

WELSPUN INDIA

Growth takes a hit; margins reach a trough

India Equity Research | Midcap Textiles

Welspun India's (WLSI) Q2FY18 revenue, at INR16.1bn (down 10% YoY), came 9% below estimate, impacted by customer destocking coupled with the base effect. Higher raw material (RM) and GST impact led to EBITDA margin contracting ~650bps YoY with adjusted PAT falling 46%. Factoring in immediate headwinds in US customers and lower margin guidance (19-21% vs. 21-22% earlier) we revise down FY18/19E PAT 23/18%. At this juncture, though the near-term outlook is weak, we believe this could be the trough for margin given improving RM scenario plus currency and given WLSI's long standing relationships with customers we expect revenue growth to pick up in FY19. Maintain 'BUY' with target multiple of 7.0x EV/EBITDA yielding TP of INR83 (INR101 earlier). Post the correction, the stock trades at 5.9x FY19E EV/EBITDA with 18% RoCE in FY19E.

Sector headwinds impact revenue growth

WLSI reported a sharp 10% YoY decline in revenue to INR16.1bn, 9% below our estimate. This was due to volume decline on account of customer destocking, coupled with the base effect (Target). The revenue decline was volume driven, with destocking being across all product lines, especially towels. Management stated that the scenario in the industry remains challenging and destocking is expected to persist during the coming year. WLSI estimates revenue decline in H2FY18 to be similar to H1FY18.

High raw material prices mar margin, but better days anticipated

Gross margin corrected ~760bps YoY/~500bps QoQ, impacted by higher cotton costs and GST-related transition. Going forward, current cotton costs are ~8-10% lower than the average holding price for WLSI and going forward margins are expected to improve.

Outlook and valuations: Margin guidance maintained; retain 'BUY'

Immediate headwinds in US customers, lower margin expectation due to lower incentives post GST and current RM prices have led to WLSI revising down FY18 margin guidance to 19-21% from 21-22%. Therefore, we have revised down FY18/19E PAT 23/18%. At present, though the near-term outlook is weak, we believe this could be the trough for margin given the improving RM scenario plus currency. Also, given WLSI's long standing relationships with customers, we expect revenue growth to pick up in FY19. We maintain 'BUY' with target multiple of 7.0x EV/EBITDA giving TP of INR83 (INR101 earlier). Post correction, the stock trades at 5.9x FY19E EV/EBITDA with 18% RoCE.

Financials		(INR mn)						
Year to March	Q2FY18	Q2FY17	YoY (%)	Q1FY18	QoQ (%)	FY17	FY18E	FY18E
Net Revenues	16,070	17,899	(10.2)	15,394	4.4	66,405	63,147	68,642
EBITDA	2,833	4,318	(34.4)	3,242	(12.6)	15,834	12,982	15,324
Adjusted Profit	966	1,804	(46.4)	1,243	(22.2)	6,721	5,161	6,437
Adj. Dil. EPS*	1.0	1.8	(46.4)	1.2	(22.2)	6.7	5.1	6.4
Diluted P/E (x)						10.4	13.6	10.9
EV/EBITDA (x)						6.4	7.2	5.9
ROAE (%)						30.5	19.8	21.2

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Value

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

CMP	: INR 70
Target Price	: INR 83
52-week range (INR)	: 100 / 55
Share in issue (mn)	: 1,004.7
M cap (INR bn/USD mn)	: 70 / 1,079
Avg. Daily Vol. BSE/NSE ('000)	: 1,952.8

SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	73.5	73.5	73.5
MF's, FI's & BKs	1.4	1.8	2.0
FII's	11.8	11.6	11.9
Others	13.3	13.1	12.5
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	4.7	22.0	17.3
3 months	9.4	42.8	33.4
12 months	30.3	118.9	88.6

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Q2FY18 Concall highlights

Industry

- In the future, business will go omni channel. All players in the industry are gearing up for this change.

Q2FY18:

- Total imports by US dropped significantly in Q2FY18 compared to Q1FY18.
- The entire revenue decline was driven by volumes. Price and currency were stable YoY.
- EBITDA margin is due to volume, mix and GST.
- Destocking across all product lines, including rugs. However, bed linen business has been holding up well, partially because of base effect.
- Could be an 8-10% reduction in cotton costs compared to the current inventory costs of the company. This will start reflecting from Q4FY18.
- WLSI expects to develop further business with eCommerce companies in the US in a couple of quarters.

