Welspun India – BUY

24 June 2016

Initiating coverage

Institutional Equities

Grand Slam Winner!

Welspun India, home textile player exporting largely to the US, should see 14% sales Cagr over FY16-19 given: 1) strong relationships with global retailers; 2) leadership in exports of towels/ bed sheets to the US; 3) entry into new channels (hospitality, healthcare)/ segments (smart textiles etc); and 4) 20-40% capacity addition over FY16-19. Reduction in capex (most plant addition completed) should improve balance sheet (net D/E to fall from 1.3x in FY16 to 0.3x in FY19) and in turn drive ROIC expansion (220bps over FY16-19). The resultant fall in interest costs along with increasing share of sales from higher margin innovative products should help offset headwinds from likely reduction in incentives in FY18 post WTO regulation/ GST implementation, driving 15% EPS Cagr over FY16-19. Trading at 12x FY18 EPS, we initiate with BUY.

Bed sheets/ innovative products to drive sales growth: In its key US exports market, Welspun should see higher market share gains in bed sheet segment as cotton cost advantage is stronger vs. that in towels. Also, innovative products (offering added functionality) and branded sales (Spaces/ Christy retail channels) should see healthy growth. This along with foray into new segments (smart textiles etc)/ channels (hospitality, healthcare)/ geographies should drive 14% sales Cagr over FY16-19.

Improving balance sheet to aid EPS growth: FY17 Ebitda margin would benefit from rising share of high margin innovative product sales. Albeit post FY17, removal of Merchandise Exports from India Scheme incentives and reduction in duty drawback rates under GST regime would weigh on Ebitda margin. That said with most of the capacity addition completed, capex needs and in turn debt should moderate driving lower interest costs and in turn healthy 15% EPS Cagr over FY16-19.

Return ratios to improve; Initiate with BUY: Welspun intends to reach US$2bn sales (FY19 IIFL estimate: US$1.3bn) and zero net debt (IIFL FY19 estimate: Rs12bn) by FY21. Further, its "ancillarization" model where input material manufacturers (yarn, labels etc) would cluster around Welspun's unit may reduce future capex and drive further ROIC expansion (220bps expansion likely over FY16-19). Trading at 12x FY18 EPS, we initiate with BUY (TP: Rs130 at 14x Jun-18 EPS). Key upside risks: free trade agreement with Europe, increase in export incentives.

Company update

CMP	**Rs106**
12-mth TP (Rs)	**130 (23%)**
Market cap (US$m)	**1,581**
Enterprise value(US$m)	**1,979**
Bloomberg	**WLSI IN**
Sector	**Consumer Discretionary**

Price performance (%)

	1M	3M	1Y
Absolute (Rs)	5.9	(2.2)	73.2
Absolute (US$)	6.2	(3.1)	63.8
Rel. to Sensex	(1.2)	(8.8)	76.0

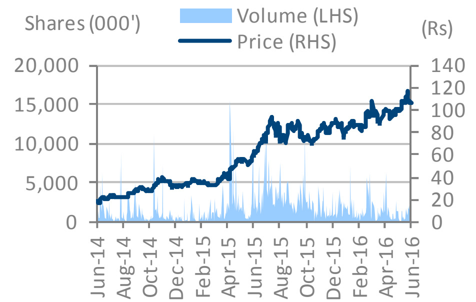
Cagr (%)	3 yrs	5 yrs
EPS	45.4	165.0

Shareholding pattern (%)

Promoter	73.5
FII	12.7
DII	2.8
Others	11.1

52Wk High/Low (Rs)	120/59
Shares o/s (m)	1005
Daily volume (US$ m)	2.0
Dividend yield FY17ii (%)	1.3
Free float (%)	26.5

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Revenues (Rs m)	53,025	59,795	68,188	77,096	87,767
Ebitda margins (%)	*24.0*	*26.0*	*26.6*	*25.2*	*25.4*
Pre-exceptional PAT (Rs m)	5,398	7,029	8,359	9,011	10,802
Reported PAT (Rs m)	5,398	7,029	8,359	9,011	10,802
Pre-exceptional EPS (Rs)	5.4	7.0	8.3	9.0	10.8
Growth (%)	*26.9*	*30.2*	*18.9*	*7.8*	*19.9*
IIFL vs consensus (%)			*0.8*	*(9.3)*	*0.0*
PER (x)	**19.7**	**15.1**	**12.7**	**11.8**	**9.8**
ROE (%)	*42.5*	*41.1*	*36.0*	*29.9*	*28.3*
Net debt/equity (x)	1.8	1.3	0.9	0.6	0.3
EV/Ebitda (x)	10.4	8.5	7.3	6.5	5.5
Price/book (x)	7.4	5.3	4.0	3.2	2.5

Source: Company, IIFL Research. Priced as on 23 June 2016

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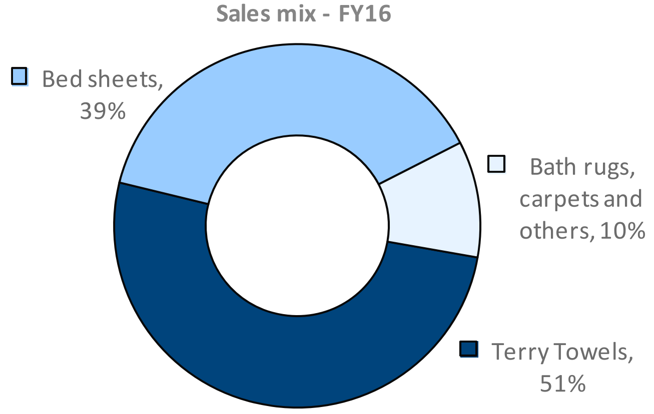
Company Snapshot

- Welspun India is India's leading exporter of home textiles. Exports account for c95% of the company's sales. The US market is the key destination for exports, accounting for c65% of sales.
- The key segments in which Welspun operates are: 1) terry towels accounting for c50% of sales; 2) bed sheets (c40% of sales); and 3) rugs, decorative carpets and others (rest 10% of sales).
- It has two integrated manufacturing facilities at Vapi and Anjar in Gujarat. The Vapi unit is largely to cater to smaller batch orders while Anjar facility is for continuous process manufacturing (for large orders). It has higher investments in downstream facilities such as sheet/ towel weaving rather than yarn manufacturing.
- In addition to supplying these products to leading global retailers (it caters to 14 of top 30 global retailers), the company also owns retail brands such as Spaces (India) and Christy (UK).
- In the towels business (60,000MTPA capacity), Welspun is the largest Indian exporter to the US and supplier of bath towels to the US, selling roughly one out of every six towels. A key competitor is Trident.
- In the bed sheets segment (72m mtrs capacity), Welspun is the number two supplier of bed sheets and pillowcases selling roughly 1 in 10 bed sheets sold in the US. Here, the leader Alok Industries is losing market share. Key competitors include Indocount, GHCL, Himatsingka Seide.
- In the rugs and carpets segment (8m sq. mtrs capacity), Welspun is a fast growing player and is slowly gaining share. It is present in the decorative carpets space and not in the wall-to-wall carpets.
- Welspun has a strong focus on innovations using end consumer surveys to determine segments of focus. It has developed new products such as Hygro (hollow core fibres that are more water absorbent), Drylon (bleach safe, quick drying and stain resistant), Nanocore (anti allergen textiles) and Flexifit (stretchable bed sheets to fit any size beds). The company has 26 patents (granted/pending) for such innovations.
- Over FY11-FY13, Welspun exited loss-making units (rug manufacturing business in Portugal, factories in Mexico, and retail businesses) and merged the marketing arm (Welspun Global Brands) into this company, which was earlier purely a manufacturing unit. This has helped drive recovery in margins.

Figure 1: Terry towels accounts for major share of sales



Source: Company, IIFL Research

Figure 2: Key management and other details

Name	Designation	Comments
B K Goenka	Chairman	Founding promoter; member of the Young Presidents organization, c30 years of experience in the textile industry
Rajesh Mandawewala	Managing Director	He has 30 years of experience across industries (from textiles to pipes). Has been associated with Welspun since inception. Cousin of BK Goenka. CA
Dipali Goenka	CEO and Joint MD	Wife of BK Goenka. Jointly heads operations with Rajesh. Completed owners/ president program from Harvard
Altaf Jiwani	CFO	c25 years experience across various industries. Joined Welspun in Feb-15. Prior experience with RPG group for 19+ years
Statutory auditors		Price Waterhouse
Credit rating		AA- by Fitch
% of pledged shares		0%

Source: Company, IIFL Research

Promoter background

Welspun India was set by B K Goenka, his father (G R Goenka) along with his cousin, RR Mandawewala. In addition to the textile business, the promoter group has interests in large diameter pipe manufacturing through Welspun Corp. Welspun was initially in the polyester yarn business and it branched into towels where it achieved its first breakthrough with Walmart. Since then, it has increased its presence in home textiles space.

