

Welspun India ----- Maintain OUTPERFORM
Revenue and cash flows track well; margins weak as expected

EPS: ◀▶ TP: ▶▶

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- Revenue growth tracking well. 4Q FY17 revenue grew 9% YoY—commendable given that it lost out on 13% of its revenue from a year ago during this period (due to the Egyptian cotton issue). FY17 revenue grew 12%, after losing ~6% on a full-year basis.
- Margins weak as expected. EBITDA margins fell 510 bp YoY (and 130 bp QoQ) on the back of higher cotton and coal prices. FY17 margins fell about 300 bp YoY to 23.8%. The trajectory is in line with expectations although management now expects 21-22% margins in FY18 versus its previously expected 22-23%.
- Cash flows tracking well too. The company ended FY17 with FCF of Rs860 mn versus our estimated Rs610 mn—this is post a one-time Rs5 bn charge. We estimate Rs4.6 bn of free cash in FY19 or a 5% FCF yield.
- We change our estimates slightly for FY18 and FY19—we assume slightly higher revenue, lower margins and lower capex. We like the stock due to a large target market, Welspun's strong positioning, different legs of growth and healthy financials.

| Bbg/RIC | WLSI IN / WLSPO | Price (25 Apr 17, Rs) | 94.25 | | |
|-----------------------------------|-----------------|------------------------|-------------------|--------|--------|
| Rating (prev. rating) | O (O) [V] | TP (prev. TP Rs) | 115.00 (115.00) | | |
| Shares outstanding (mn) | 1,004.73 | Est. pot. % chg. to TP | 22 | | |
| Daily trad vol - 6m avg (mn) | 2.7 | 52-wk range (Rs) | 117.3 - 46.8 | | |
| Daily trad val - 6m avg (US\$ mn) | 3.1 | Mkt cap (Rs/US\$ mn) | 94,695.3/ 1,473.1 | | |
| Free float (%) | 26.5 | Performance | 1M 3M 12M | | |
| Major shareholders | Founder family | Absolute (%) | 8.6 20.9 (5.1) | | |
| | | Relative (%) | 6.9 12.8 (21.7) | | |
| Year | 03/15A | 03/16A | 03/17E | 03/18E | 03/19E |
| Revenue (Rs mn) | 53,481 | 59,814 | 66,405 | 69,000 | 79,275 |
| EBITDA (Rs mn) | 12,742 | 15,575 | 15,834 | 15,008 | 17,282 |
| Net profit (Rs mn) | 5,398 | 7,029 | 8,223 | 6,046 | 7,575 |
| EPS (CS adj. Rs) | 5.38 | 7.00 | 8.19 | 6.02 | 7.54 |
| - Change from prev. EPS (%) | n.a. | n.a. | 0.0 | (1.7) | 2.1 |
| - Consensus EPS (Rs) | n.a. | n.a. | 7.30 | 6.81 | 7.86 |
| EPS growth (%) | (4.7) | 30.1 | 17.0 | (26.5) | 25.3 |
| P/E (x) | 17.5 | 13.5 | 11.5 | 15.7 | 12.5 |
| Dividend yield (%) | 1.1 | 1.4 | 0.7 | 1.3 | 1.6 |
| EV/EBITDA (x) | 9.8 | 7.9 | 7.9 | 8.2 | 7.0 |
| P/B (x) | 6.6 | 4.8 | 3.9 | 3.3 | 2.8 |
| ROE (%) | 42.5 | 41.1 | 37.5 | 23.0 | 24.1 |
| Net debt(cash)/equity (%) | 205.4 | 141.5 | 124.4 | 99.5 | 77.3 |

Note 1: Welspun is a leading company in the home textile market, and derives over 90% of its revenue from exports to largely US and Europe. It also has certain brands such as Christy.

[Click here](#) for detailed financials

Revenue growth tracking well

Welspun's 4Q FY17 revenue grew 9% YoY—commendable given that it lost out on 13% of its revenue from a year ago during this period (due to the traceability issue on Egyptian cotton). It reported 12% revenue growth for FY17, after losing ~6% of revenue on a full-year basis.

This was helped to some extent by the forward currency cover—it had an effective Rs/USD of 68.88 for FY17 which helped revenue growth by about 4%. The company covers 60% of its receivables for the next 12 months at any point and is currently hedged at Rs70—the remaining 40% would be at the spot rate. If the currency remains at the current level, there may not be much impact on FY18 revenue.

Management continues to be focused on its 'Vision 2020' plan (US\$2 bn revenue, 40% from innovative products, 25% from brands, 20% from the domestic business and zero debt).

