

# WELSPUN INDIA

## Volumes spin growth yarn; valuations limit upsides

India Equity Research | Textiles

Welspun India's (WLSI) Q1FY16 revenue at INR13.9bn, up 17.9% YoY, surpassed our estimate 2.5% driven by robust volume surge in sheets and rugs. EBITDA margin jumped to 25.9% on account of backward integration. PAT catapulted 55% YoY to INR1.63bn helped by lower depreciation expenses. The stock has run up 415% since our initiation on June 09, 2014. We estimate FY17E EPS at INR83 driven by full impact of 20% capacity utilisation. However, we anticipate the stock to hit our valuation ceiling at closer to 6x FY17E EV/EBITDA. Hence, downgrade to 'HOLD' with a revised TP of INR832 (INR586 earlier).

### Capacity utilisation at 100% plus; high US market share a concern

WLSI's overall Q1FY16 production rose ~10.5% YoY and 2.0% QoQ with bed linen growing at ~17%. The company maintained robust capacity utilisation run rate in Q1FY16 as well—estimated at above 100% in towels and bed linen. While capacities are expected to jump 20% in H2FY16, we see limited clarity in capacity creation beyond FY17. Moreover, 2 factors make us cautious on sustained volume growth beyond FY17: (1) India's high market share penetration of towel/ sheets in the US at 37.2%/49.0% limiting upsides; and (2) enhanced capacity by various players in towels/sheets in India.

### Highest ever EBITDA margin; non-remunerative capex ahead

EBITDA margin jumped to 25.9%, the highest ever. We note that most of the margin expansion has come from lower operating/other expenses, which we believe, is due to India's cost advantage. WLSI's capex in the next 7 quarters will enhance capacity utilisation by only 20%, as most of the capex will focus on automation, worker facilities and up gradation of plants. With reducing leverage (from 2.7x in March 2014 to 1.9x in Q1FY16 to ~1.0x in FY17E) and non-remunerative capex (beneficial in the long term), RoE is expected to fall from 41% in FY16 to 36% in FY17E and 31% in FY18E.

### Outlook and valuations: Reaching fair value; downgrade to 'HOLD'

While we are impressed by WLSI's exceptional Q1FY16 performance riding high capacity utilisation and robust EBITDA margin, we estimate FY17 EPS growth to dip to 18% despite factoring in full impact of 20% capacity addition in H2FY16. Our TP based on 6x FY17E EV/EBITDA comes to **INR832** (FY17E P/E of 10x) leaving only 4% upside on CMP of INR804. Hence, we downgrade to 'HOLD' from 'BUY'. Upsides to our TP will come from clarity on and execution of WLSI's planned high-RoE low-capex ancillarisation projects.

#### Financials

(INR mn)

Year to March	Q1FY16	Q1FY15	YoY	Q4FY15	QoQ	FY15	FY16E	FY17E
Net Revenues	13,885	11,773	17.9	13,658	1.7	53,025	59,253	68,961
EBITDA	3,598	2,727	31.9	3,446	4.4	12,742	15,802	18,300
Adjusted Profit	1,632	1,050	55.4	1,614	1.1	5,398	7,076	8,341
Adjusted Diluted EPS	16.2	10.5	55.3	16.1	1.1	53.7	70.4	83.0
Diluted P/E (x)						15.0	11.4	9.7
EV/EBITDA (x)						8.2	6.8	5.9
ROAE (%)						41.7	41.1	36.3

#### EDELWEISS RATINGS

Absolute Rating **HOLD**

Investment Characteristics None

#### MARKET DATA (R: WLSP.BO, B: WLSI IN)

CMP : INR 795

Target Price : INR 832

52-week range (INR) : 824 / 209

Share in issue (mn) : 100.5

M cap (INR bn/USD mn) : 80 / 1,163

Avg. Daily Vol. BSE/NSE ('000) : 177.4

#### SHARE HOLDING PATTERN (%)

	Current	Q3FY15	Q2FY15
Promoters *	73.5	73.3	73.3
MF's, FI's & BKs	4.9	5.5	6.1
FII's	3.5	2.2	1.7
Others	18.0	18.9	18.9
* Promoters pledged shares (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	5.2	19.7	14.5
3 months	0.8	70.9	70.1
12 months	22.6	228.8	206.3