Figure 3: Welspun India is the largest promoter group entity

Name	Description	Mcap (USDm)	FY16 Sales (Rs m)	FY16 PAT (Rs m)	FY16 net D/E (x)
Welspun India	Home textiles player in India	1,617	59,795	7,029	1.3
Welspun Corp	Global leader in large diameter pipes	325	83,204	2,275	0.7
Welspun Enterprises	Holding company and involved in EPC contracts	152	2,225	17.3	0.2
Welspun Investments & commercials	Investment and financial services provider	3	7	1	NA
Welspun Energy	Leading renewable energy company in India with presence in solar and wind energy sectors. Recently sold to Tata Power				
Welspun Steel	Leading manufacturer of TMT rebars, ingots, billets, blooms and rolled bars				
Welspun Natural Resources	Owns 35% stake in exploration JV with Adani group. Has interest in oil & gas exploration blocks in India and abroad				

Source: Company, IIFL Research

Bed sheets business to drive 14% FY16-19ii sales Cagr

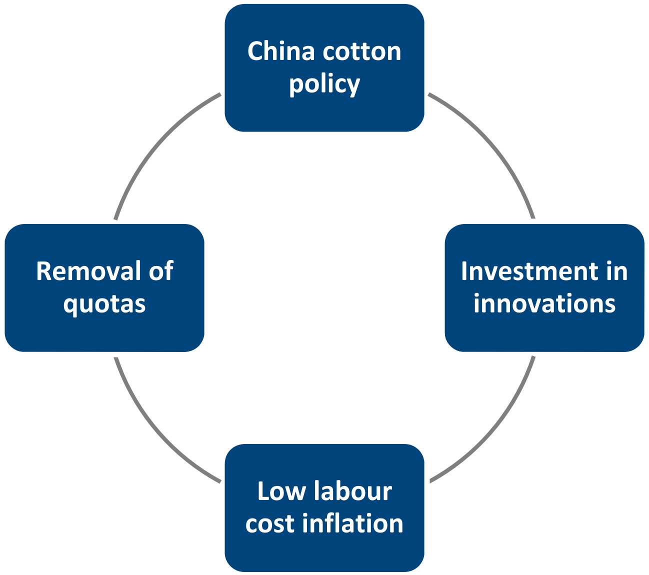
Welspun, the leading exporter of home textiles to the US, is likely to see higher market share gains in the bed sheets export market vs Chinese peers on the back of stronger cotton cost advantage. Note that since China is liquidating aged cotton inventory, the availability of quality cotton would be relatively lower than that for Indian peers. Further, labour cost inflation is lower for Indian peers vs. Chinese players – a trend that is expected to continue. This along with Welspun's initiatives in developing innovative products across towels (51% of sales), sheets segments and its foray into new categories (smart textiles etc)/ channels (hospitality, healthcare) should help drive c14% sales Cagr over FY16-19 in our view. Note that share gains from signing of FTA (free trade agreement) with Europe remains upside risk to our estimates.

Indian home textiles has carved a niche

India has traditionally not been a large player in the home textile space with presence largely in towels. This is because the earlier quota regime provided Indian players a large share of the towels market. In contrast, in the bed sheet segment, the quota regime restricted the size of the available market. As a result, the removal of the quota regime created a large space for Indian companies to grow in the bed sheets market. In the towels market, in contrast, opportunity to grow was lower as Welspun and Trident already occupied a decently large share of the export market.

Indian players were further aided by China Government's cotton policy. Following global volatility in cotton prices in 2010-11, the Chinese government started buying cotton at c35-40% premium to international prices. This led to build-up of a large inventory (c60% of global level) and pushed up cotton prices for Chinese textile players. In contrast, Indian players benefited from access to cheaper cotton. While the Chinese Government subsequently changed this policy and started providing direct subsidies equal to the difference between market and reserve price to the farmer instead of buying from the farmer, farmer-level economics were more favourable for other crops in China. As a result, cotton production in China reduced and India turned into the major production geography for cotton. While China has reducing inventory and lowered reserve price for cotton, the older cotton inventory (which was being offered) is not suitable for good quality home textiles.

Figure 4: Multiple tailwinds have helped drive growth in textile space



Source: Company, IIFL Research

Further, Indian players have invested in innovations. In order to help the retailers (customers for Indian textile companies) and improve their sales per sq ft, Indian players have focused their efforts in developing products/ designs, which meet needs of the consumer purchasing at the retailers. Indian textile players are hence able to suggest new products/ designs when sales of the existing products at the shelves of the retailer start moderating, thereby improving sales per sq ft for the retailer. This has helped differentiate Indian textile companies from their peers in Pakistan and Bangladesh (which have amongst the lowest labour and manufacturing costs and dominate the price-sensitive segment).

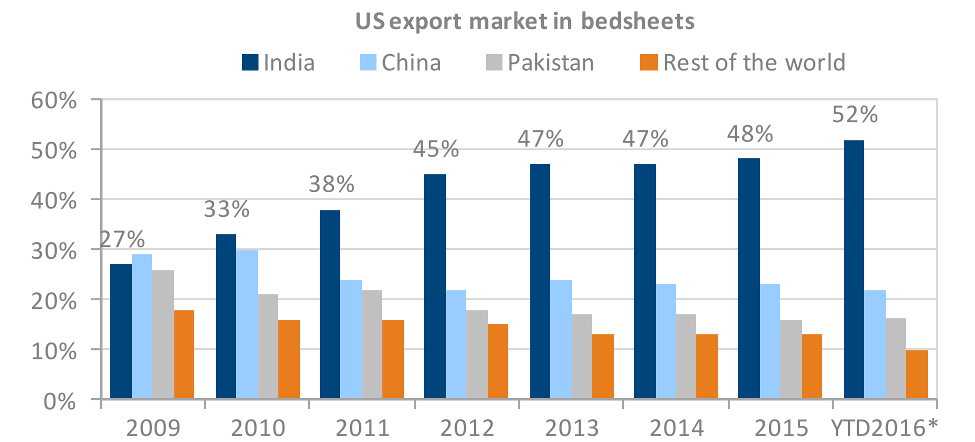
Going forward, Indian home textile players should continue to gain from their Chinese peers as labour costs for India are expected to see among the lowest inflation. This, along with textile players' ability to innovate and differentiate, places them well to continue to grow ahead of market.

Sheets segment to be key growth driver

As highlighted above, the removal of quotas as well as Chinese Government change in cotton policy has opened a large opportunity for Indian bed sheets players. This situation has been further aided by financial troubles faced by the leader, Alok Industries. These financial troubles have resulted in the leader losing market share to the other players. As a result, despite being a relatively newer entrant vs. towels (entered space in FY06), Welspun is seeing healthy volume growth in bed sheet segment (c40% of sales). Note that bed sheets segment is less consolidated reflected in the fact that global retailers have 10-12 vendors for sheets vs. only 5-6 vendors for towels.

Welspun is the second largest exporter of bed sheets to US market and has invested in innovations (for example, Flexifit Sheets which fit a range of mattress sizes, given elastic towards the ends) and value added processes to help retailer improve sales per sq ft for retailers. Further, its strong relationships with global retailer on back of strong terry towels business has placed it well to grow in this segment.

