Footwear

Initiating Coverage

2 September 2016

Mirza International

Branded domestic business to drive growth; initiating, with a Buy

Rating: **Buy**
Target Price: ₹128
Share Price: ₹85

Expecting growth to continue (driven by its strong brand, entry into upholstery and garments, and widening retail operations), we initiate coverage on Mirza, with a Buy and a target of ₹128. We anticipate robust 10%/19% revenue/PAT CAGRs over FY16-19. The Genesis merger and the tannery division's greater efficiency could expand the PAT margin 206bps. With major capex behind, FCF generation would strengthen the balance sheet, leading to higher return ratios.

Growth driven by branded domestic sales and exports. Branded footwear sales over FY12-16 came at an 11% CAGR. We expect domestic branded footwear sales to register a 25% CAGR over FY16-19, chiefly driven by a rise in the number of points of sale (EBOs, MBOs, LFS). The share of domestic footwear sales is expected to rise to 26% in FY19 (18% in FY16). We expect a 5% CAGR over FY16-19 in exports primarily due to steady sales.

Profitable tannery, upswing in upholstery drives margins. The tannery is expected to generate a positive margin primarily from better utilisation and the introduction of upholstery. A better product-mix could result in the EBITDA margin rising 108bps over FY16-19.

Genesis merger, no red flags in related-party transactions. We expect the Genesis merger and change in product mix to expand the FY19 PAT margin by 206bps, as Genesis' EBITDA margin was ~30% and it operates in an excise-benefit zone. Related-party transactions with Mirza (UK), distributing arm, and with Euro Footwear Pvt. Ltd. are at "arm's-length" prices.

Major capex completed, balance sheet to be strong. Given the rising profitability, we expect 21.2%/22.4%/22.6% RoCE in FY17/FY18/FY19. Growth capex would be funded internally.

Valuation. Mirza trades at 9.3x FY18e and 7.9x FY19e earnings. We value it at ₹128, based on 14x FY18e earnings, (the last 18 months traded multiple). **Risks.** Global slowdown, high inventories, its non-leather portfolio.

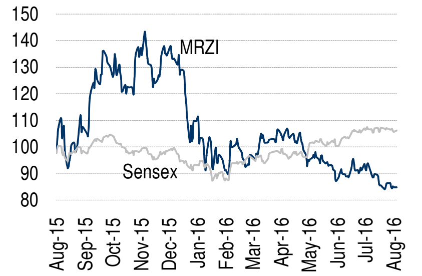
Key financials (YE Mar)	FY15	FY16	FY17e	FY18e	FY19e
Sales (₹m)	9,183	9,257	10,110	11,131	12,373
Net profit (₹m)	512	781	924	1,099	1,298
EPS (₹)	5.5	6.5	7.7	9.1	10.8
Growth (%)	18.0	17.6	18.4	18.9	18.1
PE (x)	15.4	13.1	11.1	9.3	7.9
PBV (x)	2.5	2.3	2.0	1.7	1.5
RoE (%)	17.1	20.6	19.1	19.6	20.2
RoCE (%)	18.5	20.9	21.2	22.4	22.6
Dividend yield (%)	0.6	0.6	1.4	2.7	3.2
Net debt/equity (x)	0.7	0.4	0.2	0.1	0.0

Source: Company, Anand Rathi Research

Key data	MRZI IN / MIRZ.BO
52-week high / low	₹145 / ₹84
Sensex / Nifty	27903 / 8607
3-m average volume	$0.8m
Market cap	₹10bn / $151.7m
Shares outstanding	120m

Shareholding pattern (%)	Jun '16	Mar '16	Dec '15
Promoters	73.8	73.8	66
- of which, Pledged			
Free Float	26.2	26.2	34
- Foreign Institutions	0.5	0.6	0.9
- Domestic Institutions	0.3	1.2	1.5
- Public	25.4	24.4	31.6

Relative price performance



Source: Bloomberg

Girish Solanki
Research Analyst
+9122 6626 6712
girishsolanki@rathi.com

Mrunal Savla
Research Analyst
+9122 6626 6545
mrunalsavla@rathi.com

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Net revenues	9,183	9,257	10,110	11,131	12,373
Revenue growth (%)	29.9	0.8	9.2	10.1	11.2
- Oper. expenses	7,764	7,552	8,189	8,960	9,960
EBIDTA	**1,420**	**1,706**	**1,921**	**2,170**	**2,413**
EBITDA margins (%)	15.5	18.4	19.0	19.5	19.5
- Interest	393	319	280	252	180
- Depreciation	246	258	282	299	319
+ Other income	7	30	10	10	10
- Tax	276	377	445	529	625
Effective tax rate (%)	35.0	32.6	32.5	32.5	32.5
+ Associates / (minorities)	-	-	-	-	-
Adjusted PAT	512	781	924	1,099	1,298
+ Extraordinary items	-	-	-	-	-
Reported PAT	512	781	924	1,099	1,298
Adj. FDEPS (₹ / sh)	5.5	6.5	7.7	9.1	10.8
Adj. FDEPS growth (%)	18.0	17.6	18.4	18.9	18.1

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Share capital	185	241	241	241	241
Reserves & surplus	2,940	4,216	4,973	5,742	6,650
Net worth	3,125	4,456	5,214	5,983	6,891
Total debt	2,177	1,904	1,750	1,650	1,600
Minority interest	-	-	-	-	-
Def. tax liab. (net)	117	149	149	149	149
Capital employed	**5,419**	**6,510**	**7,113**	**7,782**	**8,640**
Net fixed assets	3,104	3,448	3,517	3,567	3,598
Intangible assets	-	-	-	-	-
Investments	7	6	6	6	6
- of which, Liquid	-	-	-	-	-
Working capital	2,250	2,941	3,015	3,184	3,468
Cash	58	115	575	1,025	1,567
Capital deployed	**5,419**	**6,510**	**7,113**	**7,782**	**8,640**
W C turn (days)	89	116	109	104	102
Book value (₹ / sh)	33.7	37.0	43.3	49.7	57.3

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Adjusted PAT	512	781	924	1,099	1,298
+ Non-cash items	246	258	282	299	319
Cash profit	758	1,039	1,206	1,399	1,617
- Incr. / (decr.) in WC	284	691	75	168	285
Operating cash-flow	473	349	1,132	1,230	1,333
- Capex	198	602	350	350	350
Free-cash-flow	276	(254)	782	880	983
- Dividend	56	72	167	331	390
+ Equity raised	-	55	-	-	-
+ Debt raised	59	(273)	(154)	(100)	(50)
- Investments	-	(1)	-	-	-
- Misc. items	285	(599)	(0)	0	0
Net cash-flow	(6)	57	460	450	542
+ Op. cash & bank bal.	64	58	115	575	1,025
Cl. Cash & bank bal.	58	115	575	1,025	1,567

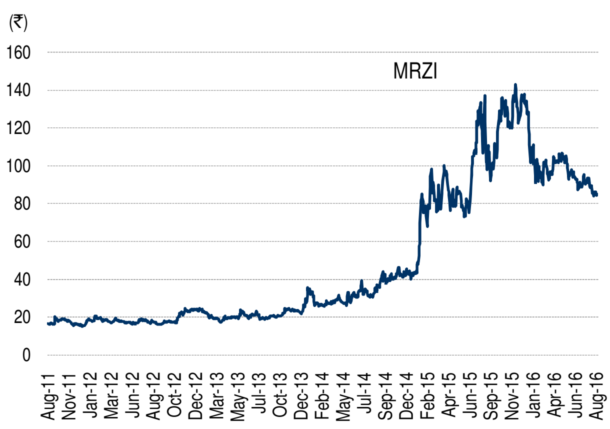
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹85

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
P/E (x)	15.4	13.1	11.1	9.3	7.9
Cash P/E (x)	10.4	9.8	8.5	7.3	6.3
EV / EBITDA (x)	8.7	7.0	5.9	5.0	4.3
EV / sales (x)	1.3	1.3	1.1	1.0	0.8
P/B (x)	2.5	2.3	2.0	1.7	1.5
RoE (%)	17.1	20.6	19.1	19.6	20.2
RoCE (%)	18.5	20.9	21.2	22.4	22.6
Dividend yield (%)	0.6	0.6	1.4	2.7	3.2
Dividend payout (%)	9.1	7.7	15.0	25.0	25.0
Net debt / equity (x)	0.7	0.4	0.2	0.1	0.0
Interest coverage	3.0	4.5	5.9	7.4	11.6
Debtor (days)	17	25	25	25	25
Inventory (days)	150	191	162	162	162
Payables (days)	55	40	21	25	25
Fixed asset turnover	2.0	1.8	1.8	1.9	2.0

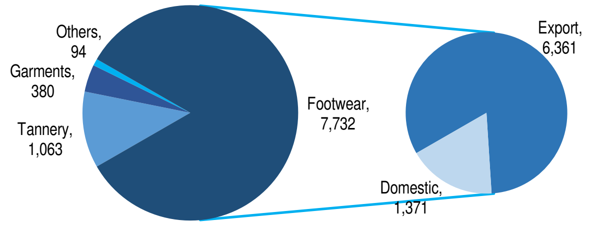
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – FY16 revenue break-down (₹ m)



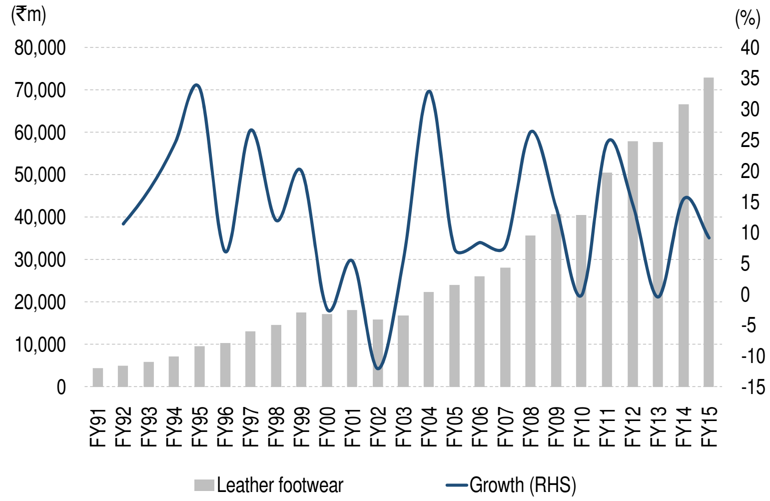
Source: Company, Anand Rathi Research

Footwear

The branded footwear business in India is built on a structurally sound business model, a sustainable revenue stream from established brands, increasing fashion trends and awareness, a growing population base and a high degree of profitability.

Domestic leather footwear has registered a 12.3% CAGR, from ₹4.5bn in 1991 to ₹72.8bn in 2015. The largest listed entities are Bata, Liberty Shoes, Mirza International, Superhouse and Sreeleathers. Other players would be private footwear businesses (Metro, Mochi, Lee Cooper, Park Avenue, Clarks, Provogue, Red Chief, Louis Philippe, Van Heusen, Woodland, etc.).

Fig 7 – Domestic consumption of leather footwear



Source: MOSPI, Anand Rathi Research

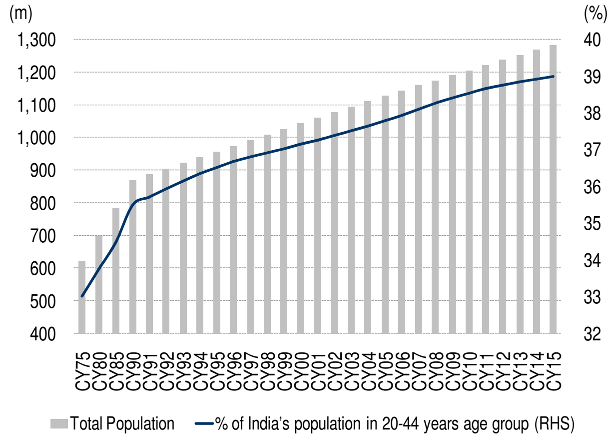
Over FY11-15, Bata's revenue registered a 14.4% CAGR. (Leather footwear comprises ~70% of its footwear sales.) Bata being a market leader, has a ~25% market share. Liberty Shoes recorded a 14.5% CAGR in revenue (incl. leather and non-leather footwear). Super House saw a 14.6% CAGR in revenue (including leather and leather products).