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## Investor Q1FY16 conference call: Key takeaways

- **Industry related**
  - US import share of Indian home textiles has further increased. Towels' share is now 37.2% compared to 36.5% in CY14 end. Share of bed sheets is now 49.0% compared to 46.5% in CY14 end.
  - TUF applications (central subsidy of 5%) for the entire textile industry are pending at the Ministry of Textiles. No approvals have been granted after October 2014. WLSI's application of INR8bn is also pending. Management is confident of receiving approval, though there can be some dilution of incentives. However, state level subsidies continue. The company is yet to receive Gujarat state subsidies of INR360mn.
- **Welspun related**
  - Revenues lower by ~3% on account of forex changes. However, it did not lead to any EBITDA impact.
  - Current EBITDA and realisation are after factoring in the impact of "Customer Variance Pricing Formula", which was revised at the commencement of the calendar year. Hence, realisation and margins are sustainable.
  - Share of sale of innovative products in FY15: 30%.
  - Employee costs are higher due to annual increases, impact of moving contract employees to core employment and capacity expansion.
  - Depreciation was lower due to the company following the WDV method of accounting.
  - Tax rate has been made uniform and will be 33-34% for the entire year.
  - Consumer sales break up is as follows: US=68%, Europe=16%, India=6%, Rest of World=10%.
  - Domestic sales grew 36% YoY riding increased store-in-store (SIS) and distribution channels.
  - WLSI's branded revenue came in at 11% of revenue, which includes Spaces, Welhome, Christies, etc.

**Table 1: Q1FY16 capacity utilization**

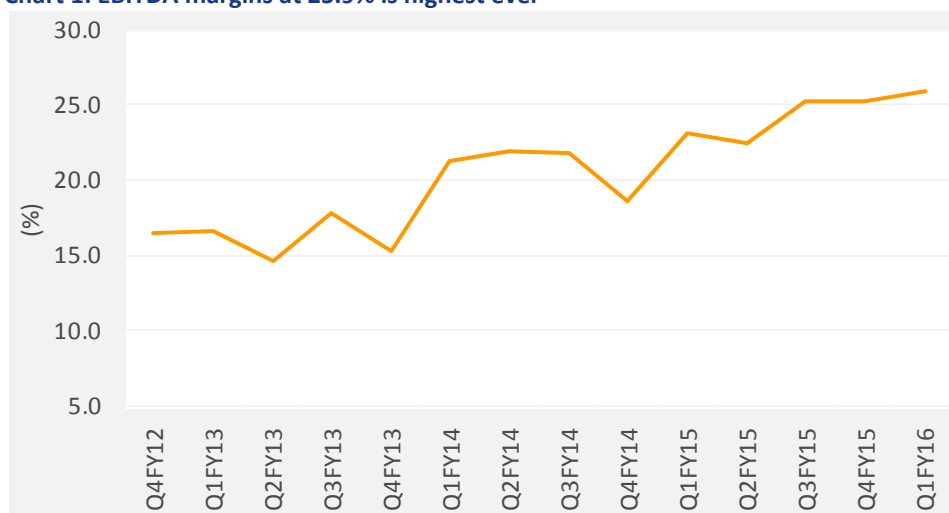
Capacity Utilisation (%)	FY15	Q4FY15	Q1FY16
Towels	102.0	102.0	105.0
Sheets	97.0	100.0	102.0
Rugs	58.0	64.0	64.0

Source: Edelweiss research

- **Capex**
  - Q1FY16 capex was at INR2.0bn. WLSI expects to spend further INR11bn till FY17 end.
  - Most of the capex will be in FY16.
  - Final capacity will be 60KTPA towels, 72mn metres of bed linen and 20KTPA rugs.

- **Ancillarisation: Expansion beyond current announced capex**
  - WLSI is planning to grow via the ancillarisation route, since spinning and weaving account for 60% of capex and is less remunerative compared to dyeing, finishing, cutting and sewing.
  - It has already appointed spinners for its textile park and is planning to appoint vendors for the weaving plant.
  - Vendors will benefit due to guaranteed off take, lower freight and packing costs, and TUF benefits from state and central government.
- **Guidance**
  - FY16 EBITDA margin guidance of 22-23% maintained, which is conservative. Margins are net off any benefits on account of MEIS export incentives, which adds 2% to EBITDA. Further, MEIS incentives are here to stay till FY18. Adding these incentives, EBITDA margin can be 24-25%.
  - FY16/17 volume growth expected at 15%. Management had guided for 8% volume growth for towels and 25% in sheets during FY15 analyst meet.