Figure 5: India has been gaining value share from peers in the bed sheets segment



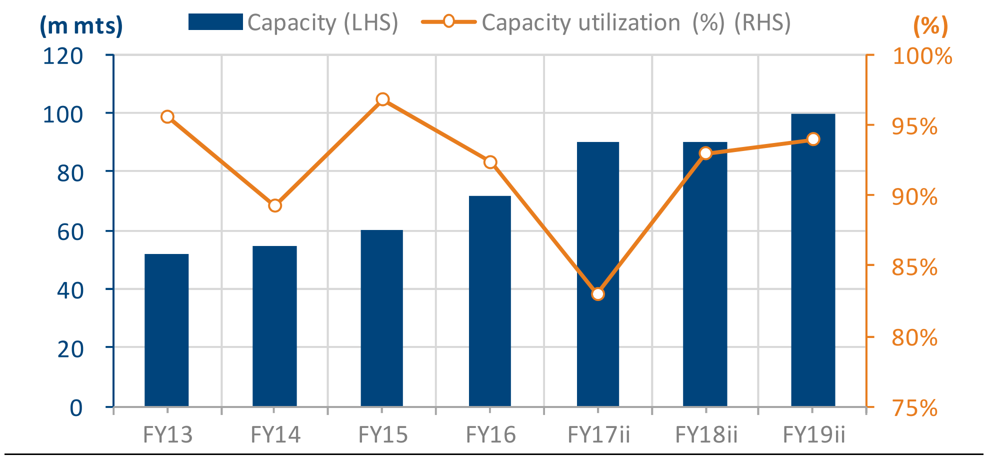
Source: Otexa, IIFL Research; *YTD represents data till April 2016

Note that Welspun volume growth in this segment has traditionally been ahead of that seen for India exports on the back of its continued innovations. This outperformance has also been seen when compared with sales growth for peers with Indocount and Welspun being broadly similar and ahead of other peers.

While large share of market share gains from Alok Industries are completed in our view, the strong competitive position of Indian players along with capacity addition should help sustain healthy 12% volume growth for Welspun over FY16-19.

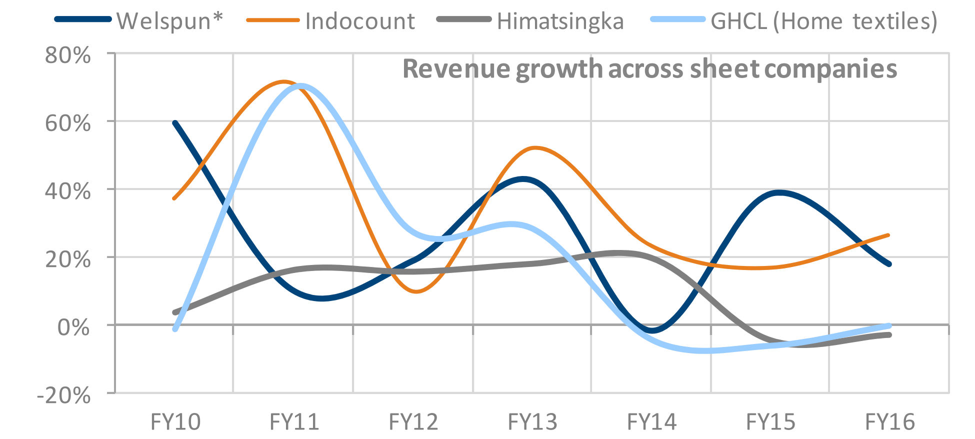
Welspun intends to reach 90m mtrs capacity in FY17 from c72m capacity in FY16. We believe Welspun would look to increase this capacity further in FY19 albeit expansion would likely be through ancillarization model and hence involve lower capex outlay. Realization growth would be driven by improving product mix and currency depreciation but is likely to be impacted by higher competitive intensity in this segment. As a result, we expect c14% sales Cagr in this segment over FY16-19.

Figure 6: Welspun would add 40% capacity over FY16-19 in our view



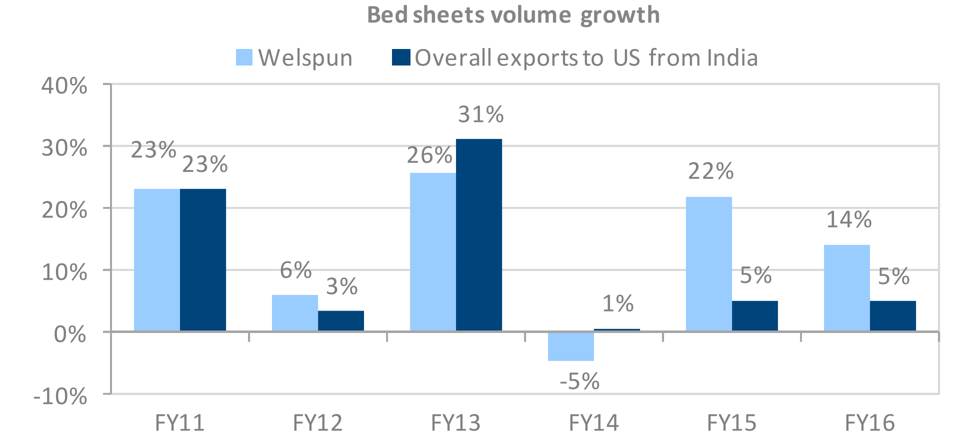
Source: Company, IIFL Research

Figure 7: Welspun has been one of the top performers in bed-sheets



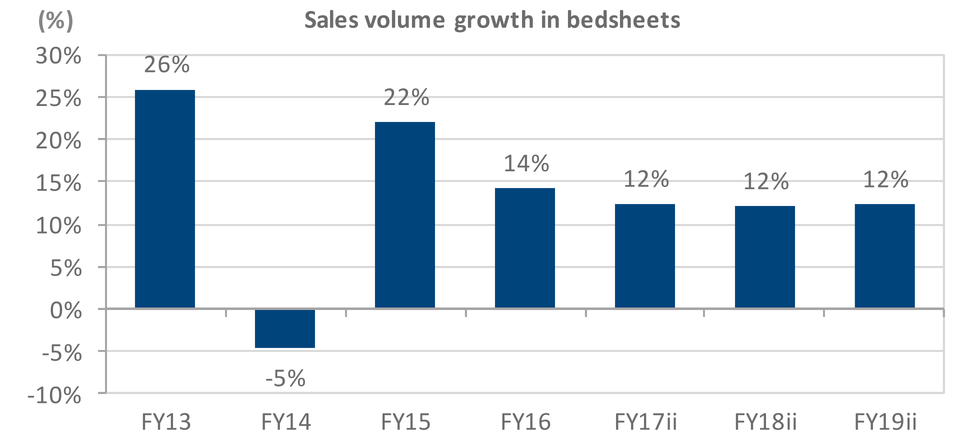
Source: Company, IIFL Research; * Welspun bedsheet segment growth

Figure 8: Welspun volume growth has been higher than India export growth in bed sheets, implying market share gains from Indian peers



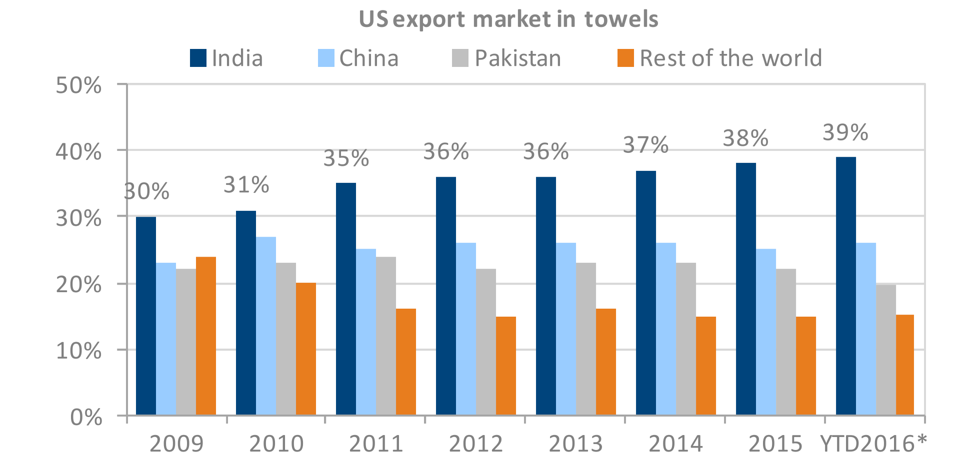
Source: Otexa, Company, IIFL Research

Figure 9: Expect volume growth in the bed sheet segment to be healthy at 12%



Source: Otexa, Company, IIFL Research

Figure 10:Increase in value market share for India in the towel segment has been lower as quota removal related gains were lower



Source: Otexa, IIFL Research; *YTD represents data till April 2016

Expect towels segment to grow ahead of market

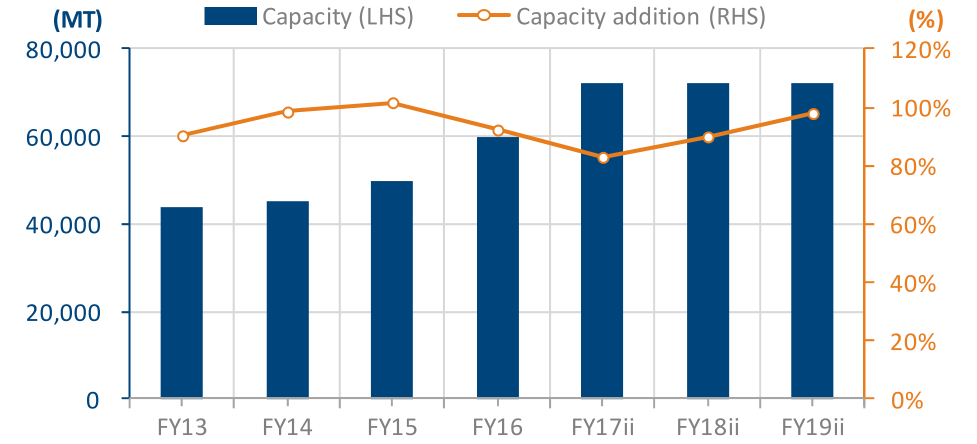
In the towels segment (c50% of sales), Welspun largely exports to the US market. It is the largest Indian player supplying to the US and enjoys healthy relationships with leading US retailers such as "Bed, Bath & Beyond", "Macy's", and "Walmart". Further, unlike the commoditized price-sensitive bidding market where each order needs to be competed based on price, Welspun has access to a specified retail space at the retailer space where it supplies products sold under private label.