Company

- Started technical textiles business. Air filter approved by an automobile company.
- Technical textiles
 - ~INR1bn revenues. The company is breaking even in the business.
 - Not invested a large amount in technical textiles, but the company has decided to take a part in the non-woven area where growth is around 8-10% globally.
 - Does not move the needle in the current quarter, but is a long-term bet. Looking at revenues of INR8-10bn over the next 5 years.
- Carpet:
 - Can clock INR10bn revenue at full capacity within 5 years.
- At present, share of branded sales is 16% compared to ~9-10% 2 years ago.
- Share of business in geographies ex- US has been intact.
- Hospitality business has been doing well. WLSI has seen a 25-30% YoY growth in this segment.

Capex:

- Estimates capex of INR4.5bn in FY18. Earlier capex guidance was INR7bn in FY18.
- All textile capex, barring INR400-500mn, has been completed.

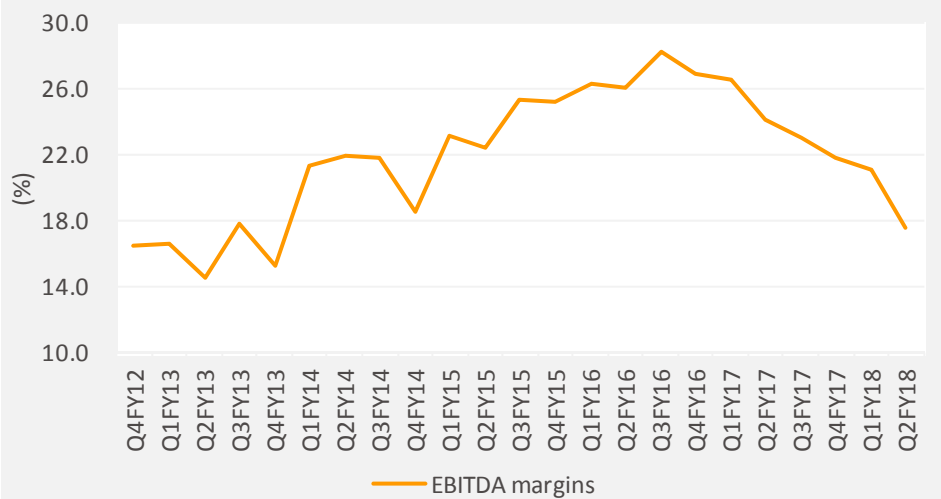
Other

- No further update on class action law suits.

Guidance

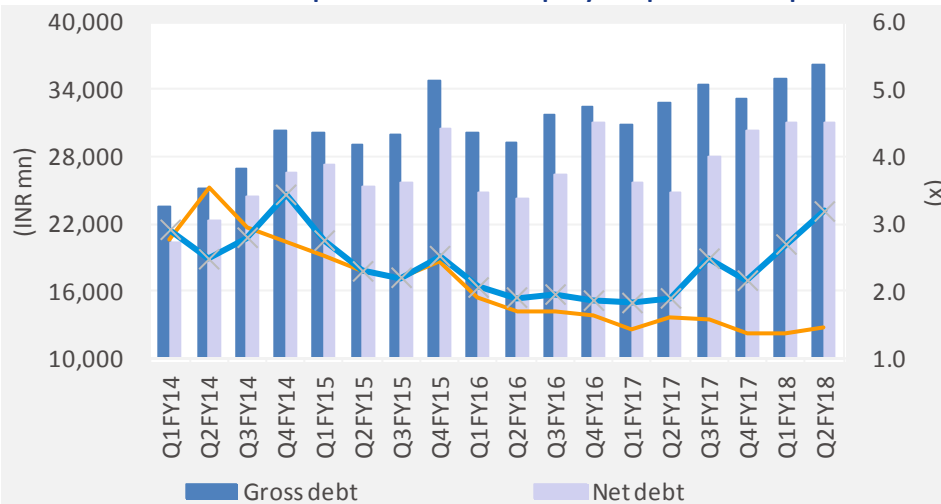
- Expects 5-7% decline in FY18 revenue.
- Full year guidance for margin 20% margin with a range of +-1%.