Good progress on the traceability issue

As we had pointed out in our recent initiation note ([link](#)), the company had taken immediate steps in various processes around the Egyptian cotton line and had appointed E&Y to audit the processes. Management confirmed that it is business as usual with all its customers now. It has also introduced a 'Wel-Trak' process, based on RFID technology, to track the product right from the cotton stage. This has been introduced for the premium cotton range but the company plans to extend that to other ranges as well.

Margins weak as expected

EBITDA margins fell 510 bp YoY (and 130 bp QoQ) on the back of higher cotton and coal prices, both of which have risen 30-40% through FY17. FY17 margins fell about 300 bp YoY to 23.8%. The margin trajectory is in line with expectations although the fall was slightly more than we expected. Management expects FY18 margins to be in the range of 21-22% versus its previously expected 22-23%. An important driver of margins would be the extent of renegotiation that the company manages with its clients during the course of the year—we believe that the process has just about commenced.

Cash flows tracking well too

The company ended FY17 with FCF of Rs860 mn versus our estimated Rs610 mn. The FCF is post the one-time settlement of about Rs5 bn related to the Egyptian cotton issue. Net working capital was 82 days versus 79 days in FY16 and the slight increase was largely due to inventory being valued at higher cotton prices. FY17 capex was Rs7.2 bn and the company has guided towards Rs7 bn capex for FY18, slightly lower than what we had earlier estimated. We estimate Rs4.6 bn of free cash in FY19 (the first full year that will not have the impact of the Egyptian cotton issue) or a 5% FCF yield.

Estimate changes

We change our estimates slightly for FY18 and FY19—we assume slightly higher revenue, lower margins and lower capex. Our TP remains unchanged at Rs115.

As we had pointed out during our recent initiation, we like the stock due to a large target market, Welspun's strong positioning, different legs of growth and healthy financials.

Figure 1: Welspun India: Mar-17 results summary

| | 4Q FY17 | 4Q FY16 | Chg YoY | 3Q FY17 | Chg QoQ |
|-------------------|---------|---------|---------|---------|---------|
| Total revenue | 17,572 | 16,162 | 9% | 15,009 | 17% |
| EBITDA | 3,829 | 4,353 | -12% | 3,463 | 11% |
| EBITDA margin | 21.8% | 26.9% | -510bps | 23.1% | -130bps |
| Other income | 156 | 232 | -33% | 210 | -26% |
| Interest expenses | 430 | 668 | -36% | 480 | -10% |
| PBT | 2,190 | 2,882 | -24% | 1,888 | 16% |
| Tax | 653 | 886 | -26% | 624 | 5% |
| Tax rate | 26.5% | 26.7% | -20bps | 28.9% | -240bps |
| Reported NPAT | 1,538 | 1,959 | -21% | 1,494 | 3% |
| Adj EPS (Rs) | 1.5 | 1.9 | -22% | 1.2 | 22% |

Source: Company data, Credit Suisse estimates

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Companies Mentioned (Price as of 25-Apr-2017)

Welspun India (WLSP.BO, Rs94.25, OUTPERFORM[V], TP Rs115.0)

Disclosure Appendix

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3-Year Price and Rating History for Welspun India (WLSP.BO)

| WLSP.BO | Closing Price | Target Price | |
|-----------|---------------|--------------|--------|
| Date | (Rs) | (Rs) | Rating |
| 10-Apr-17 | 86.90 | 115.00 | O * |

* Asterisk signifies initiation or assumption of coverage.



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|--------------------|---------------------|------------------------------|
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| Restricted | 2% | |

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Welspun India (WLSP.BO)

Method: Our target price of Rs115 for Welspun is based on DCF (discounted cash flow) model, with 12.8% cost of equity and a 8% post-tax cost of debt with a target D/E of 0.25x. Our OUTPERFORM rating is based on the following arguments: We find the fundamentals of the business attractive. While the market share of the Welspun and the Indian industry in the US is reasonably high now, increasing penetration in Europe, new segments in the US such as hospitality and healthcare, growth in the Indian market and a greater focus on brands and higher value-add products can drive attractive EBITDA growth. We see the balance sheet as being in a comfortable position. Net D/E at the end of FY17 is likely to be around 1x, net working capital around 60-70 days and even with conservative assumptions such as a slightly higher working capital requirement and lower asset turns as compared to FY16 levels, we estimate the company to generate attractive free cash post capex.

Risk: The key risks to our target price of Rs115 and OUTPERFORM rating for Welspun India include: (1) any trade barriers (such as border tax in the US), (2) high customer concentration, (3) volatility in cotton prices/currency and (4) execution of new segment expansion strategy.

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