Export market of towels from India to US is consolidated among few players, reflected in the fact that Welspun has c20% market share for US exports vs. all India share of 38%. In order to differentiate and grow market share in such a market, Welspun offers value-added services such as new product/ design suggestions when sales per sq ft start moderating. It does this by understanding the needs of the consumer purchasing from the retailer through research/ consumer surveys. Diversity in retailers (in terms of positioning) allows Welspun to utilize and apply product learnings from one retailer to another i.e. it would see the designs that are moderating at a premium retailer such as Bed, Bath & Beyond and offer a modified version to a mid-segment player such as Walmart. This allows it to maintain a healthy lead over peers.

In this segment also, continued focus on innovations has helped drive volume growth ahead of that seen for India exports and vs. peers.

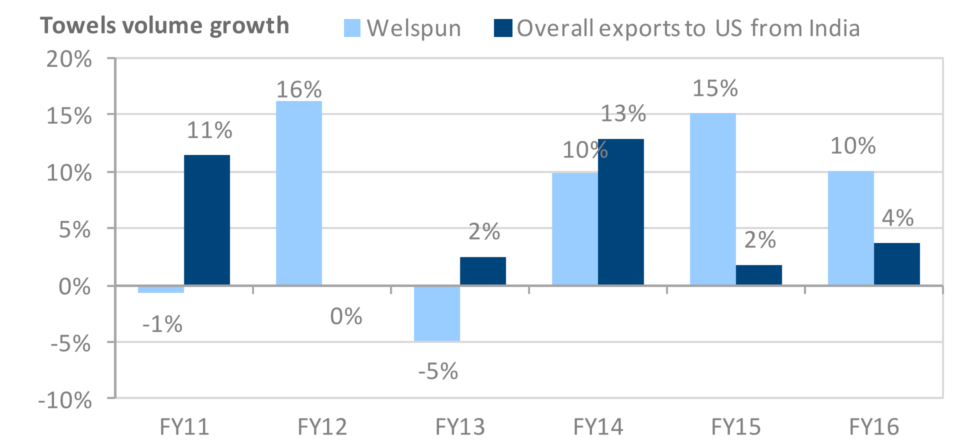
Welspun is looking to increase capacity of its towels unit from 60,000MT to 72,000MT by FY17. While Welspun's innovations (Hygro cotton towels) should aid volume growth, given consolidated nature of the market, we expect volume growth in this segment to be c8-9% levels. Realization should benefit from improving product mix, inflation in USD prices and currency depreciation. Accordingly, we expect c12% sales Cagr in this segment.

Figure 11: Capacity addition to be largely completed in FY17; expect 20% addition



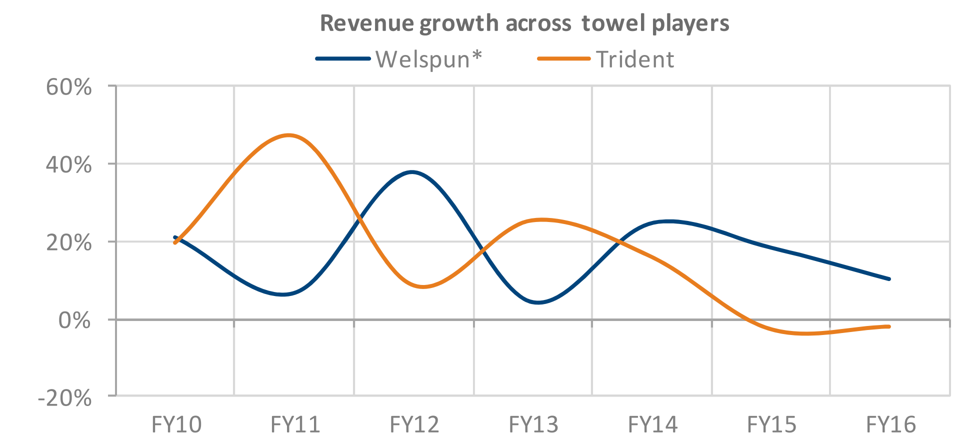
Source: Company, IIFL Research

Figure 13: Volume growth in towels has been ahead of rest of the Indian peers



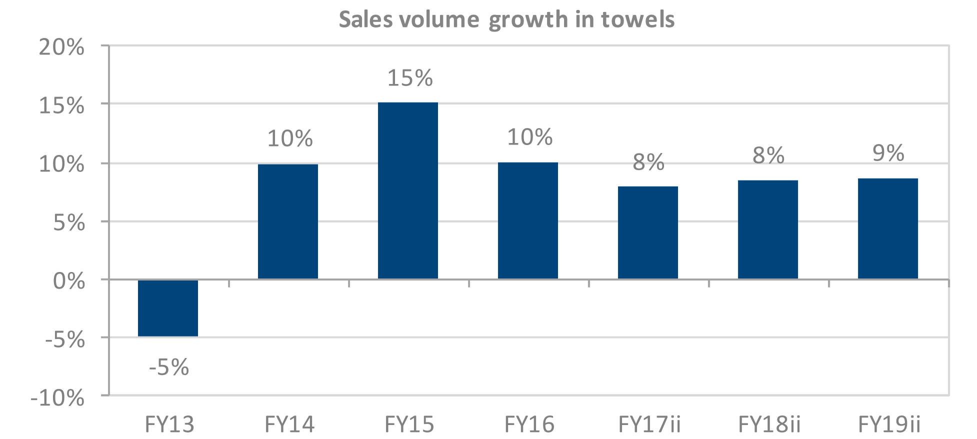
Source: Otexa, Company, IIFL Research

Figure 12: Growth rate in towels has been higher for Welspun vs. peers



Source: Company, IIFL Research; *Welspun towels division

Figure 14: Volume growth likely to be lower than that seen in sheets segment



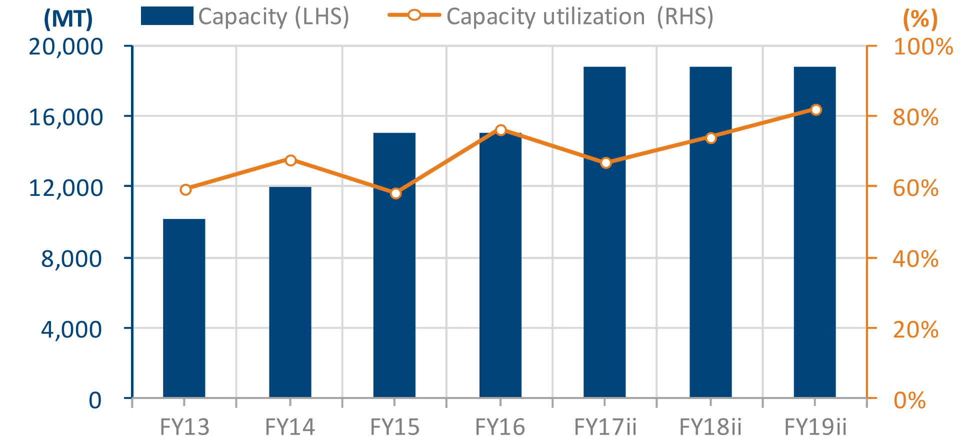
Source: Company, IIFL Research

Rugs to see healthy growth albeit on relatively lower base

The rugs, carpets and others segment (remaining 10% of sales) is a relatively nascent category in which Welspun uses its towels and bed sheet businesses to cross-sell these products. Low capacity utilization