Chart 1: This quarter has seen the lowest margin in the last 3 years



Source: Company, Edelweiss research

Chart 2: Growth in debt is expected to fall as company has pruned its capex for FY18E



Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Net revenues	16,070	17,899	(10.2)	15,394	4.4	31,464	63,147	68,642
Staff costs	1,717	1,513	13.5	1,660	3.4	3,377	6,929	7,428
Direct costs	8,560	8,173	4.7	7,436	15.1	15,996	30,949	32,552
Other expenses	2,960	3,896	(24.0)	3,056	(3.1)	6,016	12,287	13,339
EBITDA	2,833	4,318	(34.4)	3,242	(12.6)	6,075	12,982	15,324
Depreciation	1,287	1,264	1.8	1,183	8.8	2,469	4,898	5,586
EBIT	1,547	3,054	(49.4)	2,059	(24.9)	3,606	8,083	9,738
Other income	230	251	(8.6)	132	73.7	362	850	946
Interest	325	320	1.6	356	(8.8)	681	1,299	1,158
Add: Exceptional items		(4,895)	(100.0)					
Profit before tax	1,451	(1,910)	(176.0)	1,835	(20.9)	3,286	7,634	9,526
Provision for taxes	449	(400)	(212.3)	550	(18.3)	998	2,405	3,001
Minority interest	36	(35)	(202.8)	43	(15.9)	79	68	88
Reported net profit	966	(1,475)	(165.5)	1,243	(22.2)	2,209	5,161	6,437
Adjusted Profit	966	1,804	(46.4)	1,243	(22.2)	2,209	5,161	6,437
Diluted shares (mn)	1,005	1,005	-	1,005		1,005	1,005	1,005
Adjusted Diluted EPS	1.0	1.8	(46.4)	1.2	(22.2)	3.2	5.1	6.4
Diluted P/E (x)	-	-	-	-	-	-	13.6	10.9
EV/EBITDA (x)	-	-	-	-	-	-	7.2	5.9
ROAE (%)	-	-	-	-	-	-	19.8	21.2
Direct costs	53.3	45.7		48.3		50.8	49.0	47.4
Employee cost	10.7	8.5		10.8		10.7	11.0	10.8
Other expenses	18.4	21.8		19.9		19.1	19.5	19.4
EBITDA	17.6	24.1		21.1		19.3	20.6	22.3
Reported net profit	6.0	19.1		8.1		7.0	8.2	9.4
Tax rate	30.9	20.9		29.9		30.4	31.5	31.5

Change in Estimates

	FY18E			FY19E			Comments
	New	Old	% change	New	Old	% change	
Net revenue	63,147	72,972	(13.5)	68,642	78,899	(13.0)	Impact of customer destocking
EBITDA	12,982	16,612	(21.9)	15,324	18,596	(17.6)	Higher RM and GST impact
EBITDA margin	20.6	22.8		22.3	23.6		
Adjusted PAT	5,161	6,709	(23.1)	6,437	7,851	(18.0)	
Net profit margin	8.3	9.3		9.5	10.1		
Capex	4,500	7,324	(38.6)	7,000	6,860	2.0	As per guidance

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.

Margin sustainability: WLSI has consistently improved its margin. While the rise is partially attributed to currency, it has been primarily driven by increase in share of innovative products. Driven by its confidence in sustaining these margins, it has upgraded its margin guidance from 20-22% to 23-24%.

Robust free cash flow & consistently lowering leverage: WLSI is at the end of its massive INR25bn capex programme it had undertaken in FY14, with only INR8bn to be spent in FY17. The company's confidence in generating free cash is also evident from its recently announced dividend policy of 25% payout ratio. Going forward, it is expected to generate strong free cash flows and lower its leverage further. Gross debt/equity has fallen from 2.1x at FY15 end to 1.3x as of FY16. We estimate this to fall below 1.0x by FY18E.

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.

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.

Egyptian cotton issue: Egyptian cotton products manufactured by WLSI came under the scanner when Target, cut ties with the company. Post the event, other major customers have however continued their regular sourcing of other products from WLSI. But, any further customer issues will be a negative for the company.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
Company				
Towel cap. (MT)	55,000	72,000	80,000	80,000
Bed-linen cap. (000 mts)	66,000	90,000	90,000	90,000
Rugs/carpets cap. (MT)	15,000	25,000	25,000	25,000
Towel utilis. (%)	101	97	88	93
Bed-linen utilis. (%)	101	73	72	75
Rugs/carpets utilis. (%)	76	72	76	91
Raw Material (% net rev)	44.9	45.8	49.0	47.4
Other exp (% net rev)	19.2	20.8	19.5	19.4
Depreciation rate (%)	11.1	11.9	10.1	10.3
Dividend per share	1.3	0.7	1.3	1.3
Capex (INR mn)	10,596	7,003	4,500	7,000
Inventory % of costs	41.5	42.1	41.0	41.0
Debtors % of revenues	14.3	14.5	14.0	14.0
OCA % of revenues	12.4	10.9	10.9	11.0
Loans & adv (% net rev)	1.8	3.9	3.9	4.0
Incremental debt	(957)	636	(4,590)	(1,885)

