ANANDRATHI

India I Equities

Retail

Initiating Coverage

16 March 2021

Lux Industries

Branded play, merger to augment potential; initiating, with a Buy

Rating: **Buy**
Target Price: Rs.2,574
Share Price: Rs.1,710

With its healthy growth trajectory, we are upbeat on Lux's long-term growth prospects for its strong brand equity, long-standing operations in innerwear and new launches. Its extension to casual wear and women's wear via the proposed merger would unlock synergies that would further propel growth. We initiate coverage on Lux Industries with a Buy rating and a TP of Rs2,574, based on 30x FY23e EPS of Rs85.80.

Investment in creating strong brands. Through its 16 home-grown brands (incl. GenX and Lyra), Lux has created strong brands in economy and mid-premium innerwear. It has launched several products and sub-brands through the years and effectively marketed them. It spends 7-8% of its revenues on brand-building. Consistent efforts in branding and marketing have helped create strong brand equity, leading to customer stickiness.

Increasing focus on premiumisation. Levering its expertise and superior product knowhow and intending to upgrade customers to premium products, it started focusing on increasing the proportion of premium products and launching higher ASP brands and products. Efforts toward growing the premium range led to its economy-range contribution shrinking to ~35% in FY20 (~39% in FY15). Over that period, the mid-premium share in revenue grew from ~42% to ~48%, while the premium share has been ~18%.

Unlocking merger synergies. In 2018, Lux approved the merger of group companies—J.M. Hosiery (GenX brand) and Ebell Fashions (Lyra). The integration (expected to be complete by CY21) would add newer categories to Lux's product range, further raising its growth potential. The proposed merger is expected to be EPS accretive.

Financials. We expect ~10%/5% revenue/EBITDA CAGRs over FY21-23, with, by FY23, an 18.3% EBITDA margin and 26.5%/25.5% RoE/RoCE.

Valuation. We initiate coverage on Lux Industries with a Buy rating and a TP of Rs2,574, based on 30x FY23e EPS. **Risks:** Slower growth of its premium range, keen competition and rise in raw material prices.

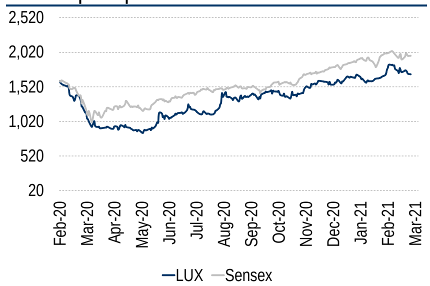
Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rsm)	12,070	12,061	13,589	14,768	16,440
Net profit (Rsm)	988	1,225	1,967	1,825	2,167
EPS (Rs)	39.1	48.5	77.9	72.3	85.8
PE (x)	35.2	19.3	21.9	23.7	19.9
EVEBITDA (x)	20.5	13.4	15.8	16.9	14.0
PBV (x)	8.4	4.8	6.9	5.8	4.9
RoE (%)	27.1	27.0	34.9	26.4	26.5
RoCE (%)	17.5	21.1	29.5	24.7	25.5
Dividend yield (%)	0.3	1.3	1.1	1.3	1.5
Net debt/equity (x)	0.4	0.3	-0.0	-0.1	-0.1

Source: Company, Anand Rathi Research

Key data	LUX IN / LUXI.BO
52-week high / low	Rs1900 / 813
Sensex / Nifty	50364 / 14910
3-m average volume	$1.2m
Market cap	Rs43bn / $595.2m
Shares outstanding	25m

Shareholding pattern (%)	Dec'20	Sep'20	Jun'20
Promoters	69.5	69.5	69.5
- of which, Pledged	-	-	-
Free Float	30.5	30.5	30.5
- Foreign Institutions	3.4	3.6	4.0
- Domestic Institutions	4.5	4.5	4.2
- Public	22.6	22.4	22.3

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues	12,070	12,061	13,589	14,768	16,440
Growth (%)	*12.0*	*-0.1*	*12.7*	*8.7*	*11.3*
Direct costs	5,753	5,268	6,183	6,719	7,480
SG&A	4,538	4,931	4,698	5,528	5,956
EBITDA	1,779	1,862	2,709	2,520	3,004
EBITDA margins (%)	*14.7*	*15.4*	*19.9*	*17.1*	*18.3*
Depreciation	112	127	134	152	188
Other income	90	38	68	74	82
Interest expenses	236	138	41	9	9
PBT	1,521	1,634	2,602	2,433	2,889
Effective tax rates (%)	*35.1*	*25.1*	*24.4*	*25.0*	*25.0*
+ Associates / (Minorities)	-	-	-	-	-
Net income	988	1,225	1,967	1,825	2,167
Adjusted income	988	1,225	1,967	1,825	2,167
WANS	25	25	25	25	25
FDEPS (Rs / sh)	39.1	48.5	77.9	72.3	85.8
FDEPS growth (%)	*26.8*	*24.0*	*60.7*	*(7.3)*	*18.7*
Gross margins %	*52.3*	*56.3*	*54.5*	*54.5*	*54.5*

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	53	53	53	53	53
Net worth	4,115	4,927	6,303	7,469	8,853
Total debt	1,777	1,424	452	102	102
Minority interest	-	-	-	-	-
DTL / (Assets)	76	178	178	178	178
Capital employed	5,968	6,529	6,932	7,748	9,132
Net tangible assets	1,319	1,408	1,485	1,582	1,894
Net intangible assets	4	2	2	2	2
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	4	8	8	8	8
Investments (strategic)	-	-	-	-	-
Investments (financial)	45	44	44	44	44
Current assets (ex cash)	6,623	7,002	6,874	7,713	8,496
Cash	20	14	685	752	1,308
Current liabilities	2,049	1,950	2,165	2,353	2,619
Working capital	4,575	5,053	4,709	5,360	5,877
Capital deployed	5,968	6,529	6,932	7,748	9,132
Contingent liabilities	-	-	-	-	-

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	1,754	1,765	2,642	2,442	2,898
+ Non-cash items	80	149	134	152	188
Oper. prof. before WC	1,834	1,914	2,777	2,594	3,086
- Incr. / (decr.) in WC	-533	492	-372	651	517
Others incl. taxes	469	461	634	608	722
Operating cash-flow	1,899	961	2,514	1,335	1,847
- Capex (tang. + intang.)	124	71	211	250	500
Free cash-flow	1,775	890	2,304	1,085	1,347
Acquisitions					
- Div. (incl. buyback & taxes)	61	411	592	659	782
+ Equity raised	-	-	-	-	-
+ Debt raised	-1,482	-357	-1,000	-350	-
- Fin investments	0	-8	-	-	-
- Misc. (CFI + CFF)	235	136	41	9	9
Net cash-flow	-3	-6	671	67	556

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

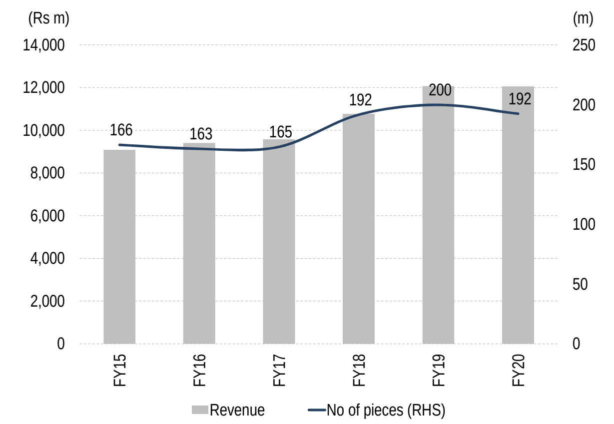
Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	35.2	19.3	21.9	23.7	19.9
EV / EBITDA (x)	20.5	13.4	15.8	16.9	14.0
EV / Sales (x)	3.0	2.1	3.2	2.9	2.6
P/B (x)	8.4	4.8	6.9	5.8	4.9
RoE (%)	27.1	27.0	34.9	26.4	26.5
RoCE (%) - after tax	17.5	21.1	29.5	24.7	25.5
RoIC (%)	13.0	15.8	23.1	20.0	21.3
DPS (Rs / sh)	3.5	12.5	19.5	21.7	25.7
Dividend yield (%)	0.3	1.3	1.1	1.3	1.5
Dividend payout (%) - incl. DDT	8.9	25.8	25.0	30.0	30.0
Net debt / equity (x)	0.4	0.3	-0.0	-0.1	-0.1
Receivables (days)	111	94	75	83	82
Inventory (days)	77	100	92	90	89
Payables (days)	49	45	45	45	45
CFO : PAT %	192.2	78.5	127.8	73.2	85.3

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – 6%/3% revenue / volume CAGRs over FY15-20



Source: Company

Established innerwear manufacturer

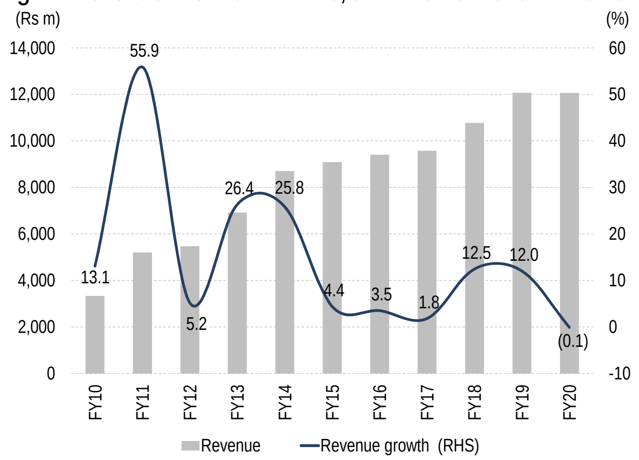
~14% market share in organized men's innerwear market

Initially, in 1957, established as Biswanath Hosiery Mills by the late Girdharilalji Todi, the name was changed in 1995. Lux Industries came out with an IPO in 2003. The Lux Group (Lux Industries, J.M. Hosiery, Ebell Fashions) is the largest mid-segment hosiery company in the country. It enjoys a ~14% market share in the organized men's innerwear market, primarily catering to economy and mid-premium segments. Its focus on branding and advertising has built a small hosiery company into an innerwear giant. Over time, with the launch of products in different segments, it has transformed itself from merely men's innerwear to a lifestyle brand.

