

# Welspun India (WLSP.BO / WLSI IN)

## RESEARCH BULLETIN

### Quick Take: Downward reset of near-term revenue and margins

Rating	<b>OUTPERFORM</b>
Price (09-Nov-17, Rs)	69.65
Target price (Rs)	115.00
Upside/downside (%)	65.1
Mkt cap (Rs/US\$ mn)	69,979 / 1,079
Enterprise value (Rs mn)	99,336
Number of shares (mn)	1,005
Free float (%)	26.5
52-wk price range (Rs)	97.90-58.65
ADTO-6M (US\$ mn)	1.4

Target price is for 12 months.

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- **Welspun's 2QFY18 results were weak on both the revenue and margin front:** Welspun's 2QFY18 revenue fell 10% YoY. The Target and Egyptian cotton business, which together constituted about 13% of revenue, is still the year-ago base and that is the primary reason for the fall in revenue. However, the decline was more than the 3% one in 1Q. The reason for that appears to be destocking by US retailers due to challenges in their businesses. This, however, may not continue beyond one more quarter as the stock in the channel cannot fall more than a certain level. In the 2H, however, the reduction in the government's duty drawback and ROSL schemes (which were input tax offsets of a sort) will optically lower the revenue growth. Consequently, the management now expects a 5-7% revenue decline for FY18 as against the earlier expectation of some slight growth.
- **EBITDA margins dropped significantly as well, reversal of cotton prices will help somewhat in 2H:** 2QFY18 margins fell 650 bps from the strong year-ago level and 340 bps QoQ. Volume decline and impact of higher cotton prices would have been key reasons. Some of the cotton prices have declined 8-10% from the quarter-ago levels and the full benefit should accrue in 4Q. However, given the reduced offsets and lower revenue growth, the company has reduced its FY18 margin guidance from 21-22% to 20% +/- 2%. This is a fairly wide range and seems driven by near-term uncertainties on both the revenue and cost front.
- **Good traction in the brands, albeit off a low base:** Welspun's own Spaces brand has grown at 47% YoY and the acquired UK brand, Christy, has grown at 15%. The company has also expanded the latter's presence in China to 24 stores.
- **Others:** The management stated that it has enough capacity to take care of double-digit growth in FY19 and FY20. It has decided to now stagger the capex of its new flooring solution and reduce it from the earlier Rs7 bn in FY19 to Rs 4.5 bn now.

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**Figure 1: Welspun India: 2QFY18 results summary**

	2QFY18	2QFY17	Chg YoY	1QFY18	Chg QoQ
Revenue	16,070	17,899	-10%	15,394	4%
Gross margin	46.7%	54.3%	-760bps	51.7%	-500bps
EBITDA	2,833	4,318	-34%	3,242	-13%
EBITDA margin	17.6%	24.1%	-650bps	21.1%	-340bps
Depreciation	1,287	1,264	2%	1,183	9%
Other income	230	251	-9%	132	74%
Interest expenses	325	320	2%	356	-9%
PBT	1,451	2,985	-51%	1,835	-21%
Tax	449	-400	-212%	550	-18%
Tax rate	30.9%	-13.4%	4430bps	29.9%	100bps
PAT	1,003	3,385	-70%	1,286	-22%
Minority	36	-35	-203%	43	-16%
NPAT (adjusted)	966	3,420	-72%	1,243	-22%
EPS (Rs, adjusted)	1.0	3.4	-72%	1.2	-23%

Source: Company data, Credit Suisse estimates

**Companies Mentioned** (Price as of 09-Nov-2017)

**Welspun India** (WLSP.BO, Rs69.65, OUTPERFORM, TP Rs115.0)

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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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Restricted	2%	

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#### 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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