Over the same period, Mirza's domestic footwear revenue registered a 13.1% CAGR. It has a ~1.5% market share in domestic leather footwear. We expect its market share to expand, primarily due to deeper penetration in tier-III and -IV cities by increasing PoS through EBOs, MBOs and LFSs.

We expect the revenue growth to continue, considering that the increase in the youth category and the number of working women are leading to changes in fashion trends, rising disposable incomes and greater brand consciousness.

Besides, the young working population, who would be required to maintain a certain office dress code, reveals the vast potential that India holds. Obviously, affordability is a huge driver for such consumers, driven by quality and price. We believe that the potential for Mirza arising from these affluent customers is vast.

Fig 8 – Increase in youth population

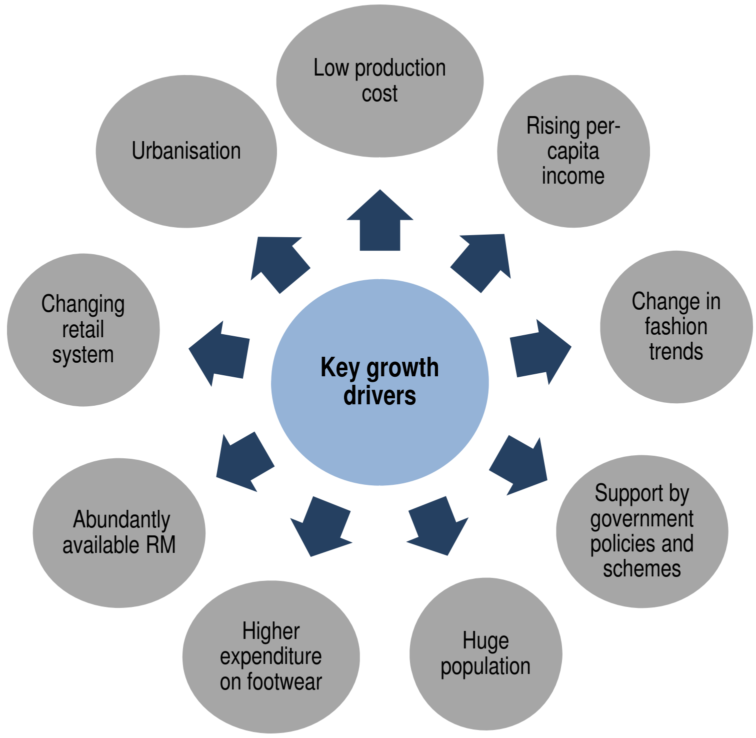


Source: Census, Anand Rathi Research

Raw material and labour

Raw materials required for the leather industry in India are plentiful. India has 21% of the world's cattle & buffalo and 11% of its goat & sheep population. Added to this are the strengths of skilled manpower, innovative technology, increasing industry compliance with international environmental standards, and the dedicated support of allied industries.

Fig 9 – Key growth drivers



Source: Anand Rathi Research

Per-capita consumption of footwear

In India per-capita consumption of footwear is 1.7, lower than in developed economies. In developed nations, consumption is 6-8 pairs per head. This indicates the potential for growth in consumption in India. According to the growth momentum of the industry, per-capita consumption is expected at 3.8 pairs in 2020.

Fig 10 – Global per-capita consumption of footwear

	2012			2013			2014			2015		
Countries	Pairs (m)	Population (m)	Per capita consumption	Pairs (m)	Population (m)	Per capita consumption	Pairs (m)	Population (m)	Per capita consumption	Pairs (m)	Population (m)	Per capita consumption
UK	459	64	7.2	447	64	7.0	523	65	8.1	560	65	8.6
United States	2,237	314	7.1	2,285	316	7.2	2,295	319	7.2	2,442	321	7.6
France	371	66	5.7	402	66	6.1	435	66	6.6	422	67	6.3
Germany	389	80	4.8	407	82	5.0	435	81	5.4	445	81	5.5
Italy	208	60	3.5	286	60	4.7	312	61	5.1	312	61	5.1
Japan	690	128	5.4	674	127	5.3	608	127	4.8	660	127	5.2
Brazil	787	202	3.9	816	204	4.0	807	206	3.9	786	208	3.8
Indonesia	532	248	2.1	540	251	2.1	548	254	2.2	826	258	3.2
China	3,279	1,351	2.4	3,678	1,357	2.7	3,646	1,364	2.7	3,800	1,371	2.8
India	2,260	1,264	1.8	2,068	1,279	1.6	2,048	1,295	1.6	2,196	1,311	1.7

Source: World Footwear Yearbook – 2012, 2013, 2014 and 2015

Per-capita footwear consumption in India is set to grow rapidly from its present level. The global average is three pairs a year; in developed countries it is more than five pairs per annum.

The Indian footwear market

The Indian footwear sector is dominated by the unorganised market (representing small cottage-industry manufacturers), constituting 65-70% of the sector. The organised market is likely to grow more than 20% as domestic footwear companies expand their networks and a greater number of international manufacturers enter the market. On-line shoe shopping is also likely to drive sales of brand-named manufacturers.

India, the second-largest footwear manufacturer in the world next only to China, has an ever-growing domestic market. Only 10% of the footwear produced in India is exported, 90% is sold in India.

The leather industry has a prominent place in the Indian economy. This sector is known for consistently high export earnings and is one of the country's top-ten foreign-exchange earners.

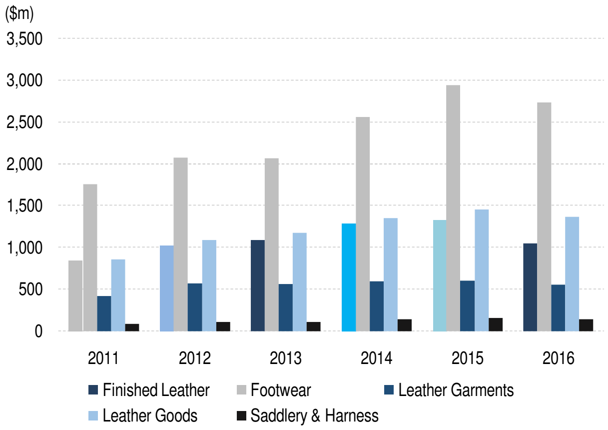
With customers aspiring to fashionable products, brand consciousness will help the organised segment grow faster than the sector. The rising operations of organised operators in tier-I and -II cities where consumption power is high, would expand and continuously grow the women and kids' sections. A young population, an increase in the number of working women, rising income levels, increasing brand awareness and urbanisation are expected to drive the organised segment in coming years. Also, with strict laws and enforcement of GST, the unorganised shoe-making units face the danger of closure, which would help the organised sector to grow.

Global footwear market

Bata's annual report shows that the global footwear market is divided into four regions: North America, Europe, Asia and the RoW. Asia is the largest market, commanding ~40% of volumes. At present, the global footwear market, valued at ~$210bn, is expected to see a 2.5% CAGR from 2015 to 2023. In volumes, the global footwear market would number ~10bn pairs.

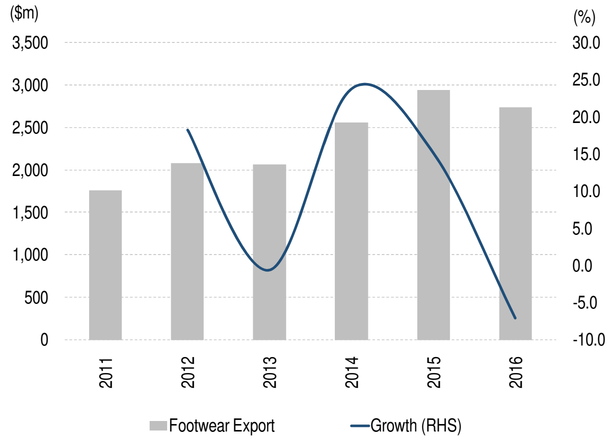
Further, the Council of Leather Exports says that export of footwear products (leather, non-leather and leather shoe-uppers) from India registered a 9.3% CAGR over FY11-16. Further growth would be powered largely by the rise in the average selling price and some increase in volumes.

Fig 11 – Export of leather and leather products . . .



Source: Council for leather export, Anand Rathi Research

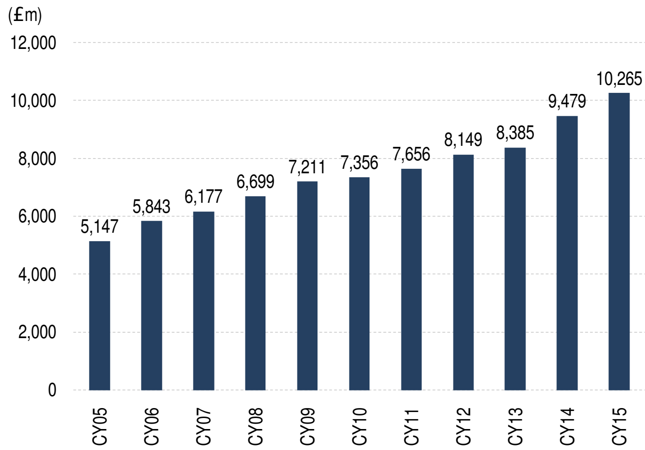
Fig 12 – . . . Footwear growth being the highest



Source: Council for leather export, Anand Rathi Research

European countries (especially the UK) are major consumers of Indian leather footwear. Indian footwear exports highly depend on European markets.

Fig 13 – Annual expenditure on footwear in the UK (based on volumes)



Source: Statista, Anand Rathi Research

The European Union accounts for a significant share (65%) of leather exports from India. However, recent crises in the euro zone have affected India's leather exports.

Government's favourable policies

The GoI allows 100% FDI in the footwear manufacturing sector through the automatic route. This helps boost the footwear industry by reducing excise duty on certain footwear categories.

In its Budget 2016, the government proposed reducing excise duty on rubber sheets for soles and heels from 12.5% to 6%, and raising the abatement from the retail sale price for calculating excise duty for footwear from 25% to 30%. The duty-drawback scheme on exports ranges from 9% to 11%. Excise duty on manufacturing footwear with leather uppers and with a retail price of more than ₹1,000, has been halved to 6%.

Under the Export Promotion Capital Goods (EPCG) Scheme of the Foreign Trade Policy, capital goods (machinery) required by the industry do not attract import duty, subject to meeting the export obligation of six times the duty saved in six years. State governments have a single-window-clearance system in place to fast-track clearances to establish production units.

Under leather technology, innovation and environment issues, a sub-scheme of the Indian Leather Development Programme (ILDP), assistance is provided for technology benchmarking and environment management for the upgrading of common effluent treatment plants (CETPs) for solid waste management and to conduct environmental workshops.

The Integrated Development of the Leather Sector (IDLS) sub-scheme, implemented as part of the ILDP, has significantly contributed to capacity modernisation and technological upgrading of the leather sector. The tanning industry has adopted zero liquid discharge (ZLD) systems to meet environmental regulations.

Under the Leather Technology, Innovative and Environmental Issues sub-scheme of the ILDP, assistance is provided for up to 50% of the project cost, with a ceiling of ₹500m to upgrade/install a CETP to address environmental pollution caused by leather units.