Improving profitability and cash generation

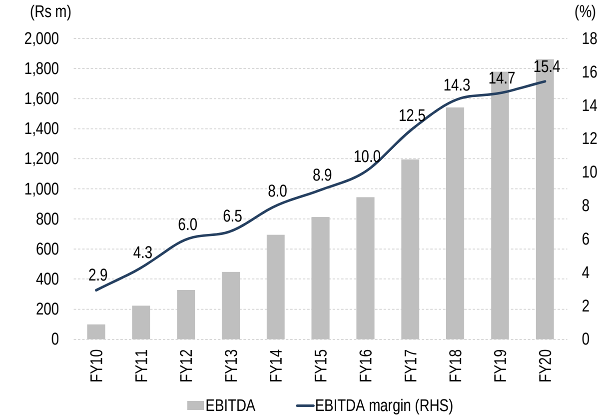
Powered by its wide product range, innovative launches and relentless brand investments, Lux achieved a 14% revenue CAGR over FY10-20. The CAGR would have been better if not for the Covid-19 impact in Q4 FY20 (sliding 25.3% y/y) as 9M FY20 revenue grew 11% y/y. Its brand investments have helped the share of its mid-premium/premium products to increase, leading to higher average realisation and profitability. Also, the EBITDA has clocked an impressive 10-year ~34% CAGR, with the EBITDA margin expanding 1,251bps to 15.4% in FY20. The margin expansion was aided by the 1,476bp gross-margin expansion (incl. sub-contracting expenses), manufacturing and cost efficiencies. The controlled working capital (steady, averaging ~140-150 days) and greater profitability have led to positive operating cash-flows in four of the last five years.
Ahead, as it continues to launch innovative products, increase its share of mid-and premium products, and build its brand, we believe its revenue and profit trajectories would continue.

Fig 7 – Revenue: Rs12bn in FY20, a 14% CAGR over FY10-20



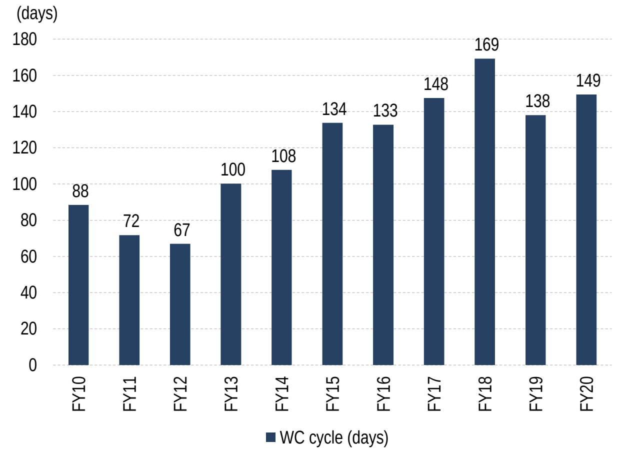
Source: Company, Anand Rathi Research

Fig 8 – EBITDA, a 34% CAGR, margin expanded 1,251bps over FY10-20



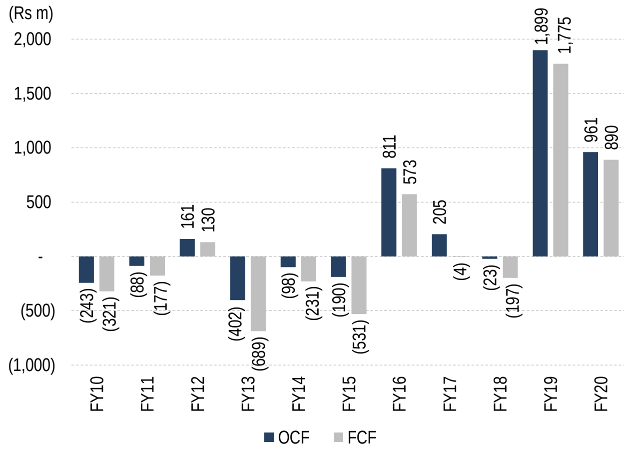
Source: Company, Anand Rathi Research

Fig 9 – Steady working-capital cycle (on sales)



Source: Company, Anand Rathi Research

Fig 10 – Improving cash-flow generation



Source: Company, Anand Rathi Research

Branded presence in mass and mid-premium categories

Over time, the company has developed its home-grown brands and launched branded products in the economic, mid and premium innerwear and apparel sub-segments. It has broadened its product range to cater to different ages, regions and seasons. Through its 16 home-grown brands (incl. GenX and Lyra), it has created a strong position in economy and mid-premium innerwear.

Its value proposition and steady expansion have been key growth drivers. However, Lux has been stepping up its margin betterment by increasing its operations in the mid-premium and premium segments.

Lux Cozi and Venus are parent brands. Most of the sub-brands were created 15-16 years prior. Lux Cott's Wool and Lux Inferno were created for winterwear, Lux Big Shot for underwear, etc. The company is working on consolidating its sub-brands under the mother brands. This would reduce the number of brands and provide synergies in advertising. This, however, will be a 5- to 10-year process.

Fig 11 – Snapshot of Lux's brands, sub-brands

Source: Company Note: Lyra and GenX are part of group companies

Consistently launching innovative products

Lux has more than 100 products for men, women and kids across ages, regions and seasons. Under its brands and sub-brands, it has over 5,000 SKUs to address the needs of its growing customers. Its power brands (Lux Venus, Cozi, Inferno, Cott's Wool, ONN, Lyra and GenX) enjoy high brand recall for comfort, innovation and a superior price-value proposition. Its power brands are those with a turnover of at least Rs1bn.

The products cover categories ranging from economy (Venus, Cott's Wool), mid-premium (Cozi, Inferno) to premium (One8, ONN). Prices range from Rs38 to Rs1,350 per stock-keeping unit (SKU).

Fig 12 – Lux's brands and product range

Year of launch	Brand	Products
1993	Lux Venus	Vests and briefs
1995	Lux Classic	Vests and briefs
1997	Lux Karishma	Panties, camisoles and leggies
1998	Lux Touch	Panties, camisoles and leggies
2000	Gen X	Designer vests and casual inners
2001	Lux Cozi	Innerwear
2003	Lux Cozi Big Shot	Premium trunks
2005	Lux Cott's Wool	Thermals and outerwear
2007	Lux Inferno	Quilted thermals
2009	Lux Mozze	Premium socks
2010	ONN	Premium wear
2012	Lyra	Leggings, lingerie, pallazos, knit pants, night pyjamas, track pants and t-shirts
2016	Lux CoziGlo	Vests, briefs and drawers
2017	Lux Cozi Her	Panties, slips, racer backs and boy legs
2018	Re-launched Lux Classic as Lux Venus Classic	Vests and briefs
2019	One8	Innerwear
2019	Lux Nitro	Casualwear product line

Source: Company

The company has launched several products and sub-brands through the years, and effectively marketed them. Apart from innovative launches, it has strongly endorsed its existing products. It launched neon and bright coloured innerwear under Lux Glo, a sub-brand of Lux Cozi, to address a new sub-segment targeting a younger clientele. In FY20, it improved its winter offerings, leading to the latter's 25% growth. The launch of ONN outerwear in recent years has obtained good results. In FY19, it launched a scented vest, the first time in India. It addressed the need for a pre-scented vest, which was introduced through a sizeable promotional outlay.

Through Lyra, it has small operations in women's lingerie. It plans to penetrate deeper into women's innerwear and is concentrating on the mid-priced sub-segment. Also, it plans to get into kids' wear.

Relentless brand investments

Brand investment by organized innerwear manufacturers has been significant (averaging 8-10% of revenues) in order to raise brand visibility to help gain market share from the unorganized sector. Over the years, Lux has pulled in several celebrities to endorse its brands.