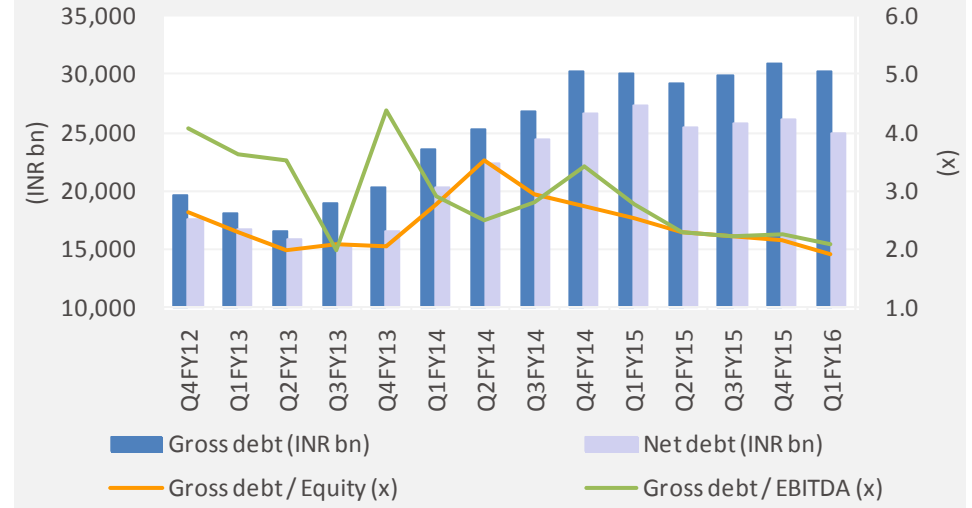
**Chart 1: EBITDA margins at 25.9% is highest ever**



Source: Edelweiss research

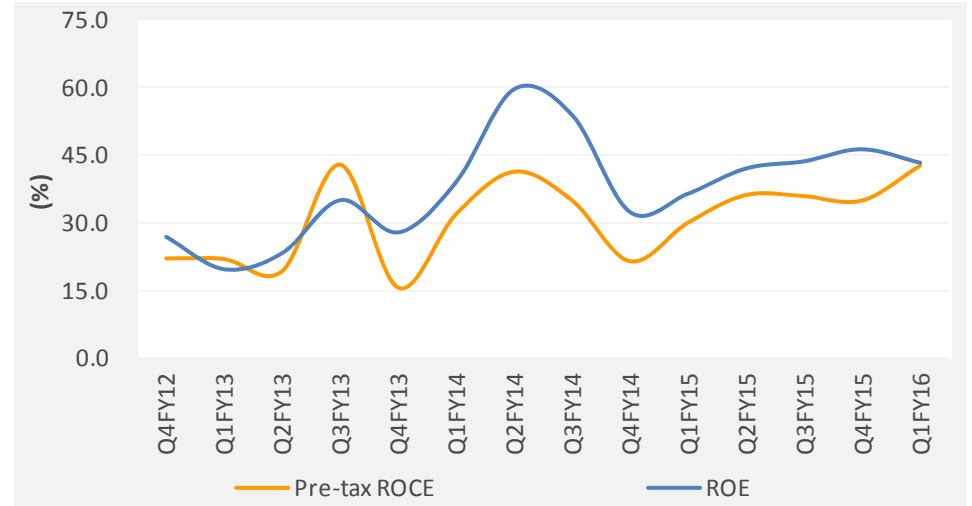
Margin improvement driven by increased backward integration