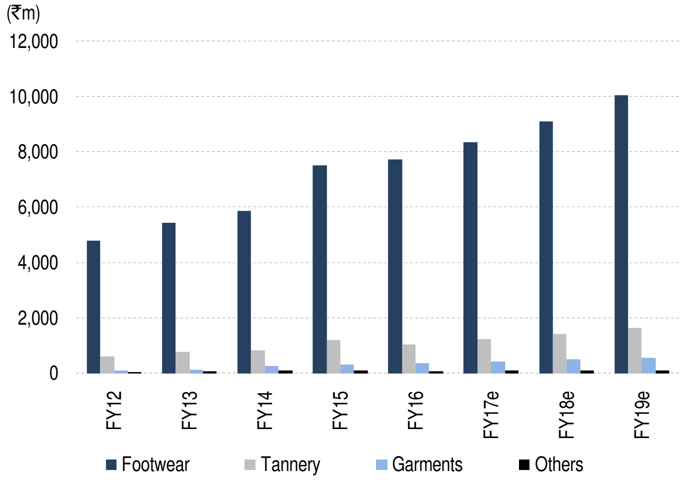
Rising branded domestic sales, exports

Mirza's branded footwear sales over FY12-16 came at an 11% CAGR. We expect domestic branded footwear sales to register a 25% CAGR over FY16-19, chiefly driven by a rise in the number of points of sale (EBOs, MBOs, LFSs) and online operations.

Over FY12-16, exports registered a 13% CAGR. We are factoring in a lower, 5%, CAGR over FY16-19, primarily due to steady sales in its markets

Mirza is the leading exporter of finished leather and leather footwear. Revenue from its footwear, tannery divisions, garments and others, were respectively ~83%, 12%, 4% and 1% in FY16

Fig 14 – Revenue break-down



Source: Company, Anand Rathi Research

Branded domestic footwear sales – the Red Tape brand

The revenue share of domestic branded footwear sales to rise to 26% in FY19, from 18% in FY16

Domestic footwear revenue from the Red Tape brand has seen an 11.4% CAGR over FY12-16. We expect domestic revenue at a 25% CAGR over FY16-19, chiefly driven by deeper penetration in the domestic market through an increase in the number of EBOs and MBOs along with a rise in LFSs and e-commerce.

In the domestic market the Red Tape brand has emerged as a premium life-style brand for the young. Mirza has leveraged its brand from footwear to allied areas of garments and accessories, making it available in the 'Head to Toe' category.

Expanding operations

Mirza has been extending its network and operations. It has a distribution network across tier-1 and -2 cities.

It plans to expand its EBOs to tier-2 and -3 markets where lease rentals and other operating costs are lower than in tier-1 cities.

- On 30th Jun'16 Mirza had 124 EBOs in 70 cities. The number of EBOs has seen a 14.4% CAGR over FY12-16. We expect this to increase to 190 stores by FY19. At end-Mar'16 Mirza had tie-ups with more than 185 LFSs and more than 800 points of sales, including MBOs.

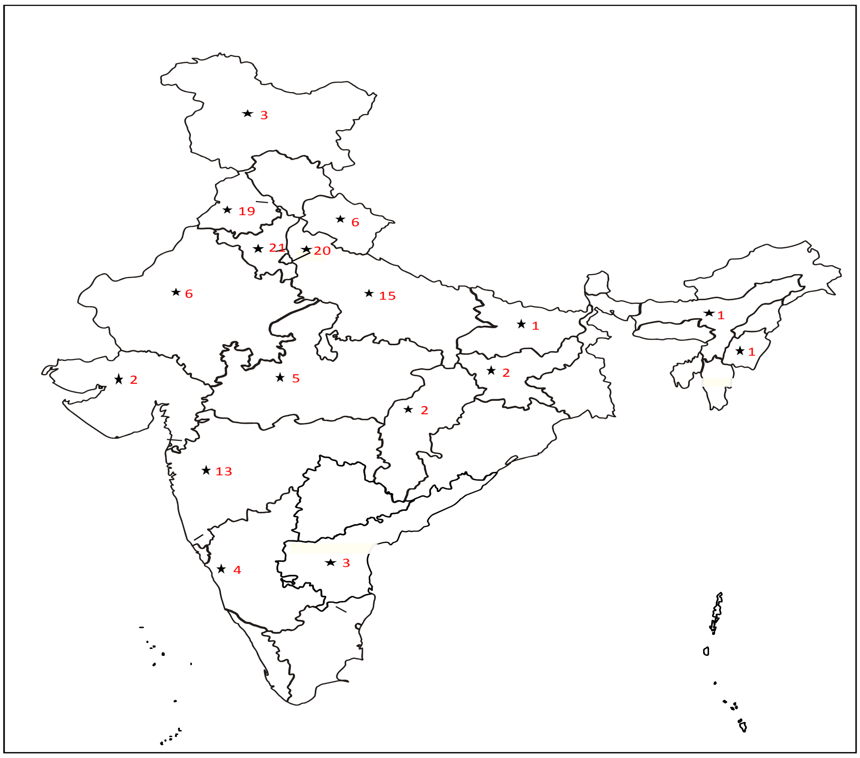
Fig 15 – Sales by channel and number of PoS

	FY12	FY13	FY14	FY15	FY16	FY17e	FY18e	FY19e
Revenue (₹ m)								
EBOs (exclusive brand outlets)	354	455	644	729	858	1064	1319	1636
MBOs and Shop-in-shops	632	656	755	656	895	1083	1327	1597
Number of outlets								
EBOs (exclusive brand outlets)	70	72	99	108	120	145	170	190
MBOs and Shop-in-shops	760	795	865	895	985	1060	1120	1180
Total	**830**	**867**	**964**	**1,003**	**1,105**	**1,205**	**1,290**	**1,370**

Source: Company, Anand Rathi Research

- Mirza's retail expansion in the domestic market will be through an increase in EBOs, more tie-ups with LFSs and an increasing number of points of sales through MBOs.
- Shop-in-shops and MBOs are given a 25-35% mark-up on the MRP, depending on various factors – credit period, discount structure, manpower at the outlet, etc. Of 124 operating EBOs, ~60 are COCO (company-owned, company-operated), the rest are FOFO (franchise-owned, franchise-operated), with ~50 in existence for more than two years.
- Mirza's EBOs are concentrated in the north. Its domestic revenue is likely to register a 25% CAGR over FY16-19 due to the increase in points of sale.

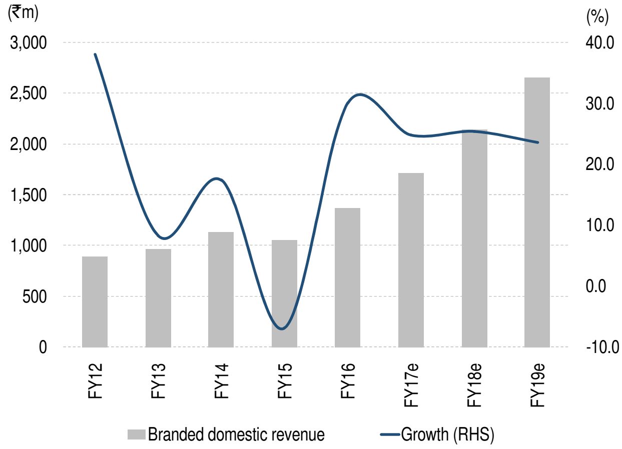
Fig 16 – EBOs Concentration analysis



Source: Company, Anand Rathi Research

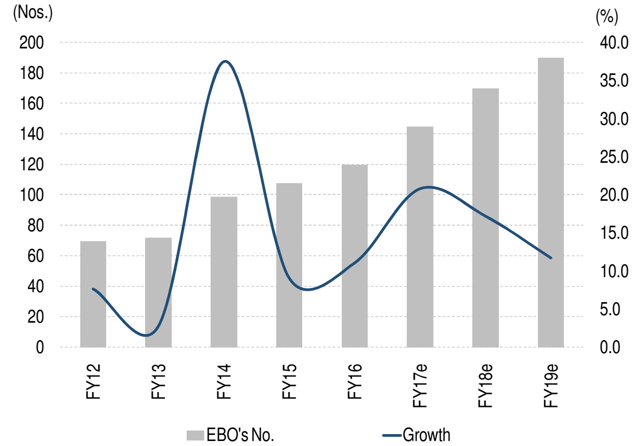
- Red Tape is available on leading e-commerce websites. From Q1 FY17 Mirza has modified its supply chain, selling through e-commerce websites, and directly in the market-place (formerly, through distributors).

Fig 17 – Increase in retail sales. . .



Source: Company, Anand Rathi Research

Fig 18 – . . . through a wide distribution network

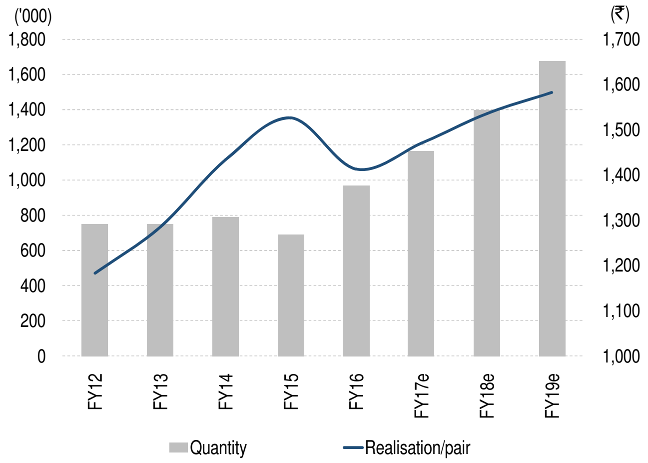


Source: Company, Anand Rathi Research

Domestic sales have grown 30% during FY16, due to the number of PoS added and vigorous brand building

The company sold ~752,000 pairs in FY12, which increased to 970,000 in FY16. We expect it to sell 1.67m pairs by FY19, driven by the Red Tape brand and an increase in disposable incomes of the young and middle-aged. We expect domestic revenue at a 25% CAGR over FY16-19, primarily driven by a 20% CAGR in volumes over FY16-19.

Fig 19 – Branded domestic footwear - Quantity and realisations



Source: Company, Anand Rathi Research

However we noted that the drop in FY15 was due to a decrease in sales of sandals. Sandals are outsourced and procured from vendors. We understand from management that supply issues arose with a couple of vendors, alleviated by long-term contracts with them.

Revenue from garments and accessories over FY12-16 has recorded a 41% CAGR, from ₹96m to ₹380m. Garments and accessories, procured from vendors, command a 40-45% gross margin. We expect garments and accessories to register a 15% CAGR over FY16-19.

Fig 20 – Revenue – garments and others

(₹ m)	FY12	FY13	FY14	FY15	FY16	FY17e	FY18e	FY19e
Garments and accessories	96	147	267	330	380	437	503	578
% growth	47.7	53.1	81.6	23.6	15.2	15.0	15.0	15.0
Others	60	70	100	112	94	99	104	109
% growth	(25.0)	16.7	42.9	12.0	(16.1)	5.0	5.0	5.0

Source: Company, Anand Rathi Research

Exports

Branded exports

Around 12% of the footwear exported is sold under the company's own brands, Red Tape and Oaktrak. The remaining footwear is supplied to reputed global retailers. Exports of Red Tape and Oaktrak have come at a 10.8% CAGR in the past four years.

In the UK the Red Tape brand is available at 300 prime outlets and 1,200 shop windows. In the US, it is seen in more than 500 shop windows

The company has positioned the brand in the UK at the men's mid-segment category, making it the leading brand in fashion footwear.