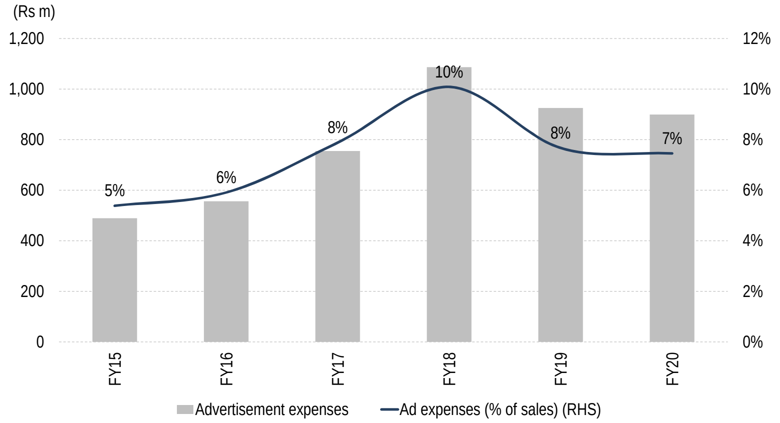
Fig 13 – Celebrities endorsing its various brands

Year of Launch	Brand	Products
2000	Lux Cozi	Sunny Deol
2010	ONN	Shah Rukh Khan
2017	Lux Cozi brand	Varun Dhawan
2017	Lux Venus, Lux Inferno	Amitabh Bachchan
2019	Lux Inferno	Kartik Aaryan
2019	Lyra	Taapsee Pannu

Source: Company

Lux has consistently invested in its brands. It spends 7-8% of its revenues on brand building through celebrity endorsements, extensive publicity and quality-enhancing programmes. This has helped drive a strong brand recall. Its cumulative brand investments from FY11 to FY15 were Rs2bn, more than doubling over FY16-20 to Rs4.2bn – in line with its revenue growth. Given the Covid-19 pandemic and planned cost reductions, management decided to cut FY21 advertising expenditure, expected at 4-5% of revenue (vs. 7-8% in the past). However, given its emphasis on branding, these expenses will return to past levels from FY22.

Fig 14 – Lux's ad-expenses to sales: averaged ~7% in the past

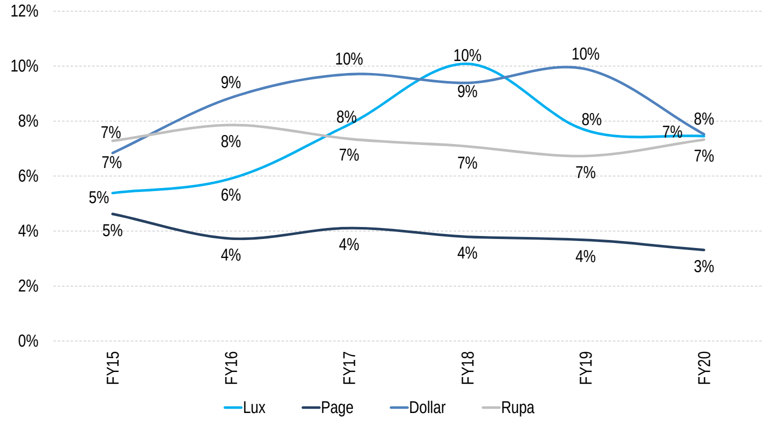


Source: Company

The company also works on promotional schemes to boost growth. After the slowdown due to the GST, it launched consumer promotions such as 'Buy any two Lux products and get a pair of socks FREE' to provide an impetus to growth, which was very successful.

All the initiatives toward branding have helped create strong brand equity leading to customer stickiness. This enables it to pass on raw-material price rises and benefits to consumers without curtailing its margins.

Fig 15 – Lux's brand investments, in line with peers



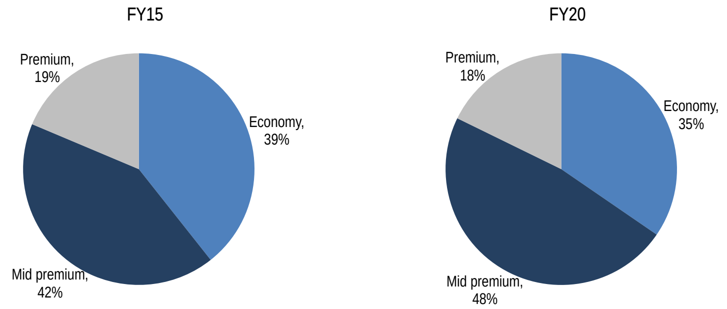
Source: Company

Enhancing operations in premium innerwear

Most Indian innerwear brands largely cater to the mid-to-economy sub-segments. For decades, Lux had focused on the mid and economy price categories. Its average realisation was Rs54 a piece in FY15. Its branded operations in the mid-premium category, bridging the gap between the premium and mass ones, resulted in the mid-premium sub-segment growing fastest for it, at a 9% CAGR over FY15-20. The premium and economy categories grew 5% and 4% respectively, leading to the average realisation rising to Rs66 a piece in FY20.

Apart from the increasing share of premium and mid premium products, up-trading has been seen within segments, reflected in improving average realisations across the three sub-segments. The average realisation for the economy segment has risen from Rs45 a piece in FY15 to Rs50 in FY20; similarly, mid-premium realisations grew to Rs79 a piece vs. Rs58. The premium segment (ONN+exports) realisation was Rs80 a piece in FY15 vs. Rs72 in FY20. ONN realisation was a higher Rs138 a piece in FY20 vs Rs90 in FY15.

Fig 16 – Revenue mix shifting toward mid-premium, premium



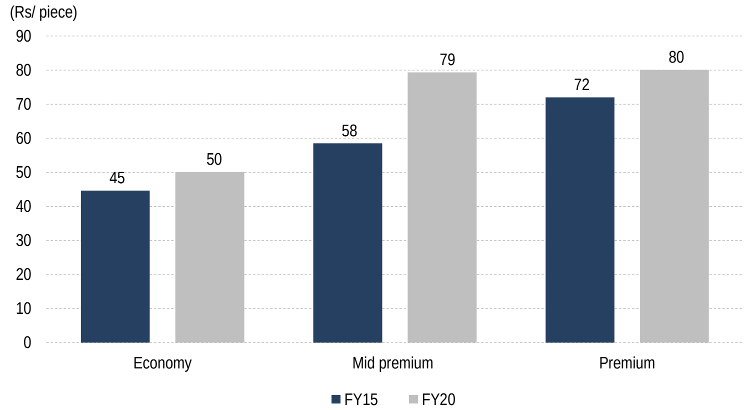
Source: Company, Anand Rathi Research

Fig 17 – Mid-premium, premium segments - better margin profile

Segment	Revenue contribution % (FY20)	Five-year CAGR %	Two-year CAGR %	EBITDA margin profile %	Avg realisation (Rs / piece) (FY20)
Economy					
Lux Venus	28	3	-3	8-10	43
Cott's wool	6	9	22	8-10	191
Mid premium					
Lux Cozi	37	8	-3	13-15	67
Inferno	10	17	45	13-15	231
Premium					
ONN	7	10	10	15-18	138
Exports	11	3	12	15-18	63

Source: Company, Anand Rathi Research

Fig 18 – Realisation rising across segments



Source: Company, Anand Rathi Research

Levering its expertise and superior product knowhow and intending to upgrade customers to premium products, the company started focusing on increasing the proportion of premium products and launching higher ASP brands. Launched in 2010, ONN is its premium innerwear brand. In FY17, under this brand it extended its offerings with the launch of outerwear (in active wear and sportswear). In FY20, it further extended its product range with ONN T-shirts, and launched a promotional campaign. The brand has registered a 10% CAGR over FY15-20.

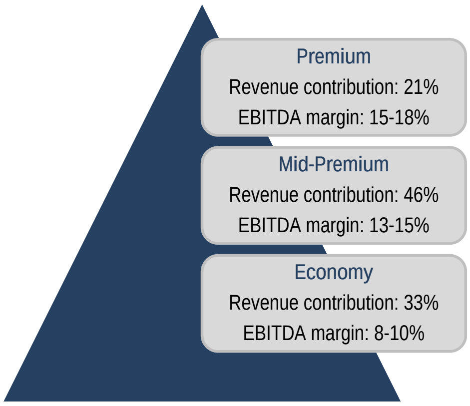
Further, along its premiumization journey, in FY19 it acquired the manufacturing and marketing rights of Virat Kohli's brand One8, thus increasing its share of the men's premium innerwear sub-segment. Artimas Fashions Pvt. Ltd was created as a subsidiary to develop independent, and build dedicated, manufacturing capacities to manufacture all the products sold by the One8 brand. The company worked on a differentiated strategy for One8. In the past, new products were marketed through its existing distribution network. For One8, however, a new distribution channel was created. The product was first online, and then marketed through a select distribution network without much promotional and advertising support. The increasing proportion of repeat orders from trade partners led to growth in offtake. The brand clocked Rs60m revenue in FY20 with 0.2m pieces sold.

Efforts toward growing the premium portfolio led to Lux's economy range contribution shrinking to 35% in FY20 (from 39% in FY15). Over the same period, the share of revenue of its mid-premium range grew from 42% to 48% while that of the premium range held steady at ~18%.