Income statement

Year to March	FY16	FY17	FY18E	FY19E
(INR mn)				
Net revenue	59,238	66,405	63,147	68,642
Materials costs	26,594	30,396	30,949	32,552
Gross profit	32,645	36,009	32,198	36,090
Employee costs	5,367	6,373	6,929	7,428
Other Expenses	11,352	13,803	12,287	13,339
EBITDA	15,927	15,834	12,982	15,324
Depreciation	3,718	5,054	4,898	5,586
EBIT	12,208	10,780	8,083	9,738
Add: Other income	904.4	805.52	849.6	945.89
Less: Interest Expense	2,368	1,583	1,299	1,158
Add: Exceptional items	-	(4,648)	-	-
Profit Before Tax	10,745	5,355	7,634	9,526
Less: Provision for Tax	3,253	1,731	2,405	3,001
Less: Minority Interest	126	48	68	88
Reported Profit	7,365	3,576	5,161	6,437
Exceptional Items	-	(3,145)	-	-
Adjusted Profit	7,365	6,721	5,161	6,437
Shares o /s (mn)	1,005	1,005	1,005	1,005
Adjusted Basic EPS	7.3	6.7	5.1	6.4
Diluted shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Diluted EPS	7.3	6.7	5.1	6.4
Adjusted Cash EPS	11.6	12.2	10.7	12.8
Dividend per share (DPS)	1.3	0.7	1.3	1.3
Dividend Payout Ratio(%)	33.4	1.7	23.0	25.0

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	73.1	76.2	79.4	77.7
Materials costs	44.9	45.8	49.0	47.4
Staff costs	9.1	9.6	11.0	10.8
S G & A expenses	19.2	20.8	19.5	19.4
Depreciation	6.3	7.6	7.8	8.1
Interest Expense	4.0	2.4	2.1	1.7
EBITDA margins	26.9	23.8	20.6	22.3
Net Profit margins	12.6	10.2	8.3	9.5

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	11.7	12.1	(4.9)	8.7
EBITDA	25.0	(0.6)	(18.0)	18.0
PBT	42.6	(50.2)	42.5	24.8
Adjusted Profit	36.4	(8.8)	(23.2)	24.7
EPS	36.4	(8.8)	(23.2)	24.7

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,005	1,005	1,005	1,005	
Reserves & Surplus	18,696	22,967	26,941	31,768	
Shareholders' funds	19,700	23,971	27,945	32,773	
Minority Interest	412	355	423	512	
Short term borrowings	14,556	12,954	11,524	11,639	
Long term borrowings	17,922	20,160	17,000	15,000	
Total Borrowings	32,478	33,114	28,524	26,639	
Long Term Liabilities	1,931	2,354	2,521	2,523	
Def. Tax Liability (net)	597	1,466	2,159	3,025	
Sources of funds	55,119	61,260	61,573	65,471	
Gross Block	35,227	43,572	48,278	55,280	
Net Block	31,559	35,011	34,821	36,238	
Capital work in progress	1,832	564	357	355	
Intangible Assets	1,925	1,879	1,887	1,895	
Total Fixed Assets	35,316	37,454	37,065	38,489	
Non current investments	39	29	29	29	
Cash and Equivalents	1,490	2,857	5,199	6,261	
Inventories	11,046	12,810	12,689	13,346	
Sundry Debtors	8,499	9,601	8,841	9,610	
Loans & Advances	1,050	2,567	2,441	2,746	
Other Current Assets	7,321	7,265	6,908	7,551	
Current Assets (ex cash)	27,916	32,242	30,878	33,252	
Trade payable	6,652	7,517	7,494	8,099	
Other Current Liab	2,989	3,804	4,105	4,462	
Total Current Liab	9,642	11,321	11,599	12,561	
Net Curr Assets-ex cash	18,275	20,920	19,279	20,692	
Uses of funds	55,119	61,260	61,573	65,471	
BVPS (INR)	19.6	23.9	27.8	32.6	
Contingent Liability	414.3	414.3	414.3	414.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	7,365	3,576	5,161	6,437	
Add: Depreciation	3,718	5,054	4,898	5,586	
Interest (Net of Tax)	1,651	1,071	890	793	
Others	1,076	143	253	284	
Less: Changes in WC	530	1,522	(1,808)	1,411	
Operating cash flow	13,280	8,322	13,011	11,690	
Less: Capex	10,596	7,003	4,500	7,000	
Free Cash Flow	2,684	1,319	8,511	4,690	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Welspun India	1,079	13.6	10.9	7.2	5.9	19.8	21.2
Arvind	1,735	25.0	16.7	12.8	9.7	11.8	15.5
Himatsingka Seide	540	19.0	12.1	9.7	7.1	16.1	21.4
Median	-	19.0	12.1	9.7	7.1	16.1	21.2
AVERAGE	-	19.2	13.2	9.9	7.6	15.9	19.4