Fig 21 – Red Tape revenue - exports

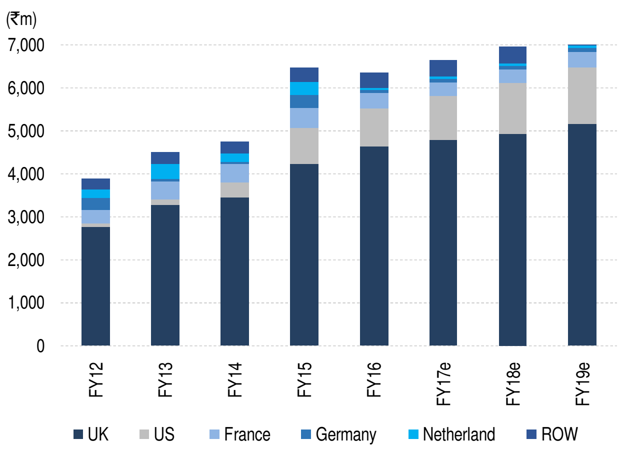
(₹ m)	FY12	FY13	FY14	FY15	FY16	FY17e	FY18e	FY19e
Export revenue under Red Tape brand	520	636	466	522	782	829	905	962
% of total export	13.3	14.2	9.8	8.1	12.3	12.5	13.0	13.0
% growth		22.4	(26.8)	12.1	49.9	6.1	9.1	6.3

Source: Company, Anand Rathi Research

Exports still to be substantial contributor

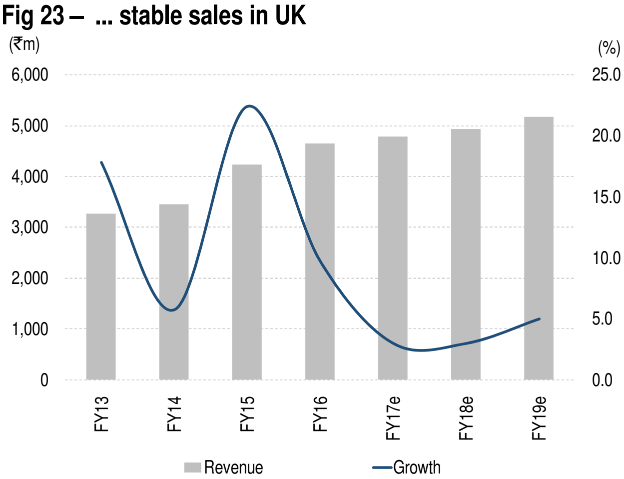
- Of its export revenue, 85% primarily arises from global private labels. Mirza provides made-to-order products for global brands with in-house expertise from designing to manufacturing. Most exports are to the UK (73%) and the US (14%). Over FY16-19 we expect a 5% CAGR in the company's footwear exports.
- Sales to the UK market (to brands such as Dunnes Store, Cleon, NEXT, ASDA, ASOS, New Look, etc.), constitute ~73% of exports. We understand from the management that sales to these brands do not exceed 5-7% of total sales. The UK market has steadily grown, at a 14% CAGR over FY12-16. We expect the UK market to register a 4% CAGR over FY16-19 primarily due to slower volume off-take and the currency effect
- Sales in the UK are primarily through Mirza (UK), which is the distributing arm for Mirza International. According to Mirza, it has a 25% market share of the UK's mid-segment men's category.

Fig 22 – Export composition...



Source: Company, Anand Rathi Research

Fig 23 – ... stable sales in UK

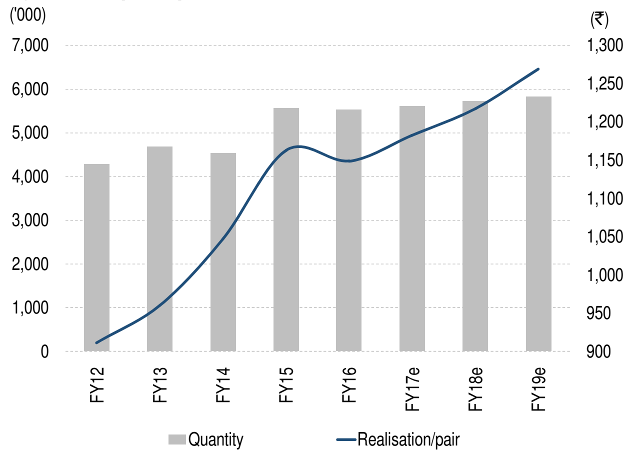


Source: Company, Anand Rathi Research

Export growth in the short term would be subdued due to the BRexit effect; however, in the long run strong growth momentum will be seen

- There will be pressure on Mirza's exports to the UK and the EU in the immediate future as both the pound and the euro have depreciated, rendering its products more competitive. BRexit would not have much of an impact on Mirza's trade with the UK or the EU in the long run. If Britain secures the same treatment in terms of free tariff and free movement of persons, not much will change for Mirza. If the UK secures treatment applicable to non-member countries, it may be positive for Mirza's exports to the EU as well as to the UK. However, Mirza follows a cost-plus method for export orders; an increase/ decrease in cost is passed on to buyers.
- Over FY12-16 the US market has registered an 83% CAGR. We expect a 14% CAGR over FY16-19, driven by an increase of products available at more shop windows. In the US, the company sells to brands such as Steve Madam, Elan Polo, Kennith Cole, etc. Sales in the US are handled by agents who act as aggregators for Mirza. Commission paid to these agents is around 5-10% of sales.
- Mirza is also exploring new markets to grow exports. Management has appointed agents for the Middle East and South Africa
- Export prices and volumes have registered respectively 6% and 6.7% CAGRs over FY12-16. We expect a 2% CAGR in volumes over FY16-19, with realisations at a 3% CAGR
- Export volumes have raised from 4.2m pairs in FY12 to 5.5m in FY16. We expect ~5.8m pairs by FY19, primarily by steady sales in the UK and the expansion into newer areas.

Fig 24 – Export quantities and realisations . . .



Source: Company, Anand Rathi Research

Fig 25 – . . . UK being highest contributor

Source: Company, Anand Rathi Research

Tannery division efficiency, upswing by upholstery

We expect the tannery division to generate positive EBITDA primarily from better utilisation and the introduction of upholstery. The better product-mix could result in the EBITDA margin rising 108bps over FY16-19. We expect a 16% CAGR in tannery revenue over FY16-19.

Business model

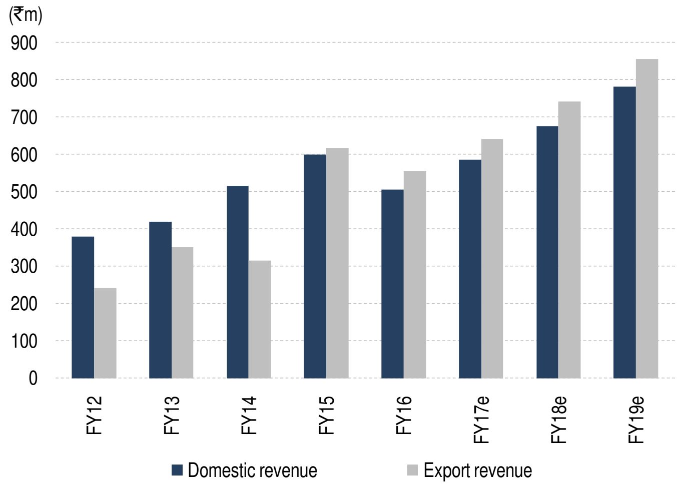
Mirza has been developed as a "Raw to Retail" integrated brand. From sourcing the highest quality of raw material and processing it to finished leather, designing a product range to manufacturing it in-house and then despatching products to retail stores and customers across the globe.

The business model of the tannery involves procuring raw hide locally on a per-unit basis, processing it to wet blues, and further drying and processing them to finished leather, sold per sq.ft.

Operational efficiency expected in the tannery division during FY17-19, leading to positive margins

The company has complete backward integration for footwear manufacturing. Raw hides are processed at its tannery, then used in manufacturing footwear; the balance sold in domestic and international markets.

Fig 26 – Tannery - domestic and export revenue



Source: Company, Anand Rathi Research

Tannery performance

Tannery revenue has increased from ₹622m in FY12 to ₹1,063m in FY16 at a 14.3% CAGR. From FY12 to FY16 the tannery division had been a losing proposition. From Q3 FY16 the tannery has had a positive EBIT primarily due to cost efficiency and better utilization.

We expect a 15.5% CAGR over FY16-19 in tannery revenue. We also expect the division to be profitable primarily due to the upholstery segment. The company has secured a sample order for upholstery. Management expects realisations to improve due to the sale of finished leather for upholstery.

Fig 27 – Tannery division profitability

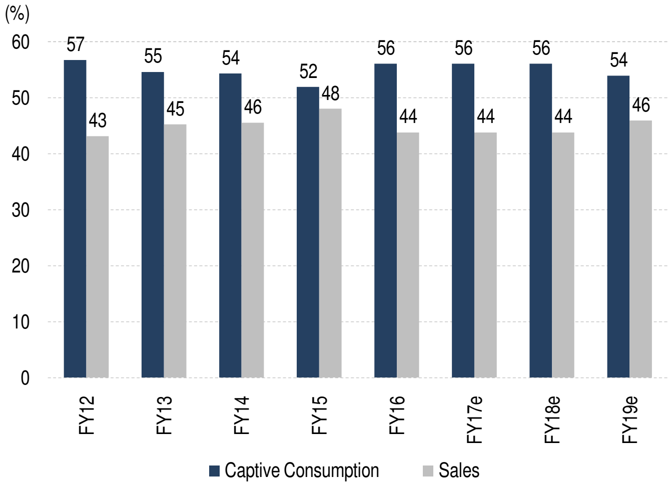
(₹m)	FY 12	FY 13	FY 14	FY15	FY16	FY17e	FY18e	FY19e
Revenue	622	772	832	1,219	1,069	1,228	1,418	1,638
EBIT	(12)	(8)	(6)	(106)	16	50	167	150
EBIT %	(1.9)	(1.0)	(0.7)	(8.7)	1.5	4.1	8.7	9.1
Unallocated exp	42	63	66	89	80	88	100	107
PAT	(54)	(71)	(72)	(194)	(65)	(38)	23	43
PAT %	(8.6)	(9.2)	(8.7)	(16.0)	(6.0)	(3.1)	1.6	2.6

Source: Company's Audit Report, Anand Rathi Research
Note: Unallocated expenses have been divided in proportion of revenue of the footwear and tannery divisions

Captive consumption and third-party sales

Of the finished leather produced, ~50-55% is utilised in-house by the footwear division. The rest is sold domestically and internationally.

Fig 28 – Tannery captive consumption vs. sales

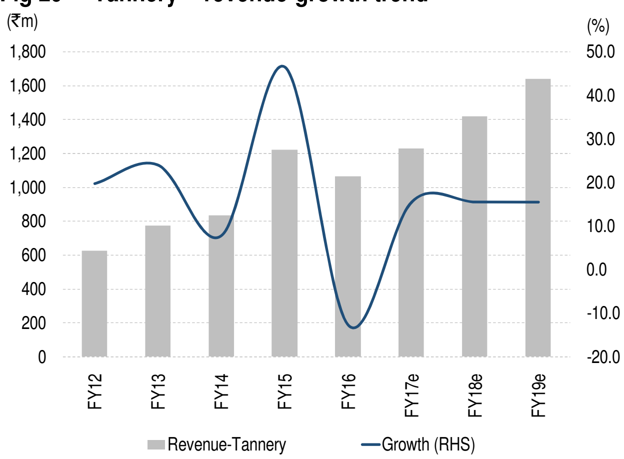


Source: Company, Anand Rathi Research

Exports of finished leather have seen a 23% CAGR, from ₹242m in FY12 to ₹556m in FY16. Domestic revenue has registered a 7.5% CAGR over FY12-16. Domestic sales of finished leather are primarily to Euro Footwear, the job-worker manufacturing shoes for Mirza.

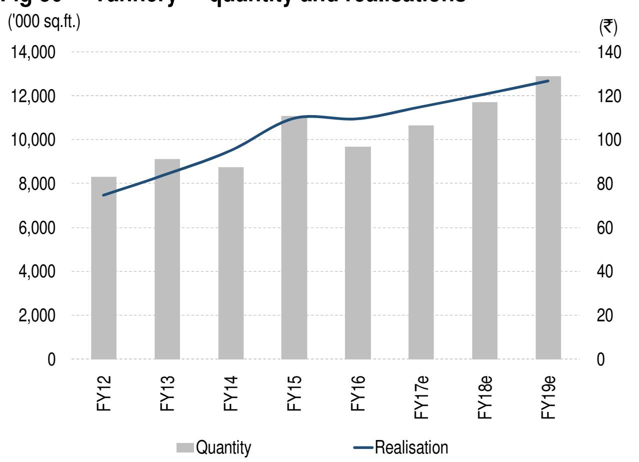
Realisations have increased from ₹75 a sq.ft. to ₹110 at a 10% CAGR over FY12-16. We expect realisations to register a 5% CAGR over FY16-19.