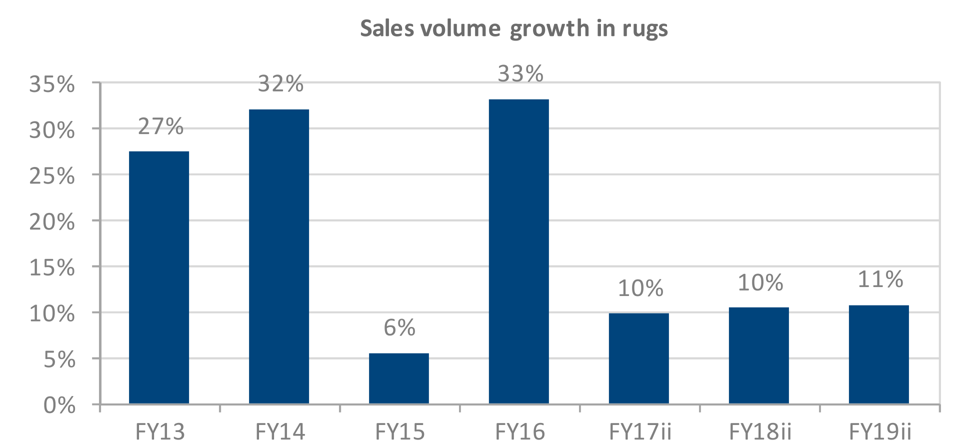
(76%) and the ability to cross-sell products to existing retailers should help drive healthy c18% sales growth in this segment over FY16-19.

Figure 15:Capacity addition to be completed in FY17



Source: Company, IIFL Research

Figure 16:Expect sale volume growth to be healthy at 10-11%



Source: Company, IIFL Research

Innovative products/ new channels/segments key growth driver

Welspun has maintained focus on innovations in order to maintain its leadership position across the key towels and bed sheets segments. Accordingly, it has invested in product level innovations such as Hygro, Drylon, Nanocore, Flexifit etc. These innovations have been seeing healthy growth. For example, Welspun has invested in making Hygro an ingredient brand for towels/ sheets similar to how Intel is for laptops/ PCs. Accordingly it has tied up with various retailers to incorporate "Hygro" logo in their private labels. This has met with success and Welspun expects sales under "Hygro" to increase from USD150m in FY16 to cUSD200-250m in FY17.

Figure 17: Key product innovations and their functional benefits

Innovative products	Features
Hygro	Hollow core fibres which are more water absorbent
Flexifit	Stretchable bed sheets to fit any size beds
Drylon	Bleach safe, quick drying and stain resistant
Nano core	Anti allergen textiles

Source: Company, IIFL Research

Hygro and similarity to Intel Inside

Hygro cotton products have a hollow cotton core, which ensures that the product regulates temperature and become softer after each wash.

In order to market this product innovation, Welspun has invested in placing the Hygro logo on the labels for key private label towels across retailers such as Walmart. This has allowed it to market Hygro as a brand similar to how Intel markets its products.

In addition to strong tailwinds in each of the major segments, Welspun has added new channels to supplement growth going forward. For example, it recently forayed into hospitality segment where it has met with success. It is contemplating entering the healthcare segment soon. Continued progress in these channels should aid volume growth across towels and sheets segments. In addition, Welspun is exploring expansion into new geographies such as Europe, Australia, Japan and

Africa using its strengths from US market. Signing of Free Trade Agreement (FTA) with Europe would help unlock strong growth in European region.

Welspun is also looking to enter new allied segments. In our last interactions, Welspun has highlighted about potential foray into “Smart Textiles”. While the company has not shared details on the likely products under the “Smart Textiles” foray, our industry checks point to a few likely products under this foray. A start-up Eight has launched mattress covers, which help, set the bed temperature, control room lights as well as communicate with the smartphone to highlight the heart rate, sleep timings etc. We believe Welspun may look to foray into something similar and create mattress covers, which provide functional utility.

Smart textiles

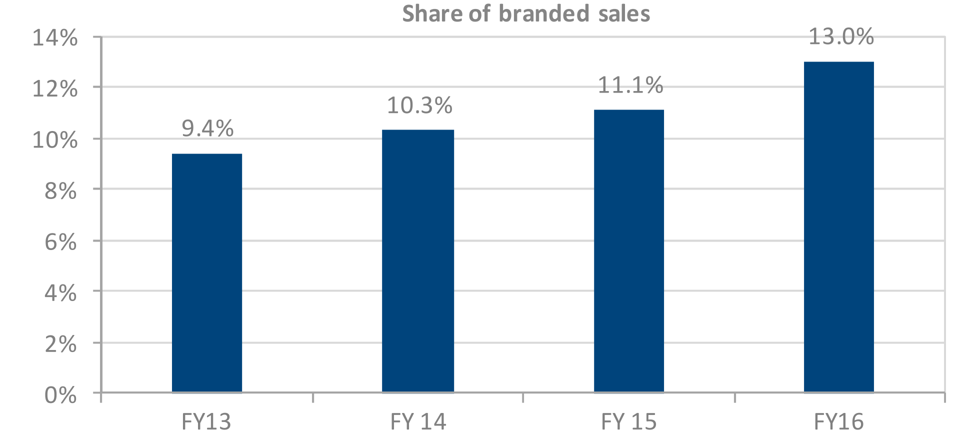
Smart textile is any technological advancement embedded in a textile, which adds more utility to the end product. These may be wearable or non-wearable. For example, fabrics that track heart rates, or clothes that regulate body temperature.

In the home textiles segment, Eight has devised a product that helps to track upon ones sleeping patterns and improve the same. Eight sleep system tracks sleep through a mattress cover, without the need to wear a device. Based on the key metrics that it tracks, such as breathing rate, heart rate, temperature, amount of movement, hours slept, etc., it arrives at a sleep score.

Further, post its foray into rugs and decorative carpets, Welspun may consider expansion into flooring segment. Unlike wall-to-wall carpeting solutions in the US market where Welspun would need to set up service centres, it may consider catering to the Indian market where currently most of the requirement is imported. Note that currently imported carpets attract 15-20% duty providing Welspun a clear cost advantage vs. existing imports.

In addition, Welspun continues to focus on branded retail segment in home textiles with its existing channels: “Christy’s UK” (stores in UK acquired in 2006), “Spaces” and “Welhome” (retail stores in India). As a result, share of branded sales has increased from c9% in FY13 to c13% in FY16. Management intends to improve the share of branded sales further to c25% by 2020.

Figure 18: Target increasing share of sales from retail chains to c25% by 2020



Source: Company, IIFL Research

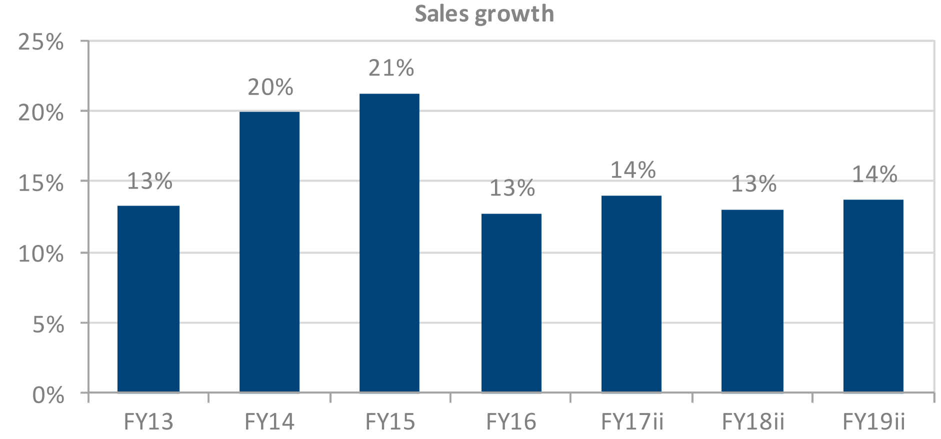
Expect 14% sales Cagr over FY16-19

We expect healthy growth in the bed sheet segment along with tailwinds from innovative products/ new segments/ channels/ geographies should help drive 13-14% sales growth over next three years. Welspun has achieved 23% revenue Cagr over the last five years (despite 1-1.5% annual volume growth in underlying US market) on back of its innovation-led market share gains. We believe this innovation-led strategy along with increasing contribution from other channels such as hospitality and healthcare would help maintain healthy sales growth going forward.