The proportion of revenue from its premium brands, at ~18%, is more than its peers (Dollar: in single digits, Rupa: ~11%). The average realisation grew to Rs66 a piece in FY20 (Rs54 in FY15). Comparatively, in FY20 Dollar's average realisation was ~Rs62; Page's was Rs175.

The rising shares of its mid-premium and premium categories have given a fillip to the company level EBITDA margin, which expanded a significant 650bps from FY15 to FY20. The economy category's EBITDA margin is 8-10%. The fast-growing mid-premium category has a 13-15% margin and the premium range enjoys 15-18% margins. The company will continue to work on increasing the percentage of revenue of the premium category in the overall mix, thus providing further possibilities of margin expansion

Fig 19 – Premium range enjoys higher EBITDA margins of 15-18%



Source: Company Q3 FY21 presentation

Fig 20 – Peer price comparison (MRP) Rs

Product	Lux	Dollar	Rupa	Page
Men				
Innerwear				
Briefs	86-260	70-300	110-360	150-550
Trunks	109-245	60-300	139-410	199-599
Vests	79-319	50-250	76-202	209-319
Outwear bottom				
Boxer shorts	375-575	300-450	120-200	399-470
Thermal				
Long-sleeves T-shirts	220-500	200-700	337-480	599-899
Long pants	243-825	100-700	337-520	599-650
Women				
Camisoles	~198	70-200	115-300	269-399
Leggings	279-700	400-450	NA	899-1499

Source: Page, Rupa – Website, Lux, Dollar - Company

In-house manufacturing capabilities; labour intensive process outsourced

To control quality, Lux focuses on in-house manufacturing. All its high-end work is carried out in-house. It has cumulative capacity of 200m garment pieces a year across its six manufacturing plants, located in Dankuni, Srijan Industrial Logistics Park, Dhulagarh and BT Road (West Bengal), Tirupur (Tamil Nadu) and Ludhiana (Punjab). It purchases its raw material (ie, yarn) and further processes it. Raw-material prices fluctuate often and the mills from which yarn is procured are run exclusively under Lux supervision, thereby, absorbing price fluctuations.

In the manufacturing process, knitting of yarn into fabric is done in-house. Fabric colour processing (which is capex driven) is outsourced. 80-90% of job-worker capacity is taken up by Lux, ensuring quality control. Cutting is then done in-house, where costing is controlled. Stitching for premium brands (ie, Lyra, ONN, exports) is done in-house (~10% of total stitching), the others are outsourced. Packing is entirely in-house.

Innerwear producers generally outsource some part of the labour-intensive work required in manufacturing. Rupa procures yarn and carries out dyeing, knitting (partly), designing and cutting in-house while outsourcing, through job work, stitching and knitting, which is labour intensive. Similarly, Dollar outsources some of the processing like dyeing and stitching through job work. Page has a strong manufacturing base with >70% in-house manufacturing, with the balance outsourced (outsourcing in outerwear is greater).

Fig 21 – Lux's manufacturing process flow

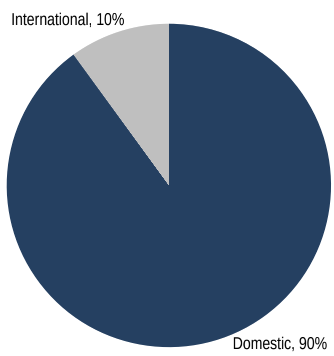
Process	Manufacturing
Yarn	Outsourced
Knitting	In-house
Processing (bleaching, dyeing, colouring)	Outsourced, but fully controlled
Cutting	In-house
Stitching	Outsourced, but fully controlled
Packaging	In-house

Source: Company

MBO-focused distribution network . . .

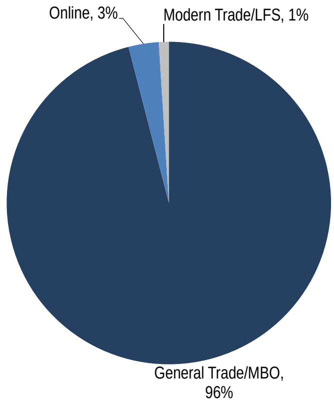
Lux's extensive distribution network is spread across the country, comprising more than 950 distributors and 500,000 retailers. It exports largely under its own brands (~95% of exports) to ~46 countries. Exports accounted for ~10% of revenue in FY20 (11% in FY19). In FY20, MBO/ general trade contributed ~96%, with the balance 3% and 1% from online and modern trade respectively.

Fig 22 – Domestic revenue contribution: 90%



Source: Company

Fig 23 – MBO / general trade contribution: 96% (FY20)



Source: Company

Peers such as Rupa and Dollar also largely follow a wholesale-driven model with most revenues arising from the MBO channel (>90% of revenue). Page has followed a two-pronged approach with significant EBO operations (more than 810 EBOs) bringing ~16% to revenue.

While there are no exclusive terms, Lux Industries enjoys exclusivity with most distributors (~90%) due to its good relations. Distributors who sell to wholesalers keep 3-7% margins, whereas distributors who sell direct to retailers enjoy a 7-8% margin. Distributors generally carry two months inventory on average. A few years ago, Lux would give cash discounts, ie, ~2% Then, it introduced a 120-day lock-in period, any delay beyond that would lead to restricted supplies. At present, it gives a 2% cash discount for 60 days and 1% for 90 days.

In the past couple of years Dollar's receivables cycle has been stretched. However, it is following a strict 60-day credit policy to improve its working capital cycle. Page follows a strict receivables-day cycle for its distributors. To avail of a cash discount, they have to pay the company within seven days. Without any cash discount/penalty, they can pay within 21 days.

… stepping up its EBO operations

Lux has had small operations in EBOs through its ONN brand. It recently began extending its network under 'Cozi World' EBOs, where all its products (manufactured by the Lux Group) would be sold. It aims at 75-80 EBOs by next year. The product mix would differ from city to city. The strategy is to build awareness regarding its entire product range as a fraction of products now make up most of the sales. Hence, products that are not so popular would be given more shelf space.

EBO operations help in brand acceleration, especially with awareness about a company's premium products, and helps build acceptance. In a bid to focus on premiumisation, Lux and Rupa have also started opening EBOs, and each target more than 100-150 EBOs in the next 1-2 years.

Fig 24 – Retail points of Lux's peers

	FY16	FY17	FY18	FY19	FY20
Lux					
EBOs			9	9	12
LFSs			160	160	160
Distributors		900	950	950	950+
Retailers	450,000	450,000	450,000	450,000	500,000
Dollar (retail reach)					
Retail reach	75,000	80,000	95,000	100,000	100,000+
Rupa					
Dealers	1,000	1,000	1,000	1,000	1,000
EBOs	6	6	10	10	7
Retail	118,000	118,000	125,000	125,000	125,000
Page					
EBOs	270	367	477	626	756
Retail reach	30,000	50,000	50,000	55,000	66,000

Source: Company

Unlocking synergies via mergers

J.M. Hosiery and Ebell Fashions to merge with Lux Inds.

In 2018, Lux approved the amalgamation of the group companies J.M. Hosiery and Ebell Fashions with Lux Industries. J.M. Hosiery owns the men's brand, GenX; Ebell Fashions owns the women's brand, Lyra.

Established in the 1980s as a manufacturing company only, despite being in a similar business as Lux Industries, J.M. Hosiery was set up as a separate entity for accounting purposes as was the practice then. As it was the group's first foray into womens' wear, Ebell was created in 2013 as a separate entity so as not to burden Lux Industries with the risk associated with a new category. Now, that both these have a strong hold in their categories, the Board approved their merger with Lux Industries.

Given that these companies operate in a similar line of business as Lux, the proposed merger is synergistic and expected to help in market-share gains. The consideration is in form of issue of shares and does not involve any cash transaction. The post-amalgamation business model will extend the company's products to include the value-added women's range and casual wear.

Our assessment indicates that the integration is expected to be completed in CY21, after receiving NCLT approval.

Scheme of merger benefits Lux's minority shareholders

- Ebell Fashions Pvt. Ltd.
  - 1,142 shares of Lux Industries will be issued for every 100 shares of Ebell.
- J. M. Hosiery & Company
  - 29 shares of Lux Industries will be issued against every 100 shares of J.M Hosiery.
- Based on the proposed merger, Lux Industries would issue 4.8m new equity shares as consideration for the amalgamation. This would result in ~16% equity dilution.

Lux's men's outerwear operations to increase via GenX ...

J.M. Hosiery (JMH) manufactures, markets, sells and distributes men's wear. In 2000, GenX was started as an innovatively designed, affordable innerwear brand to address the youth market. Operations were gradually extended, however, to gym wear in 2005 and casual wear in 2009. Further, in 2019, a wide range of pre-winter products was launched (sweatshirts, hoodies, jackets, track suits) at prices of Rs500 to Rs1,100. Despite being priced higher than competing products (Rs400-700), the off-take was good, given the product positioning and better quality. Ahead, the company plans to introduce five designs a year and invest more on marketing and advertising the brand.