Fig 29 – Tannery - revenue-growth trend



Source: Company, Anand Rathi Research

Fig 30 – Tannery – quantity and realisations



Source: Company, Anand Rathi Research

Capex and utilisation

Mirza has installed capacity of 36m sq.ft. for finished leather, and produced ~22m sq.ft. by 31st Mar'16. During FY16, its tannery was 60% utilized; ahead, we expect utilisation to rise to 75%. Over FY12-16, capex of ₹1,887m was implemented, of which ₹1,000m primarily related to an increase in capacity at the tannery from 24m sq.ft. (during FY14) to 36m sq.ft. through new specialised machinery. The company has technology installed at the tannery for overall water conservation, energy-saving and reduced chemical wastage. The tannery is equipped with a state-of-the-art 1.65m litres-per-day effluent-treatment plant.

Genesis merger, no red flags in related-party transactions

We expect the Genesis merger and change in product mix to expand the FY19 PAT margin by 206bps, as Genesis' EBITDA margin was ~30% and it operates in an excise-benefit zone. Post-merger, the promoter holding increased to 73.8%. Related-party transactions with Mirza (UK), the distributing arm for UK sales, and with Euro Footwear Pvt. Ltd., a job worker, are at "arm's-length" prices.

Merger with Genesisfootwear Enterprises Pvt. Ltd.

Genesisfootwear Enterprises Pvt. Ltd. was privately held by the promoter group. The merger of Mirza International and Genesis had been approved by the High Court of Allahabad with the appointed date as 1st Apr'15. The merger has been given effect in the financial statement for FY16. Prior to the merger, Red Tape shoes were manufactured by Genesis, procured by Mirza and sold domestically and internationally.

Synergies of the Genesis merger would flow to Mirza till 2020 and would increase its PAT margin by 206bps

Fig 31 – Abridged financials of Genesisfootwear Enterprises Pvt. Ltd.

(₹ m)	FY12	FY13	FY14	FY15	FY16
Sales	511	558	755	750	900
EBITDA	158	174	226	260	280
EBITDA Margin (%)	30.9	31.2	29.9	34.7	31.1
PAT	138	155	189	180	200
PAT Margin (%)	27.0	27.8	25.0	24.0	22.2

Source: Company. Anand Rathi Research

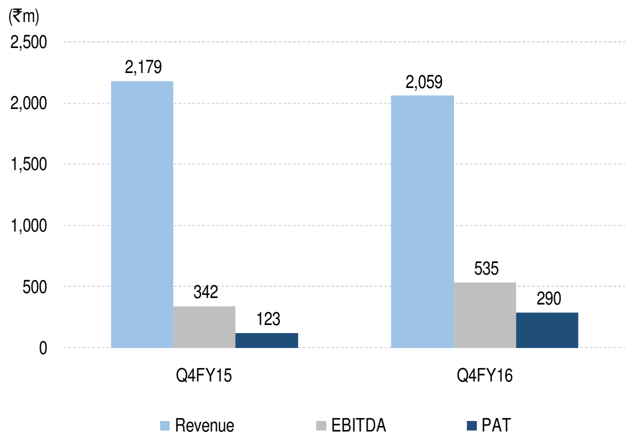
Over FY12-16, Genesis had over 30% EBITDA margin and a ~22-25% PAT margin. We expect synergies from the merger to flow to Mirza, as Genesis enjoys higher margins. Genesis, being in an excise-exemption zone, the benefit would be available till FY20.

Valuation

- This amalgamation is in nature of a "merger". The accounting format, as prescribed by "Accounting Standard -14", is the "pooling of interest" method. The merged entity's FY16 financial statements have shown a line-by-line consolidation, which has led to a ₹581m increase in reserves.
- Genesis shareholders would get, over two years, 92 shares of Mirza for every 100 of Genesis. Of these 92 shares, 52 equity shares of ₹2 each of Mirza for every 100 shares of Genesis were issued in FY16; and 40 shares 0% CCPS for every 100 shares of Mirza will be issued in FY17.
- The issue of 27.6m shares to Genesis shareholders has led to a 30% dilution of Mirza's equity. Post-merger, the promoter shareholding has risen from 66% to 73.8%.

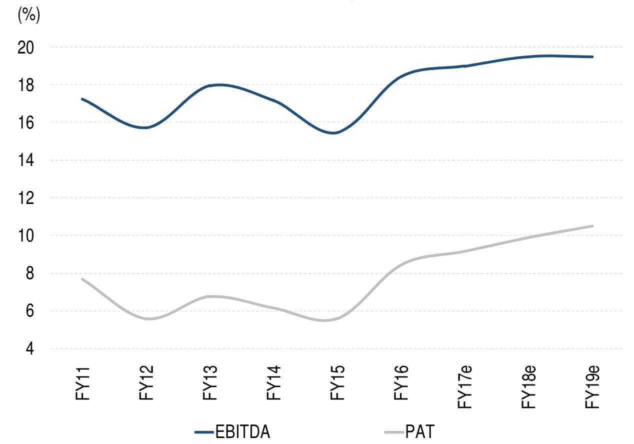
Gist of financials of the amalgamated entity

Fig 32 – Q4 FY15 results vs Q4 FY16 results



Source: Company, Anand Rathi Research

Fig 33 – ... EBITDA and PAT to improve



Source: Company, Anand Rathi Research

Despite revenue being flattish, the Q4 FY16 EBITDA and PAT have increased. We expect the benefit from the merger to continue to Mirza, thereby raising the PAT margin from 5.6% in FY15 to 8.4% in FY16

Related party - Mirza (UK)

Mirza (UK) is a wholly-owned subsidiary of Tilbrook Enterprises (a promoter-owned company incorporated in the UK). We understand from management that Mirza (UK) is a distributor for Mirza International for sales in the UK. Mirza (UK) registered a ~1–2.5% PAT over FY11-15. Below are Mirza (UK)'s financials. Management stated that there are no transactions by Mirza (UK) with any other party.

Mirza (UK); promoter owned company is distribution arm for UK, generates ~1-2% margin

Fig 34 – Abridged financials of Mirza (UK)

£m	FY11	FY12	FY13	FY14	FY15
Sales	32	30	33	34	42
Gross profit	5	5	5	5	7
Gross profit margin (%)	*16.3*	*16.5*	*15.5*	*16.4*	*16.1*
PAT	1	0	1	0	1
PAT margin (%)	1.7	1.2	1.5	0.9	2.4
ROCE	4.4	3.5	3.8	2.4	7.2
ROE(%)	18.3	14.1	16.6	10.1	21.3
Debt / equity (x)	0.5	0.5	0.4	0.3	0.4

Source: Company, Anand Rathi Research

Our observations of inter-company transactions between Mirza International and Mirza (UK) – Sales of Mirza International to Mirza (UK) and purchases of Mirza (UK) are in line. Sales to Mirza (UK) in FY15 were ₹3,243m and purchases in the books of Mirza (UK) were £33m (~₹3,200m). The audit report of the latter mentions that transactions with the former are at an arm's-length price.

Euro Footwear Pvt. Ltd.

We understand from management that Euro Footwear Pvt. Ltd. is a job worker for Mirza International. Mirza provides finished leather to Euro Footwear, which manufactures products according to the former's specifications. The promoter family of Mirza International has a 49% stake in Euro Footwear Pvt. Ltd. The rest of the equity is owned by Mr Rehman and family.

We have analysed Euro Footwear's financials (shown below). Revenue has recorded a 25% CAGR over FY11-15.

Fig 35 – Abridged financials of Euro Footwear Pvt. Ltd.

₹ m	FY11	FY12	FY13	FY14	FY15
Sales	624	784	946	1,096	1,499
EBITDA	74	118	169	185	277
EBITDA margin (%)	11.8	15.1	17.9	16.9	18.5
PAT	41	68	102	114	164
PAT margin (%)	6.6	8.7	10.8	10.4	10.9
Debt / equity (x)	0.1	0.17	0.12	0.3	0.3

Source: Company, Anand Rathi Research

We have noticed that Euro Footwear's EBITDA margin has risen from 11.8% in FY11 to 18.5% in FY15, and the PAT margin from 6.6% to 10.9%.

Purchases from Euro Footwear in related-party disclosures in the audit report of Mirza are in line with domestic sales shown in the former's financials.

Financials

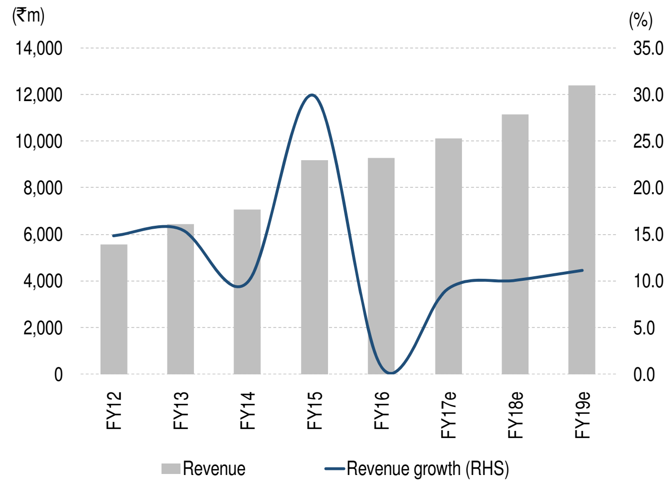
Revenue growth along with higher margins

10% revenue CAGR over FY16-18e

We expect a steady 10% CAGR in revenue over FY16-18, to ₹11bn, aided by a 5% CAGR in exports, and 25% in domestic sales. Growth in domestic sales, we expect, would primarily be driven by a rise in the number of EBOs, more points of sale (MOS, LFS) online operations and scaling up garments and accessories.

We expect domestic revenue to record a 25% CAGR over FY16-18, primarily due to an increase in retail operations and brand-building

Fig 36 – Revenue-growth trend



Source: Company, Anand Rathi Research

Revenue break-up

Brand-building and more points of sales lead us to anticipate 10% revenue CAGR over FY16-18, driven by domestic sales of footwear and of exports along with an increase in sales of finished leather.

Fig 37 – Revenue break-up

₹ m	FY12	FY13	FY14	FY15	FY16	FY17e	FY18e	FY19e
Footwear	4,788	5,459	5,879	7,521	7,732	8,347	9,106	10,049
% growth	14.5	14.0	7.7	27.9	2.8	8.0	9.1	10.3
% of sales	86.0	84.7	83.1	81.9	83.4	82.6	81.8	81.2
Tannery	622	772	832	1,219	1,063	1,228	1,418	1,638
% growth	19.7	24.0	7.8	46.5	-12.8	15.5	15.5	15.5
% of sales	11.2	12.0	11.8	13.3	11.5	12.1	12.7	13.2
Garments	96	147	267	330	380	437	503	578
% growth	47.7	53.1	81.6	23.6	15.2	15.0	15.0	15.0
% of sales	1.7	2.3	3.8	3.6	4.1	4.3	4.5	4.7
Others	60	70	100	112	94	99	104	109
% growth	(25)	17	43	12	(16)	5	5	5
% of sales	1	1	1	1	1	1	1	1
Total	**5,566**	**6,447**	**7,078**	**9,182**	**9,269**	**10,110**	**11,131**	**12,373**

Source: Company, Anand Rathi Research

Fig 38 – Revenue break-up, area-wise

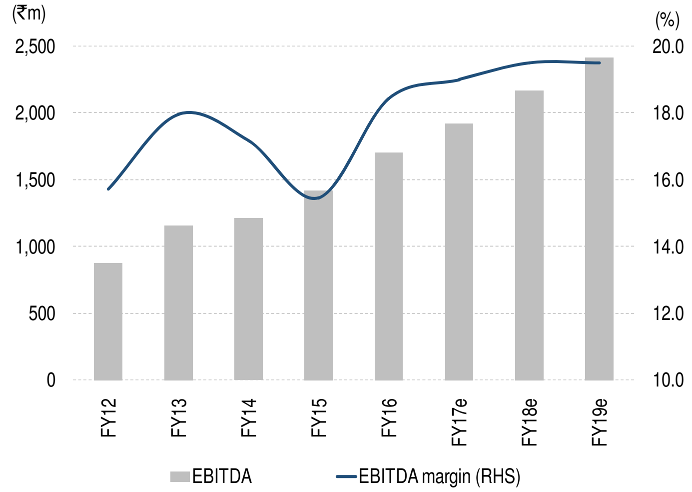
₹ m	FY12	FY13	FY14	FY15	FY16	FY17e	FY18e	FY19e
Exports	4,140	4,846	5,063	7,085	6,917	7,278	7,703	8,253
Domestic	1,426	1,601	2,015	2,096	2,352	2,832	3,428	4,120
Total	**5,566**	**6,447**	**7,078**	**9,182**	**9,269**	**10,110**	**11,131**	**12,373**

Source: Company, Anand Rathi Research

EBITDA margin to expand

We expect the EBITDA margin to improve 108bps over FY16-18, to 19.5%. In absolute terms, we expect the consolidated EBITDA to register a 12.8% CAGR over FY16-18, driven by the positive effect of the Genesis merger, better utilisation and cost efficiency of the tannery division.