Note that Welspun in its last analyst meet has shared its 2020 (FY21) guidance of reaching US$2bn revenues driven by branded/ innovative products and domestic sales (20% share by FY20). The company expects to increase share of innovative products to c40% of revenue from current 34% and the share of branded products to c25% from 13% now. On a blended basis, this would translate into c50%+ contribution from innovative/branded products in FY20 from c40% now.

In contrast, we have conservatively assumed that Welspun only reaches USD1.3bn sales in FY19.

Figure 19: Expect 13-14% sales growth over next three years



Source: Company, IIFL Research

Improving balance sheet to aid EPS growth

Welspun should benefit from improving product mix (increasing share of sales from high margin innovations/ channels) in FY17 driving expansion in Ebitda margin. However, in FY18, margins would be impacted by likely removal of 200bps Merchandise Exports from India Scheme (MEIS) incentives. In addition, lower duty drawback rate (150-200bps impact) under GST regime remains a possible headwind not factored into our estimates. As a result, Ebitda Cagr over FY16-19 is likely to be lower than sales growth. EPS Cagr is likely to be stronger at 15% over FY16-19 as cashflow from operations are used largely to lower debt levels driving reduction in interest levels.

Increasing share of innovative products to aid margins

As highlighted in order to grow its share of innovative products, Welspun in investing in making Hygro technology a brand by marketing Hygro as a product brand similar to how Intel has marketed “Intel Inside”. These investments are already yielding benefits reflected in the fact that Hygro is now US$150m strong brand in FY16. Welspun expects to grow Hygro to US$200-250m revenues in FY17. Further, it is investing in multiple ingredient-level innovations such as Flexifit, Drylon and Nano core, which it intends to leverage for future growth. These innovations typically have higher margin profile vs other products. Increasing share of innovative products should aid margin expansion going forward.

Increasing competitive intensity in bed sheet segment

As highlighted earlier, the bed sheet segment offers a strong growth opportunity as Indian players compete to gain market share. However, the focus of multiple players has also resulted in higher competitive intensity, which in our view, would weigh on realization growth and in turn on margins in this segment. However, we believe that this impact would be more than offset by improving share of high margin innovative sales.

Reduction in incentives remains a drag on future margins

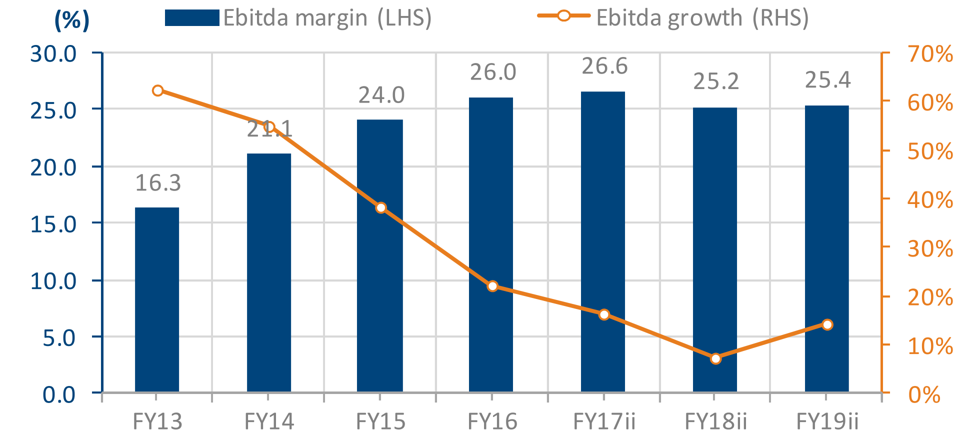
Welspun currently gets c2% incentive under MEIS for exports to certain geographies. However, these incentives are in violation of World Trade Organisation (WTO) commitments and hence would need to be phased out by end-FY17. Industry sources suggest that the Government may increase these incentives offered under MEIS for FY17 before the phase-out date kicks in. While there is a likelihood of Government introducing new incentives in a form compliant with WTO format, we factor in moderation in margins on the back of reduction of incentives under MEIS.

Further while there is no clarity on Goods and Service tax (GST), implementation of GST would result in lower duty drawback rates (rate at which excise duty is reimbursed for goods exported). Under the existing tax regime, Welspun receives 7.3% duty drawback for export sales. Under the GST regime, Welspun would not receive a blanket 7.3% drawback but would instead drawback an amount equal to the input taxes paid. Our industry interactions suggest that the current input tax paid on production is at c5-5.5%. Hence, GST implementation may result in a 150-200ps impact on margins.

Expect Ebitda margin to contract 140bps in FY18

We expect Ebitda margin to expand 50bps in FY17 on increasing share of high margin innovative products. However, reduction in incentives is likely to result in 140bps Ebitda margin contraction in FY18. As a result Ebitda Cagr over FY16-19 (13%) would be lower than sales Cagr (14%).

Figure 20: Ebitda margin should expand in FY17 but contract later as incentives reduce

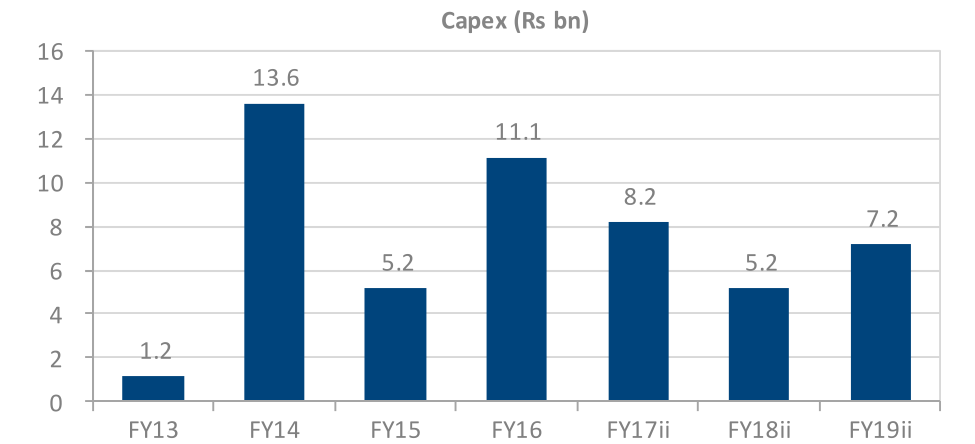


Source: Company, IIFL Research

Balance sheet health to improve as most capex completed

Over the last three years, Welspun has embarked on a strong capacity addition plan, which is close to its end. It intends to incur another Rs8bn capex in FY17 following which capex requirements would ebb off and restricted to de-bottlenecking/ maintenance activities. Further, future capacity addition is likely to be largely through ancillarization model (refer details below).

Figure 21: Capex requirements should moderate post FY17

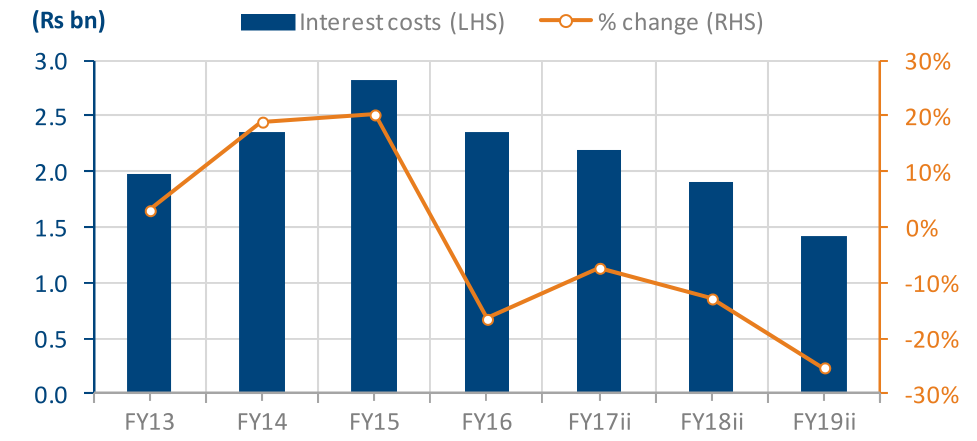


Source: Company, IIFL Research

Interest costs to decline

With capex levels moderating, we expect debt on books to moderate from Rs11bn in FY16 to cRs7bn in FY19. This is expected to result in lower interest costs.