**Chart 2: Falling leverage—Gross debt/EBITDA and gross debt/equity**



Source: Edelweiss research

**Chart 3: High RoCE and RoE; Q1FY16 RoE at 43%**



Source: Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q1FY16	Q1FY15	% change	Q4FY15	% change	FY15	FY16E	FY17E
Net revenues	13,885	11,773	17.9	13,658	1.7	53,025	59,253	68,961
Staff costs	1,239	1,004	23.4	1,180	5.0	4,460	5,022	5,753
Direct costs	6,426	5,564	15.5	6,332	1.5	25,443	27,202	31,965
Other expenses	2,621	2,478	5.8	2,700	(2.9)	10,380	11,227	12,943
EBITDA	3,598	2,727	31.9	3,446	4.4	12,742	15,802	18,300
Depreciation & amortization	793	686	15.6	1,009	(21.4)	3,329	3,407	3,850
EBIT	2,805	2,041	37.4	2,437	15.1	9,412	12,395	14,450
Other income	277	322	(13.9)	290	(4.2)	949	986	787
Interest	593	713	(16.9)	569	4.1	2,829	2,642	2,566
Add: Exceptional items								
Profit before tax	2,490	1,650	50.9	2,157	15.4	7,533	10,739	12,671
Provision for taxes	840	622	34.9	508	65.4	2,090	3,597	4,245
Minority interest	19	(22)	(184.4)	36	(48.2)	45	65	85
Reported net profit	1,632	1,050	55.4	1,614	1.1	5,398	7,076	8,341
Adjusted Profit	1,632	1,050	55.4	1,614	1.1	5,398	7,076	8,341
Diluted shares (mn)	100	100		100		100	100	100
Adjusted Diluted EPS	16.2	10.5		16.1		53.7	70.4	83.0
<b>As % of net revenues</b>								
Direct costs	46.3	47.3		46.4		48.0	45.9	46.4
Employee cost	8.9	8.5		8.6		8.4	8.5	8.3
Other expenses	18.9	21.0		19.8		19.6	18.9	18.8
EBITDA	25.9	23.2		25.2		24.0	26.7	26.5
Reported net profit	11.8	8.9		11.8		10.2	11.9	12.1
Tax rate	33.7	37.7		23.5		27.7	33.5	33.5

## Change in Estimates

	FY16E			FY17E			Comments
	New	Old	% change	New	Old	% change	
Net revenue	59,253	64,143	(7.6)	68,961	67,424	2.3	Impact of reduction in cotton prices
EBITDA	15,802	14,750	7.1	18,300	15,414	18.7	Sustained increase in contribution margins
EBITDA margin	26.7	23.0		26.5	22.9		
Adjusted PAT	7,076	6,014	17.7	8,341	6,708	24.3	Same as above
Net profit margin	12.1	9.3		12.2	9.9		
Capex	9,819	9,316	5.4	3,568	3,059	16.6	

### Company Description

Established in 1985, Welspun India today, it is one of the top three home textile manufacturers globally and the largest home textile company in Asia. It has modern manufacturing facilities at Anjar and Vapi in Gujarat where it produces an entire range of home textiles for bed & bath category. The company has state-of-the-art completely vertically integrated plants, right from spinning to confectioning.

Welspun has been ranked No.1 among home textile suppliers in the US (Source: Home Textile Today). It has a distribution network in over 32 countries including US, UK, Europe, Canada and Australia.

In addition to manufacturing facilities, which predominantly supply to private labels, the company also maintains its own brands Christy, Hygrocotton, Welhome and Spaces - Home and Beyond; it also has a tie up with Nautica for North American markets.

### Investment Theme

Innovation, diversified client and product base cement dominance: Welspun enjoys long standing relationships with top retailers in the US and Europe and supplies to 14 of the top 30 global retailers. It commands a lion's share of home textiles exported out of India. Increasing geographical and client diversification is improving the company's risk metrics. It has seven trademarks and has applied for six patents till date. Welspun derives ~30% of sales from innovative products.

Capex underway to bolster already formidable capacity: The company is undertaking a major capex programme to enhance its cost base, lending it pricing power and opportunities to increase market share globally. This will propel vertical integration to ~75% (~35% currently). The capex is being funded by low-cost subsidised debt, which will increase capacity without substantial interest burden.

Returns: High capacity utilisation and increased backward integration will drive 364bps expansion in EBITDA margin over FY14-16E. Similarly, RoEs are likely to maintain upward trend and cross the 35% mark in FY16E (890bps expansion over FY13-16E).