Fig 39 – EBITDA margin and growth



Source: Company, Anand Rathi Research

Fig 40 – Segment-wise revenue and PAT margin

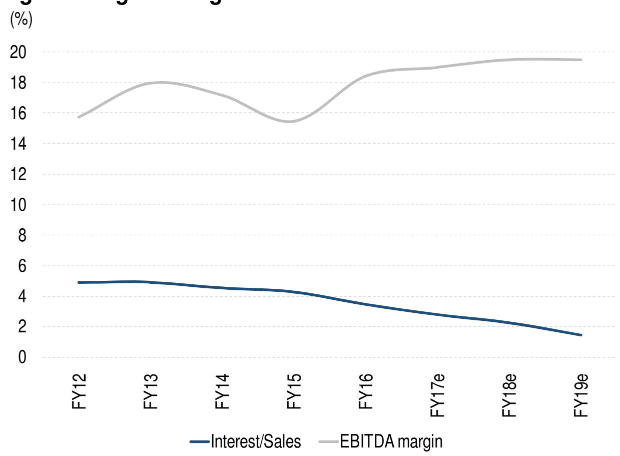
(₹m)	FY12	FY13	FY14	FY15	FY16	FY17e	FY18e	FY19e
Footwear Division								
Revenue	4,943	5,662	6,238	7,965	8,189	8,883	9,713	10,735
PAT Margin (%)	8.2	8.9	8.1	8.9	10.3	10.8	11.1	11.7
Tannery Division								
Revenue	622	772	832	1,219	1,069	1,228	1,418	1,638
PAT Margin (%)	-8.6	-9.2	-8.7	-16.0	-6.0	-3.1	1.6	2.6

Source: Company, Anand Rathi Research

Net profit to register a 19% CAGR over FY16-FY18

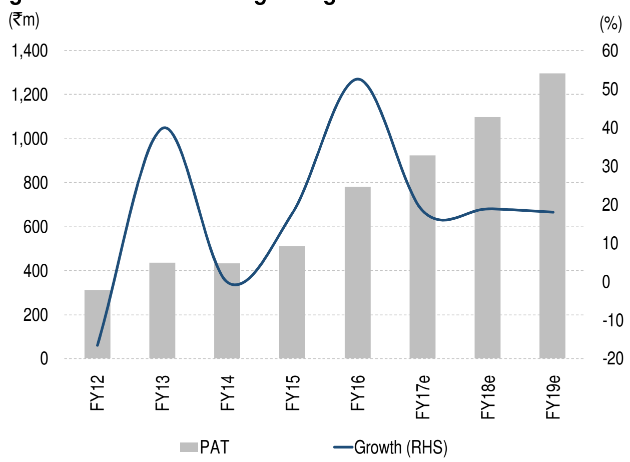
We expect a 19% CAGR in net profit over FY16-18, to ₹1.1bn, driven by the steady revenue growth, expanded operating margin and better leverage. Further, the interest cost would be reduced by ~200-250bps as Mirza has received an interest subvention from the government. It would enjoy low interest until such interest subvention is withdrawn.

Fig 41 – Higher margin and lower interest cost . . .



Source: Company, Anand Rathi Research

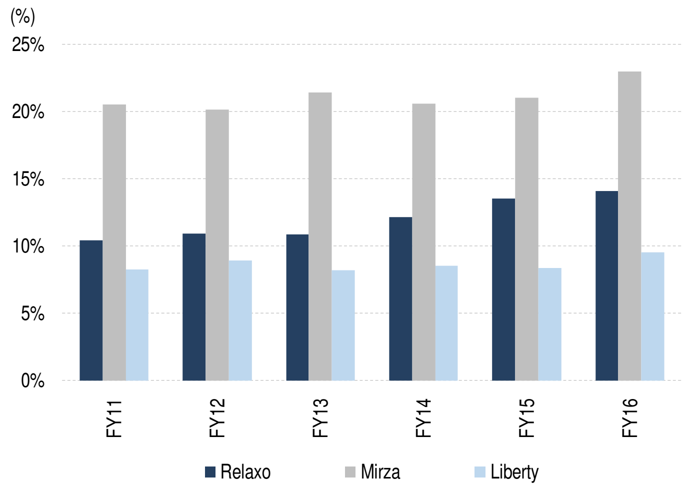
Fig 42 – . . . to drive strong PAT growth



Source: Company, Anand Rathi Research

EBITDA margin per pair higher than peers (as 100% leather)

Fig 43 – EBITDA margin per pair



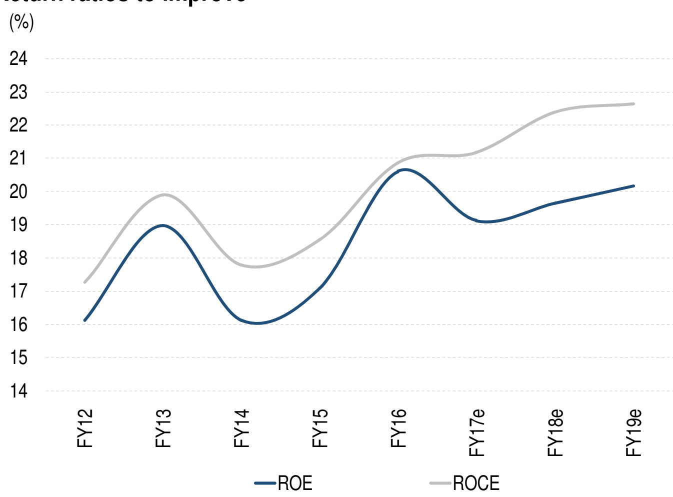
Source: Company, Anand Rathi Research

In the past the company has enjoyed a higher EBITDA margin per pair (~20%) than Relaxo (~10.5–13%) and Liberty (8-9%) as Mirza caters to the premium leather footwear market.

Promising RoE and RoCE

With strong PAT growth and better margins in the next two years, we expect return ratios to improve. The RoCE would increase from 20.9% in FY16 to 22.4% in FY18, and the RoE be maintained at ~19–20%

Fig 44 – Return ratios to improve



Source: Company, Anand Rathi Research

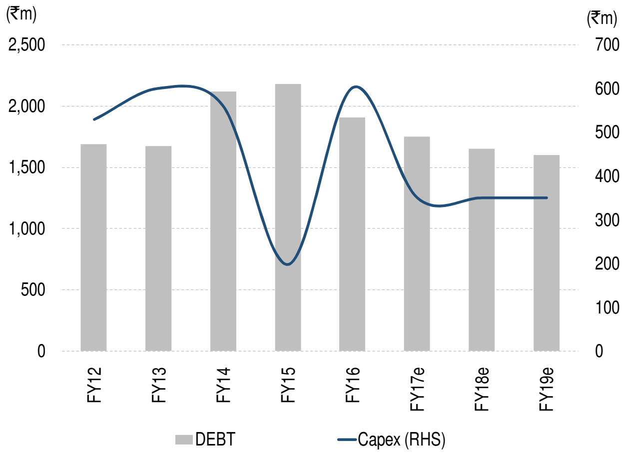
Lower maintenance capex would lead to FCF generation and a lower debt-equity ratio in the next two years

Major capex completed and lower debt lead to a strong balance sheet

With major capex completed, the company has planned capex (~₹0.7bn) for maintenance, to be funded through internal accruals. It has already started to pay off debt and we expect the debt-equity ratio to slide from 0.4 in FY16 to 0.1 in FY18.

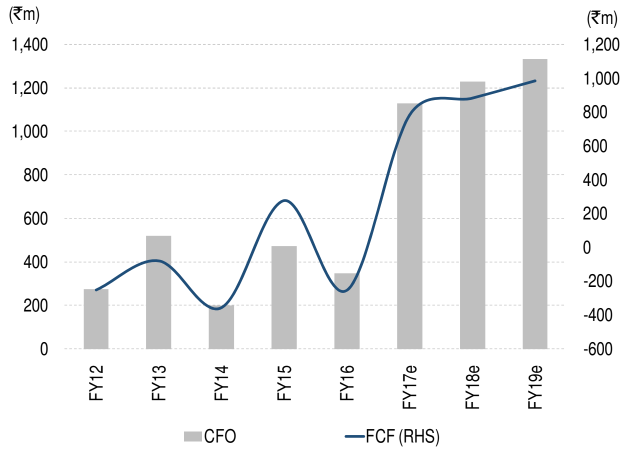
Historically, FCF was negative due to high working capital and high capex. During FY16 working capital has increased primarily due to increase in inventory and decrease in other liabilities and trade payables.

Fig 45 – Major capex done...



Source: Company, Anand Rathi Research

Fig 46 – . . . FCF generation of ₹1.6bn in FY17-FY18



Source: Company, Anand Rathi Research

Fig 47 – Income statement (₹m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Revenues	**9,183**	**9,257**	**10,110**	**11,131**	**12,373**
Growth in revenues (%)	*29.9*	*0.8*	*9.2*	*10.1*	*11.2*
Raw material expenses	5,482	5,036	5,510	6,011	6,682
% of Sales	*65.0*	*54.4*	*54.5*	*54.0*	*54.0*
Personnel expenses	457	594	607	668	742
% of Sales	*5.4*	*6.4*	*6.0*	*6.0*	*6.0*
Selling and other expenses	1,824	1,922	2,073	2,282	2,536
% of Sales	*21.6*	*20.8*	*20.5*	*20.5*	*20.5*
EBITDA	**1,420**	**1,706**	**1,921**	**2,170**	**2,413**
EBITDA Margin	*15.5*	*18.4*	*19.0*	*19.5*	*19.5*
Depreciation	246	258	282	299	319
PBIT	**1,174**	**1,447**	**1,639**	**1,871**	**2,094**
Interest expenses	393	319	280	252	180
PBIT from operations	781	1,129	1,360	1,619	1,914
Other income	7	30	10	10	10
PBT before extra-ordinary items	787	1,158	1,370	1,629	1,923
PBT	**787**	**1,158**	**1,370**	**1,629**	**1,923**
Provision for tax	276	377	445	529	625
Effective tax rate	35.0	32.6	32.5	32.5	32.5
PAT	**512**	**781**	**924**	**1,099**	**1,298**
Minority Interest	-	**-**	**-**	**-**	**-**
PAT after minority interest	**512**	**781**	**924**	**1,099**	**1,298**
Adjusted PAT	**512**	**781**	**924**	**1,099**	**1,298**
Growth in PAT (%)	*18.0*	*52.6*	*18.4*	*18.9*	*18.1*
PAT margin	*5.6*	*8.4*	*9.1*	*9.9*	*10.5*

