	5,886	6,492
Depreciation	2,441	2,644	2,813	3,261	3,754
Net block	1,303	1,531	2,190	2,625	2,738
Capital work-in-progress	6	3	81	6	6
Long-term Investments	172	172	49	49	49
Inventories	2,775	2,994	3,913	4,271	4,875
Debtors	252	302	314	468	553
Cash	562	1,356	1,229	3,026	4,905
Other current assets	832	1,442	1,733	1,846	2,047
Total current assets	4,421	6,093	7,190	9,611	12,379
Creditors	1,489	2,154	2,337	2,776	3,267
Other current liabilities	1,076	1,837	1,578	2,363	2,787
Total current liabilities	2,565	3,991	3,914	5,139	6,054
Net current assets	1,855	2,102	3,276	4,472	6,326
Total assets	**3,352**	**3,809**	**5,595**	**7,152**	**9,118**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20:Cash flow

Y/E Dec (Rsmn)	CY09	CY10	CY11	CY12E	CY13E
EBIT	1,015	1,354	1,977	2,637	3,187
Inc./(dec.) in working capital	195	547	(1,300)	600	26
Cash flow from operations	**1,210**	**1,901**	**677**	**3,237**	**3,213**
Other income	84	153	220	438	537
Depreciation	279	325	411	447	493
Deferred liabilities	(66)	(70)	(31)	90	110
Interest paid (-)	(97)	(76)	(96)	(60)	(58)
Tax paid (-)	(330)	(476)	(680)	(1,004)	(1,221)
Dividend paid (-)	(226)	(299)	(447)	(528)	(599)
Net cash from operations	**854**	**1,456**	**54**	**2,621**	**2,476**
Capital expenditure (-)	(410)	(550)	(1,198)	(808)	(606)
Net cash after capex	**444**	**906**	**(1,144)**	**1,813**	**1,869**
Inc./(dec.) in short-term borrowing	17	34	56	(16)	10
Inc./(dec.) in long-term borrowing	(213)	(147)	-	-	-
Inc./(dec..) in preference capital	-	-	-	-	-
Inc./(dec.) in borrowings	(196)	(113)	56	(16)	10
(Inc.)/dec. in investments	-	-	124	0	-
Equity issue/(buyback)	-	-	-	-	-
Cash from financial activities	**(196)**	**(113)**	**180**	**(16)**	**10**
Others / extraordinary income	46	-	838	-	-
Opening cash	268	562	1,356	1,229	3,026
Closing cash	562	1,356	1,229	3,026	4,905
Change in cash	295	794	(126)	1,797	1,879

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Key ratios

Y/E Dec	CY09	CY10	CY11	CY12E	CY13E
Per share (Rs)					
EPS	10.5	14.8	22.1	31.3	38.1
Book value	52.0	62.0	89.4	112.4	141.2
Valuation (x)					
P/E	84.0	59.2	39.7	28.1	23.1
P/sales	5.2	4.5	3.7	3.1	2.6
P/BV	16.9	14.2	9.8	7.8	6.2
EV/EBITDA	43.2	32.8	23.2	17.4	14.0
EV/sales	5.1	4.4	3.6	2.9	2.4
Return ratios (%)					
RoIC	21.1	28.3	31.8	32.1	38.7
RoCE	21.2	26.0	30.9	30.7	29.8
RoE	21.5	26.0	29.2	31.0	30.0
Margins (%)					
EBITDA margin	11.9	13.3	15.5	16.7	16.9
PBIT margin	9.3	10.8	12.8	14.3	14.6
PBT margin	9.2	11.4	20.7	16.3	16.8
PAT margin	6.2	7.6	9.2	10.9	11.2
Turnover ratio					
Asset turnover ratio (x)	3.3	3.3	2.8	2.6	2.4
Avg. inventory period (days)	104	99	108	100	97
Avg. collection period (days)	8	9	7	9	9
Avg. payment period (days)	56	71	65	65	65
Solvency ratios (x)					
Debt-equity	0.1	0.0	0.0	0.0	0.0
Interest coverage	10.5	17.7	20.5	43.6	54.5
Growth (%)					
Sales	10.6	15.3	22.6	19.7	18.0
EBITDA	42.5	29.7	42.2	29.2	19.3
PAT	10.7	41.8	49.0	41.5	21.6

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

This report is published by Nirmal Bang's Institutional Equities Research desk. Nirmal Bang has other business units with independent research teams separated by Chinese walls, and therefore may, at times, have different or contrary views on stocks and markets. This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information for the clients of Nirmal Bang Equities Pvt. Ltd., a division of Nirmal Bang, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

Nirmal Bang or any persons connected with it do not accept any liability arising from the use of this document or the information contained therein. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information. Nirmal Bang or any of its connected persons including its directors or subsidiaries or associates or employees or agents shall not be in any way responsible for any loss or damage that may arise to any person/s from any inadvertent error in the information contained, views and opinions expressed in this publication.

'Access our reports on Bloomberg Type NBIE <GO>'

Team Details:

Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	+91 22 3926 8098 / 99
Hemindra Hazari	Head of Research	hemindra.hazari@nirmalbang.com	+91 22 3926 8017 / 18
Sales and Dealing:			
Neha Grover	AVP Sales	neha.grover@nirmalbang.com	+91 22 3926 8093
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Sudhindar Rao	Dealing Desk	sudhindar.rao@nirmalbang.com	+91 22 3926 8229, +91 22 6636 8832
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
Nr. Peninsula Corporate Park
Lower Parel (W), Mumbai-400013.
Board No. : 91 22 3926 8000/1
Fax. : 022 3926 8010