### Key Risks

Raw material risk: Raw material costs, primarily cotton yarn, account for 50% of the overall expenses and are a prime driver of profitability. Volatility in cotton prices can impact the profitability adversely.

Leveraged balance sheet: Welspun ended FY14 with a net debt/equity of 2.5x. It is in the midst of a capex programme with a remaining outlay of INR12bn. This is likely to keep leverage levels high in the future and may pressurise profitability.

Currency fluctuations: Welspun exports more than 90% of its production. With a network spanning 50 countries, the company is exposed to currency fluctuations which can significantly impact profitability.

## Financial Statements

### Key Assumptions

Year to March	FY14	FY15	FY16E	FY17E
<b>Macro</b>				
GDP(Y-o-Y %)	6.9	7.4	8.0	8.7
Inflation (Avg)	9.5	5.9	5.0	5.0
Repo rate (exit rate)	8.0	7.5	6.8	6.5
USD/INR (Avg)	60.5	61.1	62.0	62.0
<b>Company</b>				
Terry towel capacity (MT)	45,000	50,000	60,000	60,000
Bed Linen capacity (000 Mts)	55,000	60,000	72,000	72,000
Rugs/carpets capacity (MT)	12,000	15,000	20,000	20,000
Terry towel capacity utilisation (%)	99	102	88	93
Bed linen capacity utilisation (%)	89	97	86	93
Rugs/carpets capacity utilisation (%)	68	58	61	75
Raw Material Cost as % Net Revenue	50.4	48.0	45.9	46.4
Other expenses as % of net revenues	21.5	19.6	18.9	18.8
Average Depreciation rate (%)	5.5	7.5	6.6	6.6
Dividend per share	3.0	10.5	14.7	17.3
Capex (INR mn)	7,186	5,555	9,819	3,568
Inventory as % of total costs (%)	44.5	43.3	44.0	44.0
Receivables as % of net revenues (%)	9.2	8.4	9.0	9.0
Other current assets as % of net revenues (%)	6.8	2.8	7.0	7.0
Loans and advances as % of net revenues (%)	12.0	14.1	12.0	12.0
Incremental debt (INR mn)	8,939	(2,313)	2,200	(4,021)

### Income statement

(INR mn)

Year to March	FY14	FY15	FY16E	FY17E
Net revenue	44,954	53,025	59,253	68,961
Materials costs	22,673	25,443	27,202	31,965
Gross profit	22,281	27,582	32,051	36,996
Employee costs	3,400	4,460	5,022	5,753
Other Expenses	9,670	10,380	11,227	12,943
EBITDA	9,211	12,742	15,802	18,300
Depreciation & Amortization	6,863	3,329	3,407	3,850
EBIT	2,348	9,412	12,395	14,450
Add: Other income	1,042	949	986	787
Less: Interest Expense	2,352	2,829	2,642	2,566
Profit Before Tax	1,037	7,533	10,739	12,671
Less: Provision for Tax	199	2,090	3,597	4,245
Less: Minority Interest	(82)	45	65	85
Reported Profit	921	5,398	7,076	8,341
Adjusted Profit	921	5,398	7,076	8,341
Adjusted Basic EPS	9.2	53.7	70.4	83.0
No. of Diluted shares outstanding	100	100	100	100
Adjusted Diluted EPS	9.2	53.7	70.4	83.0
Adjusted Cash EPS	63.0	88.9	107.3	124.8
Dividend per share (DPS)	3.0	10.5	14.7	17.3
Dividend Payout Ratio (%)	38.3	22.9	25.0	25.0

### Common size metrics

Year to March	FY14	FY15	FY16E	FY17E
Operating expenses	79.5	76.0	73.3	73.5
Materials costs	50.4	48.0	45.9	46.4
Staff costs	7.6	8.4	8.5	8.3
S G & A expenses	21.5	19.6	18.9	18.8
Depreciation	15.3	6.3	5.8	5.6
Interest Expense	5.2	5.3	4.5	3.7
EBITDA margins	20.5	24.0	26.7	26.5
Net Profit margins	1.9	10.3	12.1	12.2