Source: Company, Anand Rathi Research

Fig 48 – Balance Sheet (₹m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Share Capital	185	241	241	241	241
Reserves	2,940	4,216	4,973	5,742	6,650
Shareholders' fund	3,125	4,456	5,214	5,983	6,891
Minority Interest	-	-	-	-	-
Deferred Govt. grant	-				
Debt	2,177	1,904	1,750	1,650	1,600
Deferred Tax Liability	117	149	149	149	149
Total Capital Employed	**5,419**	**6,510**	**7,113**	**7,782**	**8,640**
Gross Block	4,889	5,460	5,810	6,160	6,510
Accumulated depreciation	1,813	2,097	2,378	2,678	2,997
Net Block	3,077	3,363	3,432	3,482	3,513
Capital WIP	28	85	85	85	85
Total Fixed Assets	3,104	3,448	3,517	3,567	3,598
Investments	7	6	6	6	6
Inventories	2,252	2,630	2,442	2,672	2,970
Debtors	433	634	693	763	848
Cash and bank balances	58	115	575	1,025	1,567
Loans and Advances	715	751	762	775	790
Total current assets	3,458	4,130	4,472	5,234	6,176
Current liabilities and provisions	1,028	941	735	865	962
Net current assets	2,429	3,189	3,736	4,369	5,214
Other long-term liabilities	43	51	56	62	69
Long-term provisions	79	82	90	99	110
Total Assets	**5,419**	**6,510**	**7,113**	**7,782**	**8,640**

Source: Company, Anand Rathi Research

Fig 49 – Cash-flow statement (₹m)

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Cash flow from operating activities					
Profit before tax	787	1,158	1,370	1,629	1,923
Depreciation	246	258	282	299	319
Interest expenses	393	319	280	252	180
Operating profit before working capital chg	**1,426**	**1,735**	**1,931**	**2,180**	**2,423**
Working capital adjustment	(284)	(691)	(75)	(168)	(285)
Gross cash generated from operations	**1,142**	**1,045**	**1,856**	**2,012**	**2,138**
Direct taxes paid	(257)	(377)	(445)	(529)	(625)
Cash generated from operations	**885**	**667**	**1,411**	**1,482**	**1,513**
Cash flow from investing activities					
Capex	(198)	(602)	(350)	(350)	(350)
Investment	-	1	-	-	-
Cash generated from investment activities	**(198)**	**(601)**	**(350)**	**(350)**	**(350)**
Cash flow from financing activities					
Proceeds from share capital	-	55	-	-	-
Borrowings/ (Repayments)	59	(273)	(154)	(100)	(50)
Interest paid	(393)	(319)	(280)	(252)	(180)
Dividend paid	(56)	(72)	(167)	(331)	(390)
Cash generated from financing activities	**(390)**	**(608)**	**(601)**	**(683)**	**(621)**
Other / Misc	(303)	599	0	(0)	(0)
Net cash increase/ (decrease)	**(6)**	**57**	**460**	**450**	**542**

Source: Company, Anand Rathi Research

Fig 50 – Ratios @ ₹85

Year-end: Mar	FY15	FY16	FY17e	FY18e	FY19e
Margin Ratios (%)					
EBITDA Margin	15.5	18.4	19.0	19.5	19.5
PBIT Margin	12.8	15.6	16.2	16.8	16.9
PBT Margin	8.6	12.5	13.5	14.6	15.5
PAT Margin	5.6	8.4	9.1	9.9	10.5
Growth Ratios (%)					
Revenues	29.9	0.8	9.2	10.1	11.2
EBITDA	16.9	20.1	12.6	13.0	11.2
Net Profit	18.0	52.6	18.4	18.9	18.1
Return Ratios (%)					
ROCE	18.5	20.9	21.2	22.4	22.6
ROIC	21.4	23.4	22.2	24.1	25.4
ROE	17.1	20.6	19.1	19.6	20.2
Turnover Ratios					
Fixed asset turnover ratio (x)	2.0	1.8	1.8	1.9	2.0
Working capital cycle (days)	89	116	109	104	102
Average collection period (days)	17	25	25	25	25
Average payment period (days)	55	40	21	25	25
Inventory holding (days)	150	191	162	162	162
Per share (₹)					
EPS	5.5	6.5	7.7	9.1	10.8
CEPS	8.2	8.6	10.0	11.6	13.4
Book Value	33.7	37.0	43.3	49.7	57.3
Solvency ratios (x)					
Net Debt/ Equity	0.7	0.4	0.2	0.1	0.0
Interest coverage	3.0	4.5	5.9	7.4	11.6
Net Debt/ EBITDA	1.5	1.0	0.6	0.3	0.0
Valuation parameters (x)					
P/E	15.4	13.1	11.1	9.3	7.9
P/BV	2.5	2.3	2.0	1.7	1.5
EV/ EBITDA	8.7	7.0	5.9	5.0	4.3
EV/ Sales	1.3	1.3	1.1	1.0	0.8
M-Cap/ Sales	0.9	1.1	1.0	0.9	0.8

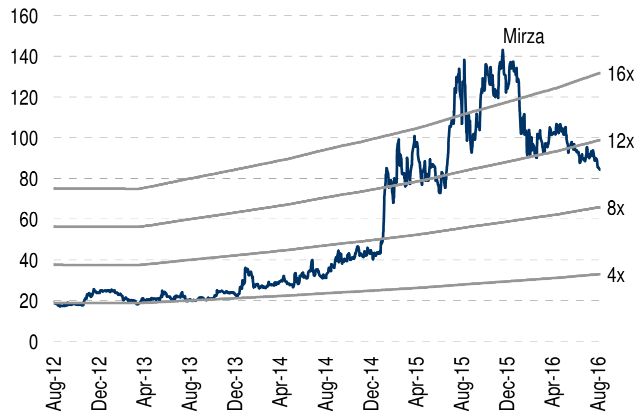
Source: Company, Anand Rathi Research

Valuation and Risks

Considering Mirza's continuing strong growth momentum (a 19% PAT CAGR over FY16-18, a sound business model and improving RoEs and RoCEs), we are sanguine about its mid- to long-term prospects.

We believe that the company's growth momentum is poised to accelerate in the next two years, driven by domestic sales, an increase in the number of EBOs and in points of sale. Further, its tannery business is expected to generate positive returns through better utilisation and cost-efficiency.

Fig 51 – PE band



Source: Bloomberg, Anand Rathi Research

The valuation gap between Mirza and peer companies (Relaxo, Bata) would narrow owing to the former's increase in retail operation and vigorous branding

Over the last 18 months the stock has traded at an average PE of 14x. We value it at a 14x PE on FY18e EPS. We believe that, after the improvement in the RoE, another round of PE re-rating is likely.

Fig 52 – Peer comparison

(₹m)	Revenue		EBITDA		PAT		Revenue Growth (%)		EBITDA Margins (%)		PAT Margins (%)	
Company	**FY17e**	**FY18e**	**FY17e**	**FY18e**	**FY17e**	**FY18e**	**FY17e**	**FY18e**	**FY17e**	**FY18e**	**FY17e**	**FY18e**
Bata India*	27,436	31,367	3,363	4,204	1,989	2,529	13	14	12	13	7	8
Relaxo Footwear*	20,464	25,459	2,877	3,588	1,533	1,996	20	24	14	14	7	8
Liberty Shoes*	5,964	6,032	492	564	224	240	27	1	8	9	4	4
Mirza International	10,110	11,131	1,921	2,170	924	1,099	9	10	19	20	9	10

*Source: Company, Anand Rathi Research, *Bloomberg Consensus*

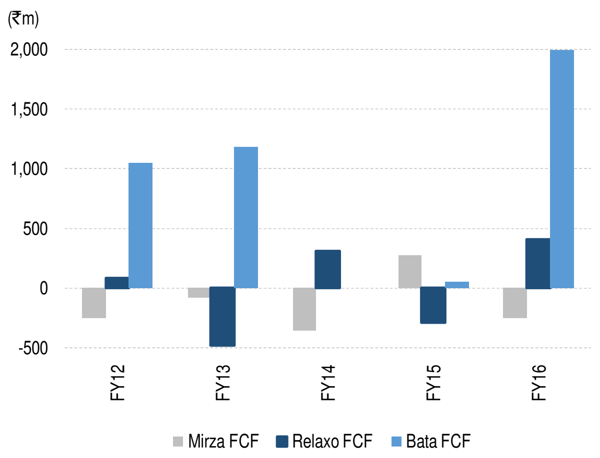
Fig 53 – Peer valuation

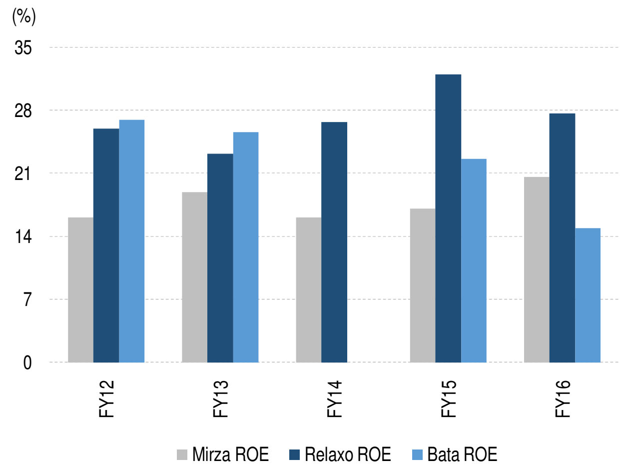
(₹m)	Equity Value (₹m)	Enterprise Value (EV ₹m)	EV / Revenue		EV / EBITDA		P/E	
			FY17e	**FY18e**	**FY17e**	**FY18e**	**FY17e**	**FY18e**
Bata India*	68,319	64,894	2	2	19	15	34	27
Relaxo Footwear*	59,066	61,068	3	2	21	17	39	30
Liberty Shoes*	3,207	4,569	1	1	9	8	14	13
Average	-	-	2	2	17	14	29	23
Mirza International	**-**	**-**	**1**	**1**	**6**	**5**	**11**	**9**

*Source: Company, Anand Rathi Research, *Bloomberg Consensus*

The valuation gap between Mirza and close competitors (Bata, Relaxo) stems chiefly from the former's brand equity, retail operations and ability to generate free cash and good return ratios. Bata and Relaxo offer higher returns.

Fig 54 – Peer comparison – FCF and RoE





Source: Company, Anand Rathi Research; Note: Bata FY15 financials were for fifteen month period ended 31 March 2015

We expect Mirza's FY18 EBITDA and PAT margin at respectively 19.5% and 9.9%, higher than Bata's (13.4% and 8.1%) and Relaxo's (14.1% and 7.8%).

We expect its valuation to increase in line with its greater expenditure on A&P, which would heighten its brand equity. We expect its strategy of increasing the number of points of sale to generate more brand awareness. We also expect the stock to be re-rated once these measures are given effect.

At present, the stock trades at 11.1x FY17e, 9.3x FY18e and 7.9x FY19e earnings. We initiate coverage on Mirza International, with a price target of ₹128, based on 14x FY18e earnings. Our target PE multiple is in line with the valuation of its peers, considering our expectation of the company's high-growth momentum, a more-than-19.5% EBITDA margin in FY18, and a strong balance sheet (considering its FCF generation and high RoCE).

Risks

- **Non-leather portfolio.** Currently, the company exclusively sells leather footwear. However, management states that it is planning to diversify by including non-leather products and would be registering a new brand for this purpose.
- **Global slowdown.** Of its export revenue, 85% arises from the UK and the US. Any deterioration in the global economy would trim revenue.
- **Duty drawback.** Mirza obtains ~11% duty-drawback on footwear, 8% on leather. The withdrawal of this would strike at its profitability.
- **Crystallisation of bill discounting.** If Mirza (UK) is unable to pay the bank an amount pertaining to bill discounting, the contingent liability in Mirza's books will be crystallised, and Mirza would be liable to pay.
- **Forex gain or loss.** Most sales are in dollars, pounds and euros. In the recent past the company has fully hedged its currency risk; however, any change in policy would directly impact profit.
- **Store location and tie-ups with MBOs and LFS**. The retail business model has been a losing proposition due to high rentals and operating costs. Store location is key to success in retailing. Key financial terms with MBOs and LFSs are vital for sustainable profitability.