Figure 22:Moderating capex should drive reduction in interest costs



Source: Company, IIFL Research

Figure 23: Expect moderation in interest costs to drive 15% EPS Cagr over FY16-19

Consolidated (Rs bn)	FY15	FY16	FY17ii	FY18ii	FY19ii
Revenue	53.0	59.8	68.2	77.1	87.8
% YoY	21.3%	12.8%	14.0%	13.1%	13.8%
Ebitda	12.7	15.6	18.1	19.5	22.3
% margin	24.0	26.0	26.6	25.2	25.4
% YoY	38.3%	22.2%	16.4%	7.3%	14.5%
PAT	5.4	7.0	8.4	9.0	10.8
% margin	10.2	11.8	12.3	11.7	12.3
EPS	5.4	7.0	8.3	9.0	10.8
% YoY	27.2%	30.2%	18.9%	7.8%	19.9%

Source: Company, IIFL Research

Return profile to remain healthy; BUY

At its last analyst meet, Welspun unveiled its vision for 2020 – “Welspun 2.0”. Under this, it is targeting to reach US$2bn sales and zero net debt by FY21. Further, it intends to use the “ancillarization” model for future capacity addition, which would reduce capex needs and sustain further ROIC expansion. Welspun is well placed to see healthy 15% EPS Cagr on the back of tailwinds from continued market share gains in bed sheet segment, strong growth in innovative products across towels and bed sheet segments, entry into new channels (hospitality, healthcare), foray into new segments (smart textiles, carpets etc) and reduction in net debt. The stock currently trades at 12x FY18 EPS. We initiate coverage with a BUY rating and TP of Rs130 (14x Jun-18 EPS).

Initial steps to develop ancillarization model

Welspun intends to incur Rs8bn capex in FY17. Post this it does not expect to make any material capacity addition. Further, to reduce capital intensity of future capacity addition, it is exploring an ancillary-based strategy of capacity addition similar to that seen for automotive players. Under this mode, spinning and weaving players would set up facilities close to Welspun’s unit. This would reduce inventory requirement of players while also ensuring lower logistics cost.

Welspun has already commenced production at one of the ancillary spinning units and is in talks with 13 other companies for its spinning and weaving requirements. We visited the ancillary facility set up by a company for Welspun and were impressed with the level of automation and knowledge share between Welspun and the ancillary player. The company is in talks with other packaging material players to set up facilities close to Welspun unit. However, with no other textile players present close to Welspun’s Anjar facility, the ancillary unit would be completely dependent on Welspun for its orders. Hence, it seems an uphill task for Welspun to develop ancillary model.

Targeting debt free balance sheet by FY21

Welspun has registered continued moderation in inventory levels, which would sustain. However, the sharp increase in creditors is a one-off phenomenon and hence, it should moderate going forward. As a result, Welpsun's working capital intensity is likely to increase marginally from current levels.

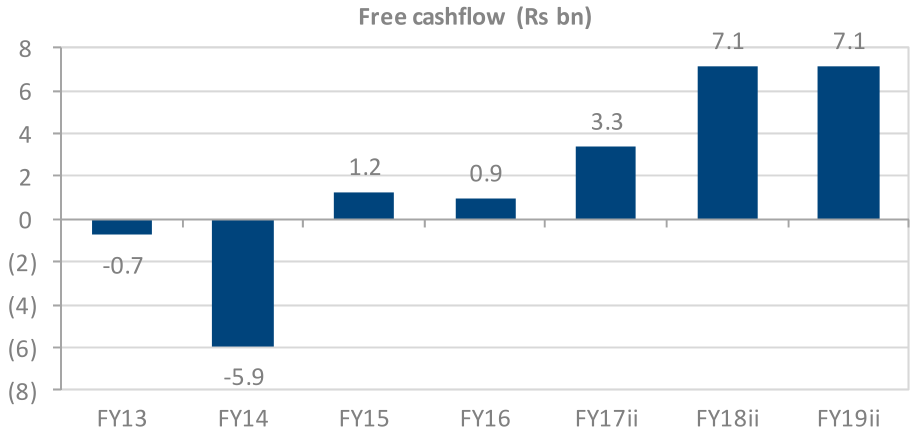
Figure 24: Increase in creditor levels a one-off event

(days of sales)	FY13	FY14	FY15	FY16	FY17ii	FY18ii	FY19ii
Inventories	82	84	76	67	67	67	67
Receivables	28	34	31	37	31	31	31
Creditors	49	51	48	62	50	50	50
Working Capital	**60**	**67**	**59**	**43**	**48**	**48**	**48**

Source: Company, IIFL Research

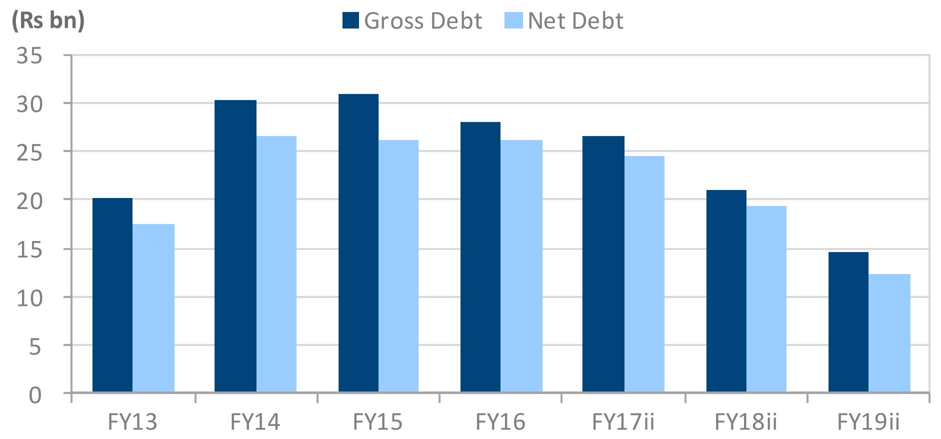
That said, with capex needs moderating going forward, the company is likely to deploy free cash flow for debt reduction. Note that Welspun has shared its target of becoming zero debt company by FY21.

Figure 25: With moderation in capex, FCF generation will improve significantly



Source: Company, IIFL Research

Figure 26: Expect debt levels to moderate from Rs28bn in FY16 to Rs15bn in FY19

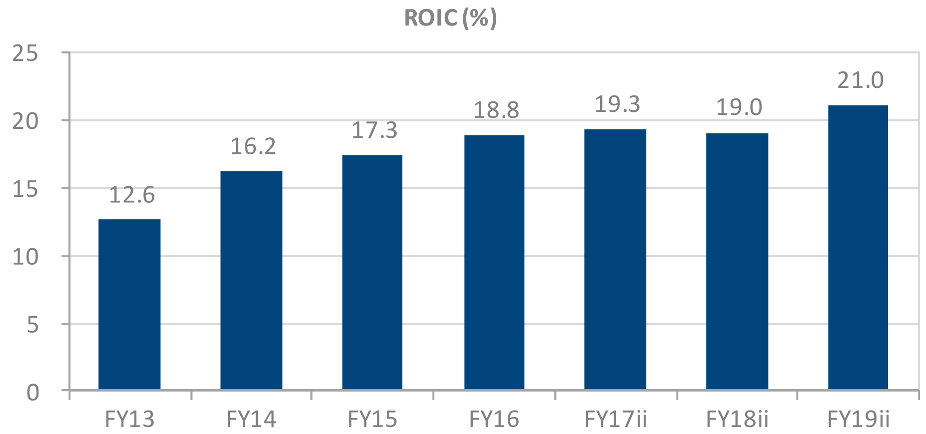


Source: Company, IIFL Research

Return ratios to see further expansion

With future capex likely to be muted and Ebitda growth remaining healthy, we expect ROIC levels to expand further. We expect ROIC to expand 220bps over FY16-19 to 21.0%. However, ROE would decline as debt levels moderate.

Figure 27: ROIC to expand 220bps over FY16-19



Source: Company, IIFL Research

Figure 28: ROE trending down due to lower debt on books

DuPont Analysis	FY15	FY16	FY17ii	FY18ii	FY19ii
Asset turnover	1.2	1.2	1.3	1.4	1.5
Equity multiplier	3.5	2.8	2.3	1.9	1.5
Ebit Margin	18%	20%	20%	19%	19%
Interest charge	0.8	0.9	0.9	0.9	1.0
Tax charge	0.7	0.7	0.7	0.7	0.7
ROE	42.5%	41.1%	36.0%	29.9%	28.3%

Source: Company, IIFL Research

Initiate with BUY

We believe Welspun India is well poised to register 15% EPS Cagr over FY16-19 given its strong relationships with global retailers, leadership in US exports of towels/bed sheets, entry into new channels such as hospitality and health care and foray into new geographies such as Australia, Japan and Africa. Further, reduction in debt and subsequent fall in interest costs coupled with higher share of high margin branded / innovative product sales should help offset headwinds from GST implementation and likely reduction in incentives in FY18 post WTO regulation. Further, ROIC expansion (220bps over FY16-19) should continue as future capacity addition would be through the ancillarization model would limit overall capex intensity. We initiate with BUY rating at a target price of Rs130 (14x Jun-18 EPS)

Signing of Free trade agreement (FTA) with Europe should help open up growth opportunity in the Europe market and remains an upside risk to our estimates.