### Growth ratios (%)

Year to March	FY14	FY15	FY16E	FY17E
Revenues	23.3	18.0	11.7	16.4
EBITDA	54.9	38.3	24.0	15.8
PBT	(65.2)	626.3	42.6	18.0
Adjusted Profit	(59.5)	486.3	31.1	17.9
EPS	(59.6)	485.6	31.1	17.9

Balance sheet		(INR mn)			
As on 31st March	FY14	FY15	FY16E	FY17E	
Share capital	1,003	1,005	1,005	1,005	
Reserves & Surplus	10,093	13,314	18,621	24,877	
Shareholders' funds	11,096	14,318	19,626	25,882	
Minority Interest	316	378	443	528	
Short term borrowings	13,498	12,034	13,173	11,959	
Long term borrowings	16,795	15,946	17,008	14,201	
Total Borrowings	30,293	27,980	30,181	26,160	
Long Term Liabilities & Provisions	1,553	1,020	6,127	2,312	
Deferred Tax Liability (net)	434	641	934	1,281	
<b>Sources of funds</b>	<b>43,693</b>	<b>44,338</b>	<b>57,311</b>	<b>56,162</b>	
Gross Block	34,049	-	54,081	57,748	
Net Block	18,395	25,049	31,695	31,513	
Capital work in progress	5,324	1,000	769	669	
Intangible Assets	1,890	1,785	1,793	1,801	
Total Fixed Assets	25,609	27,834	34,256	33,984	
Non current investments	473	15	500	500	
Cash and cash equivalents	2,974	4,657	3,905	(147)	
Inventories	10,094	11,006	11,969	14,065	
Sundry Debtors	4,117	4,467	5,333	6,207	
Loans & Advances	5,376	7,474	7,110	8,275	
Other Current Assets	3,041	1,500	4,148	4,827	
Total Current Assets (ex cash)	22,628	24,447	28,560	33,374	
Trade payable	6,144	6,910	7,387	8,612	
Other Current Liabilities & Short	1,846	5,705	2,523	2,936	
Total Current Liabilities &	7,990	12,615	9,909	11,549	
Net Current Assets (ex cash)	14,638	11,831	18,650	21,825	
<b>Uses of funds</b>	<b>43,693</b>	<b>44,338</b>	<b>57,311</b>	<b>56,162</b>	
Book Value per share (INR)	110.6	142.5	195.4	257.6	

Free cash flow		(INR mn)			
Year to March	FY14	FY15	FY16E	FY17E	
Reported Profit	921	5,398	7,076	8,341	
Add: Depreciation	6,863	3,329	3,407	3,850	
Interest (Net of Tax)	1,576	2,044	1,757	1,706	
Others	(5,130)	8,377	(3,716)	(10,149)	
Less: Changes in WC	(4,203)	2,124	(3,711)	(6,990)	
Operating cash flow	5,281	12,936	8,722	7,326	
Less: Capex	7,186	5,555	9,819	3,568	
<b>Free Cash Flow</b>	<b>(1,905)</b>	<b>7,382</b>	<b>(1,097)</b>	<b>3,759</b>	

Cash flow metrics		FY14	FY15	FY16E	FY17E
Year to March					
Operating cash flow		5,281	12,936	8,722	7,326
Investing cash flow		(9,671)	(4,910)	(9,329)	(2,790)
Financing cash flow		4,429	(6,181)	(146)	(8,588)
Net cash Flow		39	1,845	(753)	(4,051)
Capex		(7,186)	(5,555)	(9,819)	(3,568)
Dividend paid		(238)	(1,234)	(1,769)	(2,085)

## Profitability and efficiency ratios

Year to March	FY14	FY15	FY16E	FY17E
Return on Average Equity (ROAE)	7.8	41.7	41.1	36.3
Pre-tax Return on Capital	9.4	24.6	28.8	29.6
Inventory Days	121	151	124	120
Debtors Days	28	30	30	31
Payable Days	89	94	96	91
Cash Conversion Cycle	60	87	59	60
Current Ratio	3.2	2.3	3.3	2.9
Gross Debt/EBITDA	3.3	2.2	1.9	1.4
Gross Debt/Equity	2.7	1.9	1.5	1.0
Adjusted Debt/Equity	2.7	1.9	1.5	1.0
Net Debt/Equity	2.4	1.6	1.3	1.0
Interest Coverage Ratio	1.0	3.3	4.7	5.6