Company Background & Management

Incorporated in 1979 as Mirza Tanners Pvt. Ltd. by Irshad and Rashid Mirza, and converted to Mirza International in 1993, the company manufactures and markets leather, leather footwear and products. It has two divisions: (state-of-the-art) tannery and footwear, an in-house design and development studio, marketing offices and a wide distribution network.

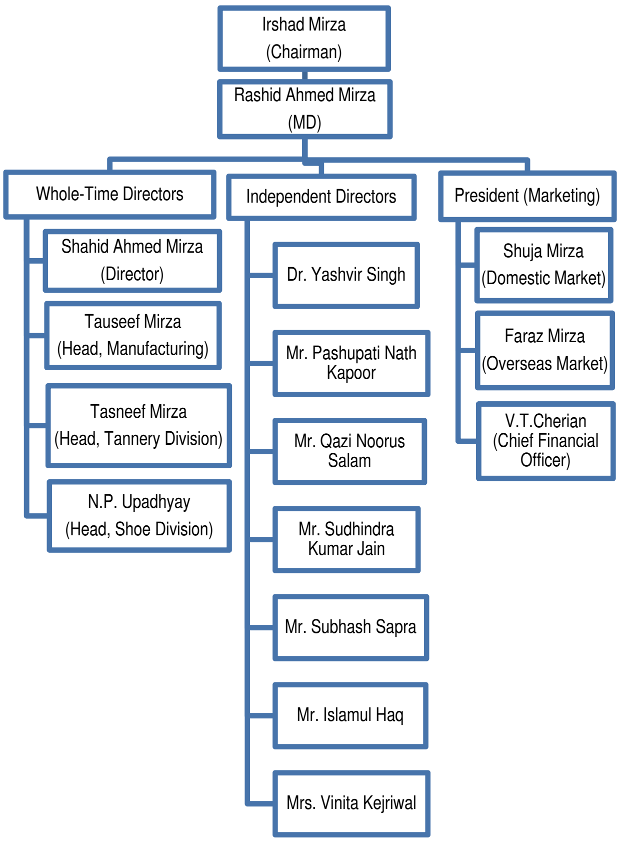
Mirza International has six fully-integrated shoe-production facilities, a tannery and design studios. Five production facilities are dedicated to men's shoes, one to women's. It has installed capacity of 6.4m pairs p.a. The units are in Unnao, Noida, Greater Noida and Kashipur

Mirza is a preferred supplier for leading global brands. It has established its own brands Red Tape and Oaktrak. Recently, it acquired the Yezdi brand (the Genesis merger). The Red Tape brand compasses men's and women's footwear, shirts, jackets, denims, tees, pants/shorts and accessories. Oaktrak is for executives and its primary market is the UK.

The management team is passionate about shoe manufacturing and brand creation; Mirza has a successor management team in place

The company has operations in 25 countries, its main markets being the UK, the USA, Germany and France.

Fig 55 – Organisation structure



Source: Company, Anand Rathi Research

Annexure

Annual report analysis

Non-funded employee benefits. Provision for gratuity and other employee benefits (₹86m) have not been funded according to the FY15 audit report. Additional outflows will be seen when the liability arises.

Loans and advances. The IDLS subsidy receivable at 31st Mar'15 was ₹20m. The government sanctioned this subsidy to modernise the tannery but it has yet to be received, the management says.

Internal controls and accounting systems. Mirza uses the J.D. Edward accounting system; its retail outlets are connected through 'Logic' ERP.

Insight from our market visit and channel checks. A typical Red Tape brand store with footwear, garments, accessories is around 400–1,200 sq.ft. Inventory is tracked through the 'Logic' ERP systems. To majority MBOs, inventory is sold outright. To EBOs and LFSs it is sold on a sale-or-return basis; hence, inventory is Mirza's liability.

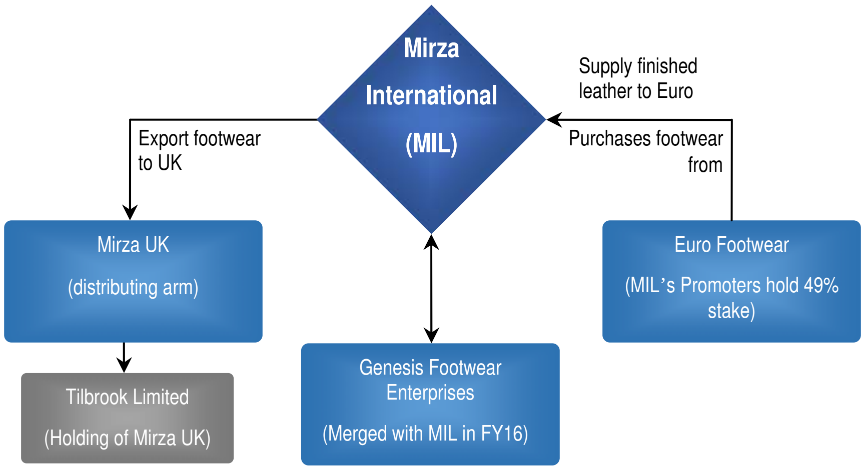
Below are related party transactions, apart from others covered in report

Fig 56 – Related-party transactions

(₹m)	FY11	FY12	FY13	FY14	FY15
Guarantee commission	6	34	32	32	79
Salary and managerial remuneration	41	53	63	62	63
Rent & maintenance charges	1	2	2	2	2

Source: Company, Anand Rathi Research

Fig 57 – Related-party company structure



Source: Company, Anand Rathi Research

Companies where the promoter has a stake

As discussed earlier, the UK sales are chiefly through Mirza (UK), a wholly-owned subsidiary of Tilbrook Enterprises, which enjoys a ~2-3% PAT margin (consolidated). Tilbrook's abridged financials follow.

Fig 58 – Abridged financials of Tilbrook

£m	FY12	FY13	FY14	FY15
Months	11	12	12	12
Sales	10	33	34	42
Gross profit	1	5	6	7
GP margin (%)	15.5	15.5	16.4	16.0
PAT	0	1	1	1
PAT margin (%)	1.1	2.1	1.6	2.9
Debt / equity (x)	1.1	0.6	0.4	0.5

Source: Company, Anand Rathi Research

Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)			
	Buy	**Hold**	**Sell**
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

Anand Rathi Share and Stock Brokers Ltd. (hereinafter refer as ARSSBL) (Research Entity) is a subsidiary of Anand Rathi Financial Services Ltd. ARSSBL is a corporate trading and clearing member of Bombay Stock Exchange Ltd, National Stock Exchange of India Ltd. (NSEIL), Multi Stock Exchange of India Ltd (MCX-SX), United Stock Exchange and also depository participant with National Securities Depository Ltd (NSDL) and Central Depository Services Ltd. ARSSBL is engaged in the business of Stock Broking, Depository Participant and Mutual Fund distributor.

The research analysts, strategists, or research associates principally responsible for the preparation of Anand Rathi research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

General Disclaimer: This Research Report (hereinafter called "Report") is meant solely for use by the recipient and is not for circulation. This Report does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. The recommendations, if any, made herein are expression of views and/or opinions and should not be deemed or construed to be neither advice for the purpose of purchase or sale of any security, derivatives or any other security through ARSSBL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security (ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by ARSSBL to be reliable. ARSSBL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of ARSSBL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report. The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. ARSSBL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment.

Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report. Research Report may differ between ARSSBL's RAs and/ or ARSSBL's associate companies on account of differences in research methodology, personal judgment and difference in time horizons for which recommendations are made. User should keep this risk in mind and not hold ARSSBL, its employees and associates responsible for any losses, damages of any type whatsoever.

ARSSBL and its associates or employees may; (a) from time to time, have long or short positions in, and buy or sell the investments in/ security of company (ies) mentioned herein or (b) be engaged in any other transaction involving such investments/ securities of company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) these and other activities of ARSSBL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall ARSSBL and its associates or employees or any third party involved in, or related to computing or compiling the information have any liability for any damages of any kind.

Details of Associates of ARSSBL and Brief History of Disciplinary action by regulatory authorities & its associates are available on our website i.e. www.rathionline.com

Disclaimers in respect of jurisdiction: This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject ARSSBL to any registration or licensing requirement within such jurisdiction(s). No action has been or will be taken by ARSSBL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. ARSSBL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to ARSSBL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

Statements on ownership and material conflicts of interest, compensation - ARSSBL and Associates

Answers to the Best of the knowledge and belief of ARSSBL/ its Associates/ Research Analyst who is preparing this report

ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have actual/beneficial ownership of one per cent or more securities of the subject company	No
ARSSBL/its Associates/ Research Analyst/ his Relative have any other material conflict of interest at the time of publication of the research report?	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have managed or co-managed public offering of securities for the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months	No
ARSSBL/its Associates/ Research Analyst/ his Relative have received any compensation or other benefits from the subject company or third party in connection with the research report	No
ARSSBL/its Associates/ Research Analyst/ his Relative have served as an officer, director or employee of the subject company.	No

Other Disclosures pertaining to distribution of research in the United States of America

This report was prepared, approved, published and distributed by the Anand Rathi Share and Stock Brokers Limited (ARSSBL) located outside of the United States (a "non-US Group Company"). This report is distributed in the U.S. by Enclave Capital LLC, a U.S. registered broker dealer, on behalf of ARSSBL only to major U.S. institutional investors (as defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities described in this report must be effected through Enclave Capital. ARSSBL accepts responsibility for its contents. Any US customer wishing to effect transactions in any securities referred to herein or options thereon should do so only by contacting a representative of Enclave Capital LLC at 646-454-8600

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Regulatory Authority, Inc. ("FINRA") or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

This material was produced by ARSSBL, solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by Enclave Capital LLC (19 West 44th Street, Suite 1700, New York, NY 10036) and elsewhere in the world by ARSSBL or an authorized affiliate of ARSSBL (such entities and any other entity, directly or indirectly, controlled by ARSSBL, the "Affiliates"). This document does not constitute an offer of, or an invitation by or on behalf of ARSSBL or its Affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which ARSSBL or its Affiliates consider to be reliable. None of ARSSBL or its Affiliates accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information. All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

1. ARSSBL or its Affiliates may or may not have been beneficial owners of the securities mentioned in this report.

2. ARSSBL or its affiliates may have or not managed or co-managed a public offering of the securities mentioned in the report in the past 12 months.

3. ARSSBL or its affiliates may have or not received compensation for investment banking services from the issuer of these securities in the past 12 months and do not expect to receive compensation for investment banking services from the issuer of these securities within the next three months.

4. However, one or more of ARSSBL or its Affiliates may, from time to time, have a long or short position in any of the securities mentioned herein and may buy or sell those securities or options thereon, either on their own account or on behalf of their clients.

5. As of the publication of this report, ARSSBL does not make a market in the subject securities.

6. ARSSBL or its Affiliates may or may not, to the extent permitted by law, act upon or use the above material or the conclusions stated above, or the research or analysis on which they are based before the material is published to recipients and from time to time, provide investment banking, investment management or other services for or solicit to seek to obtain investment banking, or other securities business from, any entity referred to in this report.

Enclave Capital LLC is distributing this document in the United States of America. ARSSBL accepts responsibility for its contents. Any US customer wishing to effect transactions in any securities referred to herein or options thereon should do so only by contacting a representative of Enclave Capital LLC.

Additional information on recommended securities/instruments is available on request.

ARSSBL registered address: 4th Floor, Silver Metropolis, Jaicoach Compound, Opposite Bimbisar Nagar, Goregaon (East), Mumbai - 400 063.
Tel No: +91 22 4001 3700 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.