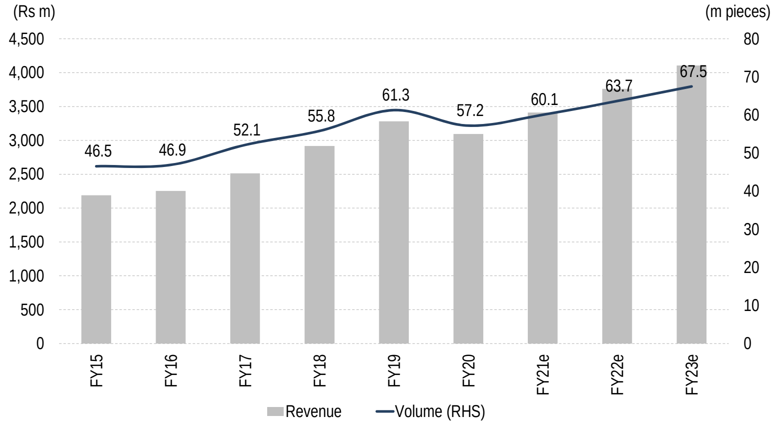
JMH revenue / EBITDA CAGRs, 7% / 11% over FY15-20

The company clocked a ~7% CAGR over FY15-20 led by 4% volume and 3% realisation CAGRs. The gross margin (cost of goods sold) expanded a significant 908bps over FY15-20 to 60.1%. The EBITDA margin expanded 136bps to 7.9%. Excl. the FY20 impact, however, the gross margins and EBITDA margins expanded 705bps and 433bps over FY15-FY19 to 51.8% and 10.9% respectively.

The company's borrowings in FY20 were Rs891m, ie, net debt-to-equity of 0.7x. The working-capital cycle (on sales) lengthened to 209 days in FY20 vs. 173 in FY15, partially due to lower sales in FY20. The average five-year working-capital cycle (FY15-19) was ~196 days.

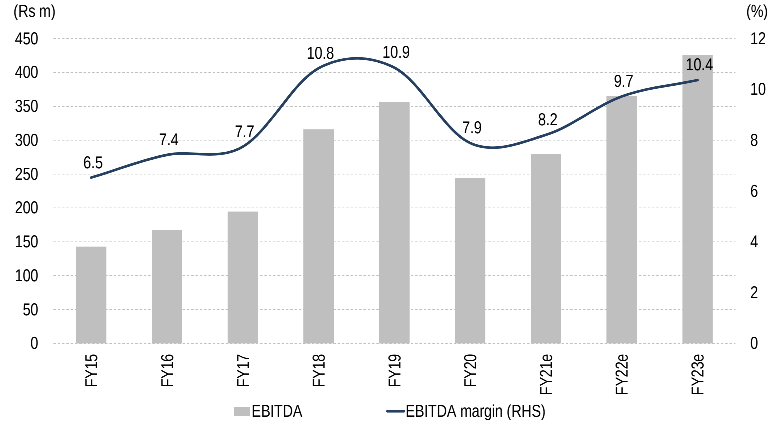
Ahead, we expect revenue to grow ~10% over FY21-23 driven by higher ASP launches with new designs supported by greater marketing efforts. We expect the margin to expand 216bps to 10.4%, driven by gross margin expansion and operating leverage.

Fig 25 – We expect JMH to clock a ~10% revenue CAGR over FY21-23



Source: Company, Anand Rathi Research

Fig 26 – We expect a 10.4% EBITDA margin for JMH in FY23



Source: Company, Anand Rathi Research

… and women's wear operations to increase through Lyra

After starting out as a leggings brand in 2012, Lyra has grown into a women's lifestyle brand, with various products for women and kids such as loungers, palazzos, track pants and T-shirts, along with lingerie. The recent launches include the pocket-leggings range. Leggings is its mainstay product and brings in most of its revenue (~90%). Lyra operates in the mid to premium sub-segments with prices ranging from Rs279 to Rs700 a piece (leggings).

The endorsements (brand ambassadors such as Parineeti Chopra and, more recently, Taapsee Pannu) and better product characteristics have helped transform the brand from a functional leggings product to a lifestyle one.

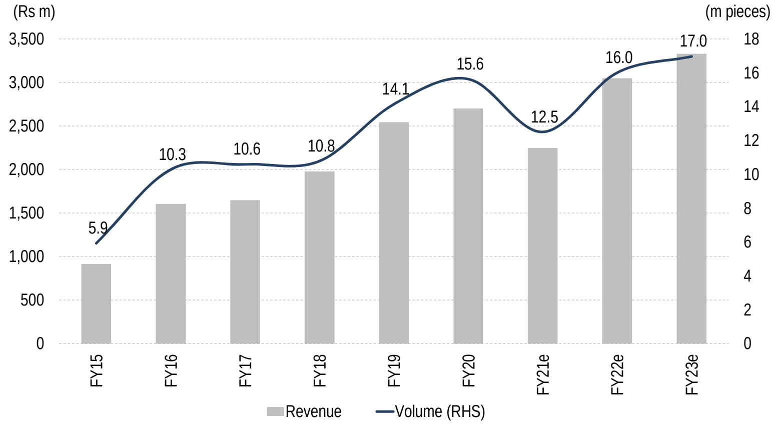
Ebell Fashions revenue/EBITDA CAGRs over FY15-20: 24%/83%

The brand registered a 24% CAGR over FY15-FY20, driven by robust 21% volume and 2% realisation CAGRs. The products have seen strong off-take, driven by endorsements and superior characteristics. The gross margin was 67.9% (41.8% in FY15), driving the EBITDA margin to 21.4% in FY20, vs. 3.1% in FY15.

Ebell Fashions is largely debt-free. The company has a more controlled working-capital cycle of 87 days (FY20).

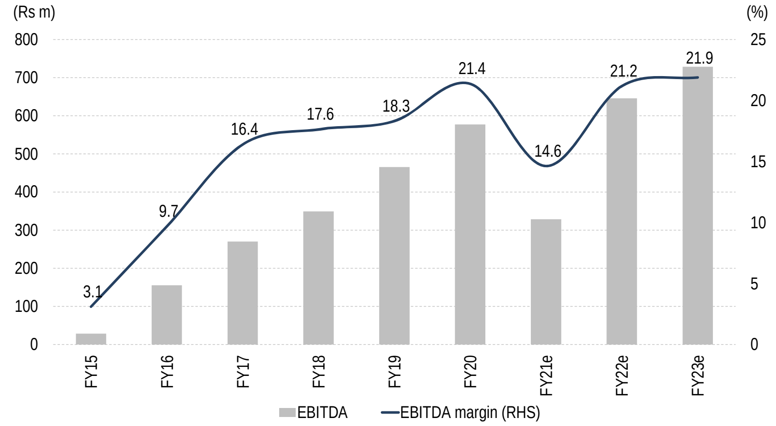
In CY20, Lyra was struck by the pandemic as women's wear (especially leggings) was more strongly hit than men's wear. We expect revenue to grow 22% over FY21-FY23 and margins to expand 726bps to 21.9%. Leggings contribute a significant 90% to revenue and the company aims to gradually increase the share of higher-margin athleisure and lingerie in the revenue pie, thus reducing the contribution of leggings.

Fig 27– We expect Ebell to clock a 22% revenue CAGR over FY21-23



Source: Company, Anand Rathi Research

Fig28 – We expect a 21.9% EBITDA margin for Ebell's in FY23



Source: Company, Anand Rathi Research

Hence, merger to widen Lux's products, boost earnings

With the two companies being profitable and the entitlement ratio being in favour of Lux's minority shareholders, the amalgamation is expected to be EPS accretive. The proposed amalgamation is expected to have synergies, given that the companies operate in similar business lines. The integration will fill gaps in Lux's range through newer categories such as women's wear (lingerie, outerwear) and men's premium outerwear, further bolstering the growth potential ahead. After the proposed merger, the combined entity will have a broader product range with a higher proportion of value-added products. The amalgamation will also lead to a singular brand image being formed, resulting in greater efficiency from marketing expenditure.

At the group level, the company was net cash at end-Dec’20, aided by the release of cash from working capital and greater profitability. J.M., at 209 days, has a slightly longer working-capital cycle than Lux’s 149 days. Lyra, at 87 days, has a more controlled cycle, leading to a similar to Lux’s working-capital cycle for the proposed amalgamated entity.

Lux’s shares outstanding will increase to 30.1m (on adding 4.8m shares) and the post-merger FY20 consolidated EPS would be Rs58.9, 21% higher than Lux’s standalone EPS, based on fewer shares outstanding.

Factoring in the proposed merger, we expect revenue to register an 11% CAGR over FY21-FY23 and the EBITDA margin to expand 18bps to 17.4%. We expect the post-merger EPS to be Rs99.4 vs. Rs85.8 (pre merger) for FY23, thereby raising the potential.