## Operating ratios

Year to March	FY14	FY15	FY16E	FY17E
Total Asset Turnover	1.2	1.2	1.2	1.2
Fixed Asset Turnover	2.3	2.3	2.0	2.1
Equity Turnover	4.2	4.1	3.4	3.0

## Valuation parameters

Year to March	FY14	FY15	FY16E	FY17E
Adjusted Diluted EPS (INR)	9.2	53.7	70.4	83.0
Y-o-Y growth (%)	(59.6)	485.6	31.1	17.9
Adjusted Cash EPS (INR)	63.0	88.9	107.3	124.8
Diluted Price to Earnings Ratio	86.7	14.8	11.3	9.6
Price to Book Ratio (P/B) (x)	7.2	5.6	4.1	3.1
Enterprise Value / Sales (x)	2.4	2.0	1.8	1.6
Enterprise Value / EBITDA (x)	11.7	8.1	6.7	5.8
Dividend Yield (%)	0.4	1.3	1.8	2.2
Market Capitalisation	79,796	79,886	79,886	79,886
EV	108,315	104,472	107,489	107,604



## Additional Data

### Directors Data

Mr. B K Goenka	Chairman	Mr. R. R. Mandawewala	Managing Director
Ms. Dipali Goenka	Executive Director	Mr. A. K. Dasgupta	Independent Director
Mr. Arun Tadarwal	Independent Director	Mr. Ram Gopal Sharma	Independent Director
Mr. Ajay Sharma	Nominee Director	Mr. Arvind Kumar Singhal	Additional Director

Auditors -

*\*as per last available data*

### Holding – Top10

	Perc. Holding		Perc. Holding
Krishiraj trading It	50.28	Welspun mercantile I	11.19
Welspun wintex ltd	8.39	Welspun infratech It	2.74
Reliance capital ass	2.68	Goldman sachs asset	2.27
Prudential icici ass	0.88	Welspun finance ltd	0.54
Bnp paribas asset ma	0.32	Dimensional fund adv	0.2

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

*\*as per last available data*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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*\*as per last available data*

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## Coverage group(s) of stocks by primary analyst(s): Textiles

Arvind, Himatsingka Seide, Welspun India

### Recent Research

Date	Company	Title	Price (INR)	Recos
26-May-15	<b>Himatsingka Seide</b>	Boost from lower costs; <i>Result Update</i>	84	Buy
15-May-15	<b>Arvind</b>	Discount driven growth; awaiting boost; <i>Result Update</i>	257	Hold
30-Apr-15	<b>Welspun India</b>	Best year ever; more expected ahead; <i>Result Update</i>	474	Buy

### Distribution of Ratings / Market Cap

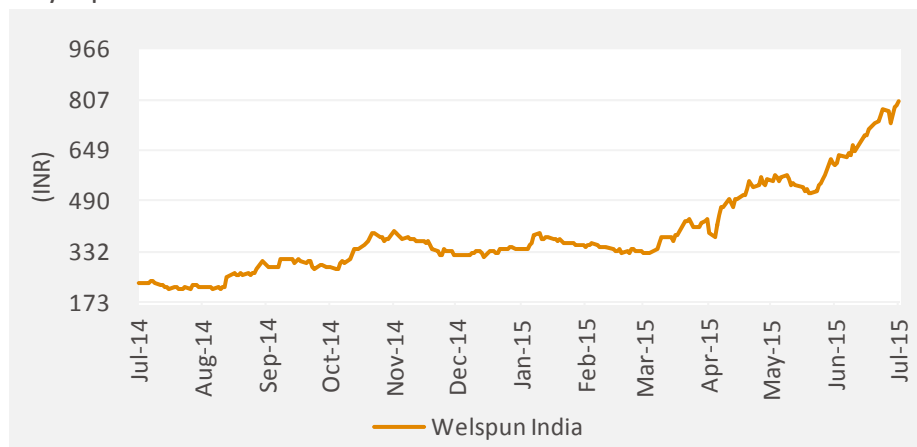
#### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	155	45	8	208
* stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	151	54	3	

### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

One year price chart



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