Figure 29: Reasonable valuations

Company	CMP (Rs)	Mcap (USD m)	ROE FY17	Net D/E FY16	P/E FY17	P/E FY18	EV/EBITDA FY17	EV/EBITDA FY18
Welspun	106	1,581	36.0	1.3	12.8	11.8	7.3	6.5
Indo Count*	948	555	42.4	0.4	11.4	9.3	7.5	6.3
Trident*	53	399	16.0	1.7	9.4	6.6	6.1	5.2
Himatsingka*	235	343	19.0	0.7	11.5	8.8	7.9	5.6

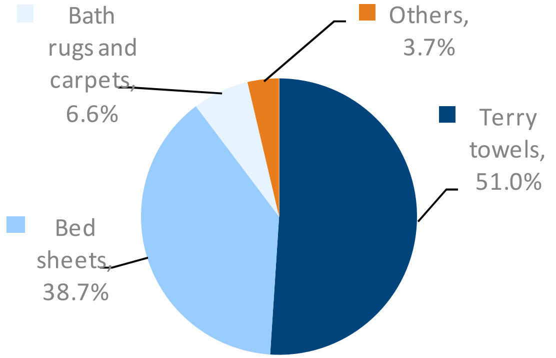
Source: Company, IIFL Research; *based on Bloomberg consensus

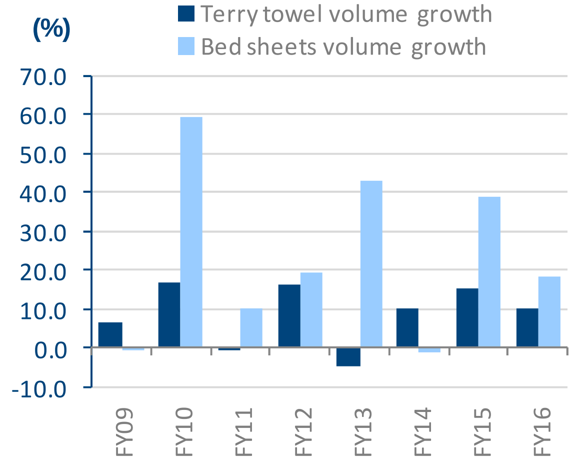
Background: Welspun India is India's leading exporter of home textiles with presence in bed-sheets, terry towels and rugs and carpets. The company was established as Welspun Winilon Silk Mills Pvt. Ltd in 1985, which subsequently became Welspun India in 1993. It is the largest exported of towels and second largest exporter of bed-sheets and pillowcases to the US. Exports account for c95% of the company's sales with contribution from US alone at 65%. The company also has retail brands such as Spaces and Christy and c26 patents for its innovations.

Management

Name	Designation
B K Goenka	Chairman
Dipali Goenka	CEO and joint MD
Rajesh Mandawewala	Managing Director

FY16 Revenue mix





Assumptions

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Terry towel volume growth	15.1	10.0	7.9	8.4	8.9
Bed sheet volume growth	22.0	14.2	12.3	12.0	12.3
Bath rugs and carpets volume growth	5.5	33.2	9.8	10.4	10.8
Tax rate (%)	27.7	31.1	31.1	31.1	31.1
Capex (Rs bn)	5.2	11.1	8.2	5.2	7.2

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Revenues	**53,025**	**59,795**	**68,188**	**77,096**	**87,767**
Ebitda	12,742	15,575	18,128	19,459	22,279
Depreciation and amortisation	(3,329)	(3,750)	(4,524)	(5,065)	(5,529)
Ebit	9,413	11,825	13,604	14,394	16,750
Non-operating income	949	915	911	807	612
Financial expense	(2,829)	(2,362)	(2,190)	(1,909)	(1,428)
PBT	7,533	10,378	12,325	13,291	15,934
Exceptionals	0	0	0	0	0
Reported PBT	7,533	10,378	12,325	13,291	15,934
Tax expense	(2,090)	(3,224)	(3,830)	(4,130)	(4,951)
PAT	5,443	7,153	8,496	9,162	10,983
Minorities, Associates etc.	(45)	(125)	(137)	(151)	(181)
Attributable PAT	**5,398**	**7,029**	**8,359**	**9,011**	**10,802**

Ratio analysis

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Per share data (Rs)					
Pre-exceptional EPS	5.4	7.0	8.3	9.0	10.8
DPS	10.5	1.3	1.4	1.5	1.7
BVPS	14.3	19.8	26.4	33.6	42.3
Growth ratios (%)					
Revenues	21.3	12.8	14.0	13.1	13.8
Ebitda	38.3	22.2	16.4	7.3	14.5
EPS	26.9	30.2	18.9	7.8	19.9
Profitability ratios (%)					
Ebitda margin	24.0	26.0	26.6	25.2	25.4
Ebit margin	17.8	19.8	20.0	18.7	19.1
Tax rate	27.7	31.1	31.1	31.1	31.1
Net profit margin	10.3	12.0	12.5	11.9	12.5
Return ratios (%)					
ROE	42.5	41.1	36.0	29.9	28.3
ROCE	23.5	26.6	27.8	27.2	30.0
Solvency ratios (x)					
Net debt-equity	1.8	1.3	0.9	0.6	0.3
Net debt to Ebitda	2.0	1.7	1.4	1.0	0.6
Interest coverage	3.3	5.0	6.2	7.5	11.7

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Cash & cash equivalents	4,766	1,777	1,931	1,727	280
Inventories	11,006	11,046	12,597	14,243	16,214
Receivables	4,467	6,114	5,791	6,548	7,454
Other current assets	8,874	8,095	9,231	10,437	11,882
Creditors	6,910	10,080	9,341	10,561	12,023
Other current liabilities	3,855	2,591	4,199	4,647	5,281
Net current assets	**18,348**	**14,361**	**16,011**	**17,747**	**18,526**
Fixed assets	26,049	33,435	37,087	37,197	38,843
Intangibles	1,785	1,775	1,775	1,775	1,775
Investments	6	30	30	30	30
Other long-term assets	0	0	0	0	0
Total net assets	**46,188**	**49,602**	**54,903**	**56,749**	**59,174**
Borrowings	30,851	28,044	26,544	21,044	14,544
Other long-term liabilities	1,019	1,681	1,818	1,969	2,150
Shareholders equity	**14,318**	**19,877**	**26,541**	**33,736**	**42,480**
Total liabilities	**46,188**	**49,602**	**54,903**	**56,749**	**59,174**

Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY15A	FY16A	FY17ii	FY18ii	FY19ii
Ebit	9,413	11,825	13,604	14,394	16,750
Tax paid	(1,767)	(3,224)	(3,830)	(4,130)	(4,951)
Depreciation and amortization	3,329	3,750	4,524	5,065	5,529
Net working capital change	(2,399)	779	(2,065)	(2,061)	(2,469)
Other operating items	668	0	0	0	0
Operating cash flow before interest	9,243	13,130	12,234	13,268	14,859
Financial expense	(2,979)	(2,362)	(2,190)	(1,909)	(1,428)
Non-operating income	237	915	911	807	612
Operating cash flow after interest	**6,501**	**11,683**	**10,955**	**12,166**	**14,044**
Capital expenditure	**(5,672)**	**(11,136)**	**(8,175)**	**(5,175)**	**(7,175)**
Long-term investments	(362)	24	0	0	0
Others	773	372	570	121	242
Free cash flow	**1,240**	**942**	**3,349**	**7,112**	**7,111**
Equity raising	4	0	0	0	0
Borrowings	568	(2,807)	(1,500)	(5,500)	(6,500)
Dividend	(711)	(1,125)	(1,695)	(1,816)	(2,058)
Net chg in cash and equivalents	1,100	(2,990)	155	(204)	(1,447)

Source: Company data, IIFL Research

Disclosure : Published in 2016, © India Infoline Ltd 2016

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BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, i.e. a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, i.e. return of less than 10%.

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