Fig 29 – We expect post-merger EPS of Rs99.4 in FY23 (merged entity financials)

	FY15	FY16	FY17	FY18	FY19	FY20	FY21e	FY22e	FY23e
Revenue (Rs m)	12,193	13,266	13,741	15,670	17,896	17,855	19,247	21,576	23,873
EBITDA (Rs m)	984	1,267	1,661	2,207	2,601	2,683	3,317	3,532	4,158
EBITDA margins (%)	8.1	9.6	12.1	14.1	14.5	15.0	17.2	16.4	17.4
PAT (Rs m)	533	676	850	1,154	1,495	1,773	2,394	2,548	2,993
PAT margins (%)	4.4	5.1	6.2	7.4	8.4	9.9	12.4	11.8	12.5
P/E (x)	97	76	61	45	34	29	22	20	17
EV / EBITDA (x)	56	44	33	25	21	20	16	14	12
EV / Sales (x)	4	4	4	4	3	3	3	2	2
P/B (x)	20	19	15	11	9	7	6	5	4
RoE (%)	21	26	27	28	28	26	29	25	25
RoCE (%) - after tax	11	12	13	16	18	20	23	23	21
RoIC (%)	9	10	11	12	14	15	19	19	20
Net debt / equity (x)	1	1	1	1	0	0	0	(0)	(0)
Receivables (days)	101	99	113	131	111	93	82	85	82
Inventory (days)	89	85	94	103	82	102	98	92	89
Payables (days)	55	48	54	65	56	45	50	48	46

Source: Anand Rathi Research

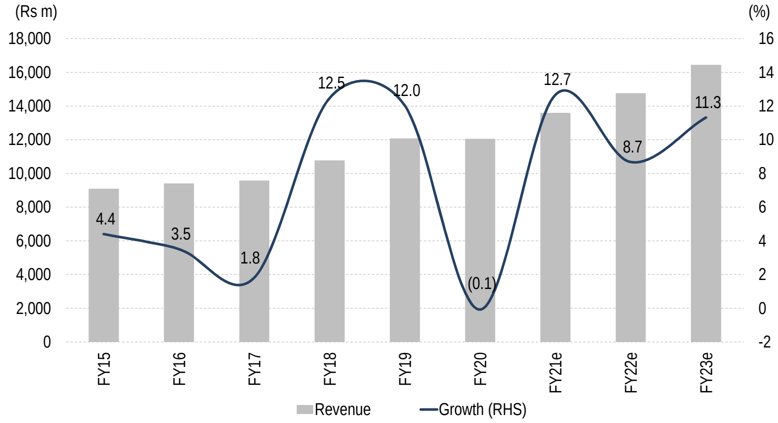
Financials

~10% revenue CAGR over FY21-23

We model a ~10% revenue CAGR over FY21-23 and expect Lux Industries' pre-merger revenue to reach Rs16.4bn by end-FY23. We expect overall volume and realisation CAGRs over FY21-23 of respectively ~8% and ~3%, driven by the wide product range, innovative launches and relentless brand investments. We expect 11%, 19% and 8% revenue CAGRs over FY21-23 in the mid-premium, premium (excl. exports) and economy segments respectively.

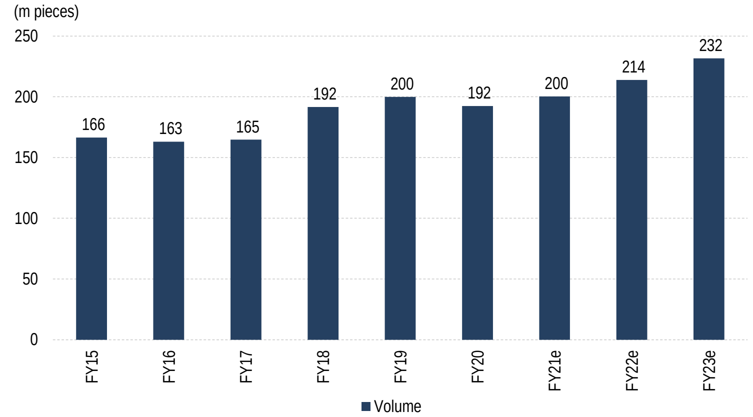
Lux has achieved a 6% revenue CAGR over FY15-20 with volume and realisation CAGRs of respectively 2% and 4%. The CAGR would have been better if not for the Covid-19 impact in Q4 FY20 (as revenue grew 12% y/y in 9M FY20. For 9M FY21 revenue grew 11% despite the lockdown in H1 FY21. The mid-premium category has grown the fastest, a 9% CAGR over FY15-20, with the premium and economy categories growing 5% and 4% respectively.

Fig 30 – We expect a 10% revenue CAGR over FY21-FY23



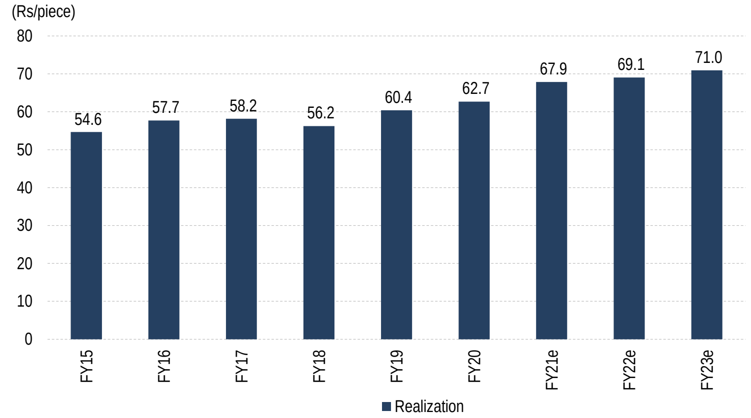
Source Company, Anand Rathi Research

Fig 31 – We expect an ~8% volume CAGR over FY21-FY23



Source: Company, AnandRathi Research

Fig 32 – We expect a ~3% realisation CAGR over FY21-FY23



Source: Company, Anand Rathi Research

Impact of Covid-19; FY21, an aberration

Q4 FY20 sales were down ~25% y/y as the bulk of sales (in Mar) were severely curbed and spilled over to Q1 FY21.

Lux then saw strong traction in all its categories and reported 11% growth for 9M FY21. The Covid-19 pandemic hurt unorganized manufacturers, who had already been faced with a cash crunch due to the GST and de-monetization. The lack of brand pull and supply-side constraints struck many small-time players, allowing Lux to gain some market share, especially in tier-2 and -3 markets. Due to curtailed expenses and greater revenue, we expect the EBITDA margin to expand ~450bps y/y to 19.9% in FY21. Operating leverage and lower expenses led to a 375bp y/y expansion in the EBITDA margin to 19% for 9M FY21.

FY21 advertising expenditure was reduced to 4-5% of sales (7-8% in the past). Ahead, though, the company will continue investing in brands in line with previous levels.

Hence, FY21 saw significant growth in its revenue and profitability. We expect them to continue their robust trajectory ahead. However FY21, being an anomaly, will not be a fair comparison for the years ahead.

~5% EBITDA/PAT CAGRs over FY21-23

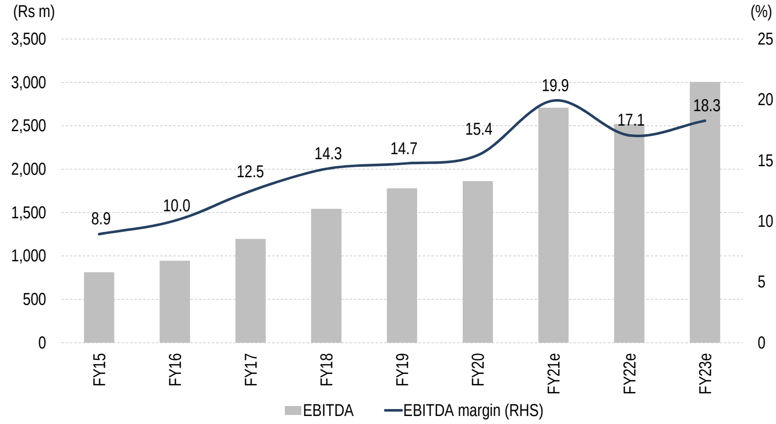
Over FY15-20 margins have expanded 650bps to 15.4%, mainly driven by the 572bp gross-margin expansion (incl. sub-contracting expenses).

We expect an 18.3% EBITDA margin in FY23 (down 165bps from FY21-FY23) as growth in FY21 has been an anomaly, leading to the highest margins (9M FY21 EBITDA margin: 19%).

However, over FY20-23, we expect the EBITDA margin to expand ~283bps, driven by the gross margin expanding ~206bps over FY20-23 to ~35.5% (incl. sub-contracting expenses). We believe the growing premiumisation will help sustain margins ahead.

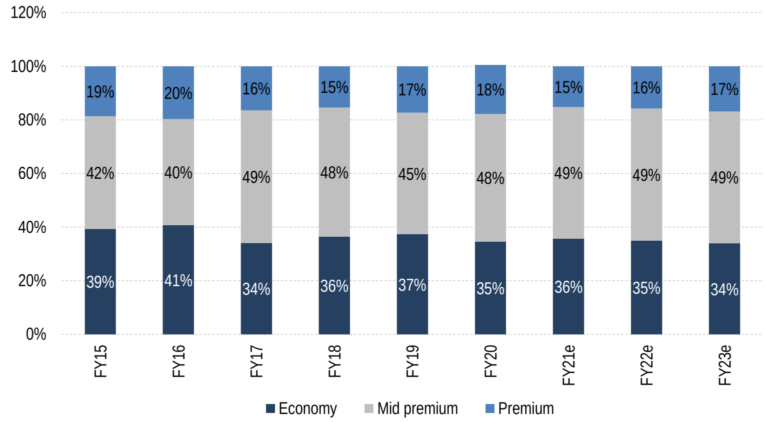
Over FY20-23 we expect revenue of the premium (excl. exports) and mid-premium categories to grow 13% and 11.4% respectively, and outpace the economy category's 10% revenue growth. Hence, we expect the proportion of revenue of the premium category (excl. exports) to rise from 6.9% in FY20 to 7.5% in FY23, driven by launches, growth in points of sales and the company's greater focus. The percentage of revenue of the premium category would have been higher if not for the slowdown in its growth in FY21 due to Covid-19. The proportion of revenue of the mid-premium category is expected to grow to ~49.2% in FY23 (from 47.7% in FY20) while the share of revenue of the economy category is expected to shrink to 33.9% (from 34.6% in FY20).

Fig 33 – We expect the EBITDA margins to reach 18.3% in FY23



Source: Company, Anand Rathi Research

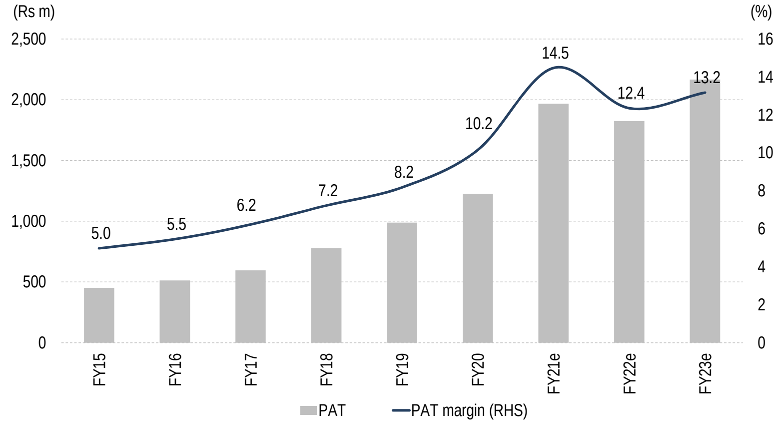
Fig 34 – Percent of revenue, category-wise (FY15 to FY23)



Source: Company, Anand Rathi Research

We expect a ~5% PAT CAGR over FY21-FY23, driven by healthy revenue growth and an improving margin profile. The PAT CAGR appears lower due to greater profitability in 9M FY21.

Fig 35 – ~5% PAT growth expected over FY21-23

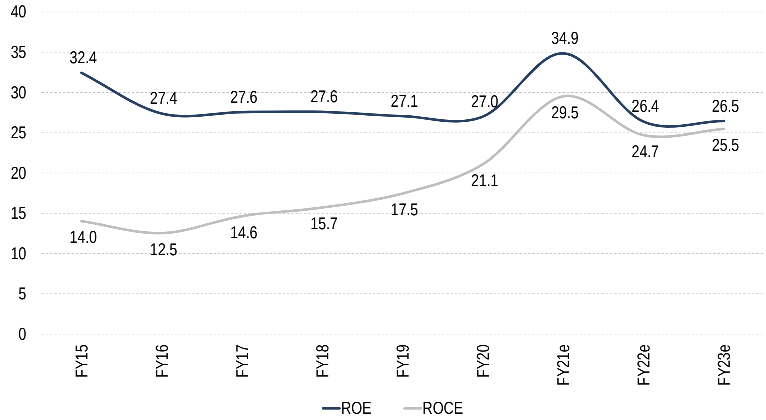


Source: Company, Anand Rathi Research

Return ratios to improve

With a healthy EBITDA margin expansion and PAT growth, we expect return ratios to remain steady. Margins and profitability have been at peaks in FY21; hence we expect a 29.5% RoCE and a 34.9% RoE. Post that, we expect a 25.5% RoCE in FY23 (vs. 21.1% in FY20) and a stable, ~27%, RoE.

Fig 36 – Improving return ratios

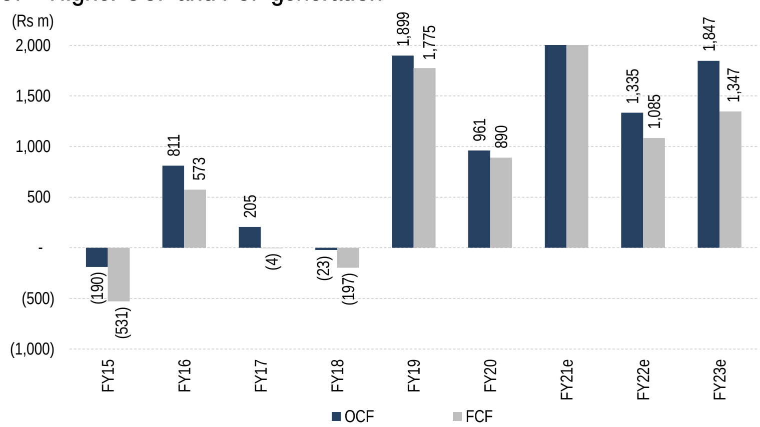


Source: Company, Anand Rathi Research

Efficient working capital, healthy cash flows

In four of the last five years (exception: FY18), Lux has generated positive operating cash-flows. With improving working capital and increasing profitability, we expect its OCF and FCF to be positive at respectively Rs1.8bn and Rs1.3bn in FY23.

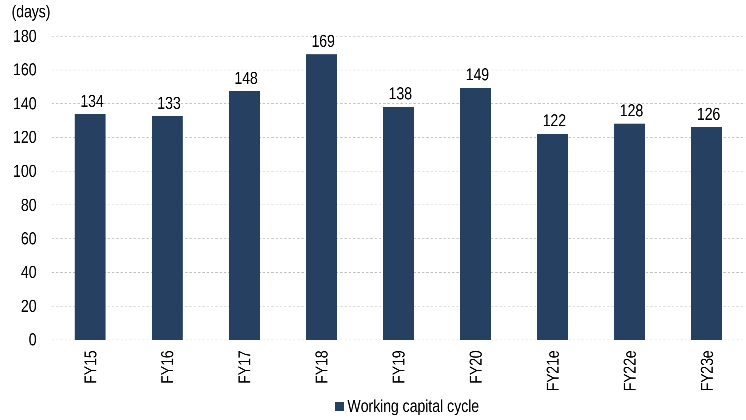
Fig 37 – Higher OCF and FCF generation



Source: Company, Anand Rathi Research

The cash-conversion cycle (on sales) has improved from a peak of 169 days in FY18 to 149 in FY20 (on lower, Covid'19-hit Q4 FY20 sales). Receivables days (on sales) have sharply shortened, from 132 in FY18 to 94 in FY20 on the implementation of a debtor collection policy. The company introduced a 120-day credit period for debtors, which was then cut to ~90 days. It plans to reduce this further to ~80 days.

Fig 38 – Improving working-capital cycle

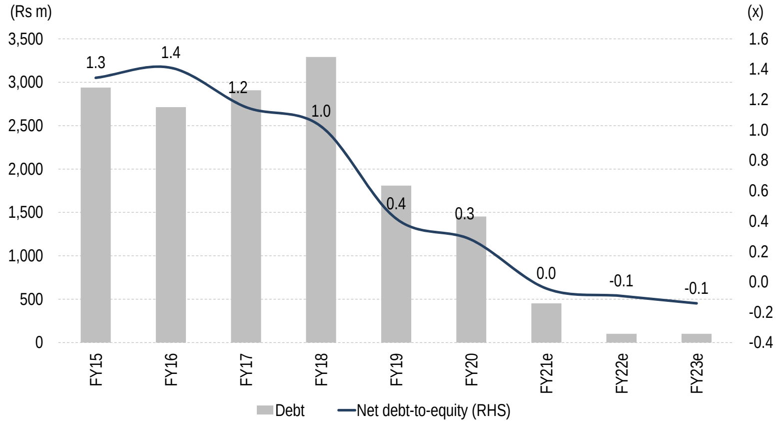


Source: Company, Anand Rathi Research

With cash being released from working capital and with greater profitability, the company turned net cash in Dec'20. Even at the group level (incl. J.M Hosiery and Ebell Fashions), the company is net cash. With all debt being repaid, its cash reserves will be utilised toward expansion (capex) and dividends. The company introduced a dividend policy of a 25% payout in FY20 subject to 1) its need for growth capital and 2) positive cash-flow and other such parameters. Its dividend payout over FY16-19 was 7-9%.

We expect ~Rs750m capex over FY22-23. Over FY18-20 capex was ~Rs370m (Rs788m over FY15-17). We expect Lux's capex to pick up pace as it spends on raising its manufacturing capacity. It is now utilising ~100% of capacity to manufacture 200m pieces a year, with the ability to increase short-term capacity.

Fig 39 – Lower debt levels, improving net-debt-to-equity



Source: Company, Anand Rathi Research

Peer comparison

Fig 40 – Relative peer valuation

	M. Cap	EV / EBITDA (x)			P/E (x)		
	Rs bn	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
Titan (consolidated)	1,330	82.6	43.5	35.5	143.4	65.2	53.0
Page	317	60.3	41.8	33.5	93.2	61.5	48.1
Relaxo	207	48.4	39.3	31.9	85.3	67.2	52.3
Bata	191	109.9	24.6	20.7	NA	51.3	42.3
ABFRL	179	61.1	18.0	13.5	NA	168.8	48.2
Lux Industries	43	15.8	16.9	14.0	21.9	23.7	19.9
TCNS Clothing	32	112.7	20.4	14.9	NA	82.7	39.5
Rupa	26	12.6	12.0	-	17.9	17.4	-
Arvind Fashions	18	NA	10.1	7.4	NA	NA	NA
Dollar Industries	15	11.1	9.0	7.4	16.7	14.2	12.1

Source: Company, Bloomberg

Fig 41 – Peer financials

	CAGR FY15-FY20 (%)			Gross Margin %	EBITDA margin %	RoCE %			RoE %			Working capital (days)		
	Revenue	EBITDA	PAT	FY20	FY20	FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20
Titan (consolidated)	12.1	16.5	12.8	28.0	11.7	23.3	23.0	22.3	23.6	24.9	23.4	110	110	125
Page	13.8	10.8	11.9	55.5	18.1	41.2	42.9	40.8	45.9	48.6	43.0	83	96	87
Relaxo	10.2	15.3	17.0	56.9	17.0	19.3	16.1	18.5	23.6	18.8	19.0	59	69	66
Bata #	6.0	31.8	10.9	57.6	27.2	12.9	16.3	19.1	15.0	18.9	17.4	38	36	52
ABFRL	12.5	23.8	NA	51.9	14.0	6.3	8.9	10.0	11.5	25.5	(11.5)	12	14	38
Lux Industries	5.8	18.0	22.1	56.3	15.4	15.7	17.5	21.1	27.6	27.1	27.0	169	138	149
TCNS Clothing	30.7	29.5	21.4	65.0	16.2	26.0	23.9	13.7	27.5	25.0	10.9	98	108	122
Rupa	(0.6)	(1.4)	4.0	60.0	13.2	17.0	14.7	11.3	19.8	17.2	13.3	162	195	212
Arvind Fashions #	9.6	17.3	NA	44.9	6.0	5.4	6.9	(10.4)	1.4	1.8	-41.9	38	65	72
Dollar Industries	6.0	13.3	24.1	53.7	10.8	16.5	14.7	10.4	23.6	19.2	13.1	174	186	205

Source: Company # *CAGR from FY16-FY20*

For 9M FY21, Lux, Dollar and Rupa have outpaced Page's performance. While no data are available to corroborate the reason for this, we believe factors contributing to the better performance for the mid ranged players could be (1) earlier and faster rural recovery where these have greater operations than Page and (2) market-share gains from the unorganized segment, especially tier-2 and -3 markets.

Fig 42 – Innerwear peer financials

	Net sales (Rs m)		Growth %	EBITDA (Rs m)		Growth %	EBITDA margins %		Growth %	PAT (Rs m)		Growth %
	9M FY21	9M FY20	Y/Y	9M FY21	9M FY20	Y/Y	9M FY21	9M FY20	Y/Y	9M FY21	9M FY20	Y/Y
Page	19,522	24,042	*(18.8)*	3,568	4,744	*(24.8)*	18.3	19.7	*(146)*	2,250	3,122	*(27.9)*
Lux	10,207	9,200	***11.0***	1,943	1,406	***38.2***	19.0	15.3	***375***	1,345	947	***42.0***
Dollar	7,292	7,317	*(0.3)*	1,070	836	*28.0*	14.7	11.4	*324*	660	452	*46.1*
Rupa	8,268	7,649	*8.1*	1,665	1,125	*48.0*	20.1	14.7	*543*	1,147	753	*52.3*

Source: Company

Valuation

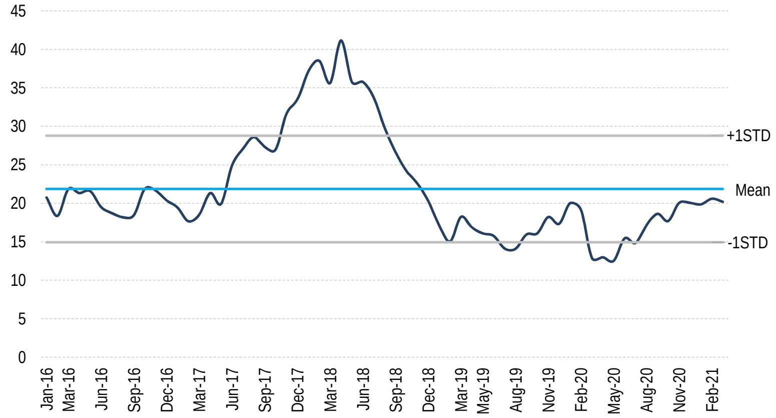
- We initiate coverage on Lux Industries, with a Buy rating and a TP of Rs2,574 based on 30x FY23e EPS of Rs85.80. At 30x FY23e PE, our target multiple is at a ~50% discount to Page Industries.
- With its healthy growth trajectory, we are upbeat on Lux's long-term growth prospects for its strong brand equity, long-standing operations in innerwear and new launches. Its extension to casual wear and women's wear via the proposed merger would unlock synergies that would further propel growth.

Fig 43 – Valuation parameters

	FY18	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	55.1	35.2	19.3	21.9	23.7	19.9
EV / EBITDA (x)	30.0	20.5	13.4	15.8	16.9	14.0
EV / Sales (x)	4.3	3.0	2.1	3.2	2.9	2.6
RoE (%)	27.6	27.1	27.0	34.9	26.4	26.5
RoCE (%)	15.7	17.5	21.1	29.5	24.7	25.5

Source: Anand Rathi Research

Fig 44 – One-year-forward P/E



Source: Anand Rathi Research

Risks

- **Macro-economic slowdown:** An economic slowdown could cut consumption, leading to sluggish demand.
- **Slower growth in its premium range:** Slower-than-expected growth in higher-value products.
- **Rise in raw material prices:** Any adverse movement in raw material prices could shave margins.

Company Background, Management

About Lux

Initially, in 1957, established as Biswanath Hosiery Mills by the late Girdharilalji Todi, the name was changed in 1995, and Lux Industries came out with an IPO in 2003. The Lux Group (Lux Industries, J.M. Hosiery, Ebell Fashions) is the largest mid-segment hosiery company in the country. It has a ~14% market share in men's organized innerwear, primarily catering to the economy and mid-premium segments. Its focus on branding and advertising has led to a small hosiery company becoming an innerwear giant. Over time, with the launch of products in different segments, it has transformed itself from merely men's innerwear to a lifestyle brand.

Fig 45 – Company milestones

Year	Milestones
2019	Engaged Kartik Aaryan to endorse the Lux Inferno winter-wear brand to attract youth. Launched One8, a brand featuring Virat Kohli, India's cricket captain; new marketing & distribution channel created
2019	Engaged Taapsee Pannu to endorse Lyra, showcasing the product as a relevant choice for the modern and emotionally independent Indian woman. Introduced a scented vest under Lux Cozi, the first time in India. Launched the Lux Nitro range of T-shirts
2018	Conducted the largest ever distributors' conference in hosiery attended by more than 900 distributors. Re-launched Lux Classic as Lux Venus Classic to create a much larger impact on consumers
2017	Engaged Amitabh Bachchan for two years to endorse winter-wear brands, Lux Venus and Lux Inferno
2017	Launched a 'Buy any two products, get one pair of socks free' scheme, the most successful in India's hosiery sector
2017	Engaged Varun Dhawan as brand ambassador for Lux Cozi
2012	Launched women's leggings
2010	Launched a premium innerwear brand, ONN, as a retail-driven product
2005	Launched two products in the thermal category
2001	Launched Lux's flagship, Lux Cozi, brand
2000	Launched GenX, an innerwear brand
1995	Launched Lux Classic as an economy product
1993	Launched Lux Venus as an economy category brand

Source: Company

Fig 46 – Key management personnel

Name	Designation	Background
Ashok Kumar Todi	*Chairman*	Commerce graduate; four decades' experience in the hosiery business. Strategic head, formulating policies of growth and expansion; looks after marketing and advertising, incl. network and distribution
Pradip Kumar Todi	*Managing Director*	Commerce graduate; looks after manufacturing and product development. Has technical knowhow of the hosiery sector; his expertise in developing new patterns, yarn combinations, knitting technologies have helped Lux introduce new and innovative products
Navin Todi	*Director - JM Hosiery*	Has ~20 years' experience in the hosiery industry. Under his leadership the company has enhanced its product offerings
Saket Todi	*President - Marketing*	Post-graduate in brand management; associated with the company since 2014
Udit Todi	*President - Strategy*	Master of Science in Finance from The London School of Economics and Political Science. Associated with the company since 2014
Saurabh Kumar Bhudolia	*Chief Financial Officer*	Member, Institute of Chartered Accountants of India. Extensive experience of over 15 years. Prior to Lux, was associated with Future Lifestyle Fashions as CFO. Previous experience includes critical roles with Mondelez International and Sula Vineyards Pvt. Ltd. and, in his early career, with Tata Steel

Source: Company

Appendix

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