Source: Edelweiss research

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		13,280	8,322	13,011	11,690
Investing cash flow		(8,011)	(7,124)	(3,660)	(6,064)
Financing cash flow		(6,198)	(990)	(7,008)	(4,564)
Net cash Flow		(929)	208	2,343	1,062
Capex		(10,596)	(7,003)	(4,500)	(7,000)
Dividend paid		(2,443)	(63)	(1,187)	(1,609)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	42.7	30.5	19.8	21.2
ROACE (%)	26.0	21.1	15.6	18.3
Inventory Days	120	113	122	118
Debtors Days	40	50	53	49
Payable Days	76	85	89	87
Cash Conversion Cycle	84	77	87	80
Current Ratio	3.0	3.1	3.1	3.1
Gross Debt/EBITDA	2.0	2.1	2.2	1.7
Gross Debt/Equity	1.6	1.4	1.0	0.8
Adjusted Debt/Equity	1.6	1.4	1.0	0.8
Net Debt/Equity	1.5	1.2	0.8	0.6
Interest Coverage Ratio	5.2	6.8	6.2	8.4

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.1	1.1	1.0	1.1
Fixed Asset Turnover	2.0	1.9	1.7	1.8
Equity Turnover	3.4	3.0	2.4	2.2

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	7.3	6.7	5.1	6.4
Y-o-Y growth (%)	36.4	(8.8)	(23.2)	24.7
Adjusted Cash EPS (INR)	11.6	12.2	10.7	12.8
Diluted P/E (x)	9.5	10.4	13.6	10.9
P/B (x)	3.6	2.9	2.5	2.1
EV / Sales (x)	1.7	1.5	1.5	1.3
EV / EBITDA (x)	6.4	6.4	7.2	5.9
Dividend Yield (%)	1.8	0.9	1.9	1.9
EV	101,430	100,642	93,778	90,919

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 Todarwal	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
FIAM Emerging Markets	1.96	Alliance Bernstein	1.64
Vanguard Group	1.64	Wasatch Advisors	1.52
Dimensional Fund Advisors	0.75	State of California	0.63
Reliance Capital	0.6	Birla Sun Life Insurance	0.43
Blackrock	0.35	Aditya Birla Asset Mgmt	0.29

**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
07 Apr 2017	MGN Agro Proerties Private Limited	Sell	679078913.00
07 Apr 2017	PRASERT MULTIVENTURE PRIVATE LIMITED	Buy	679078913.00
06 Apr 2017	MGN Agro Proerties Private Limited	Sell	679078913.00
06 Apr 2017	PRASERT MULTIVENTURE PRIVATE LIMITED	Buy	679078913.00
05 Apr 2017	MGN Agro Proerties Private Limited	Sell	679078913.00

**as per last available data*

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Aditya Narain

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

Arvind, Himatsingka Seide, Trident Ltd, Welspun India

Recent Research

Date	Company	Title	Price (INR)	Recos
08-Nov-17	Himatsingka Seide	Margin blip due to one-offs; <i>Result Update</i>	360	Buy
14-Aug-17	Himatsingka Seide	New unit ramp-up sees margin hit new high; <i>Result Update</i>	332	Buy
08-Aug-17	Welspun India	Guidance intact amidst headwinds; <i>Result Update</i>	81	Buy

Distribution of Ratings / Market Cap

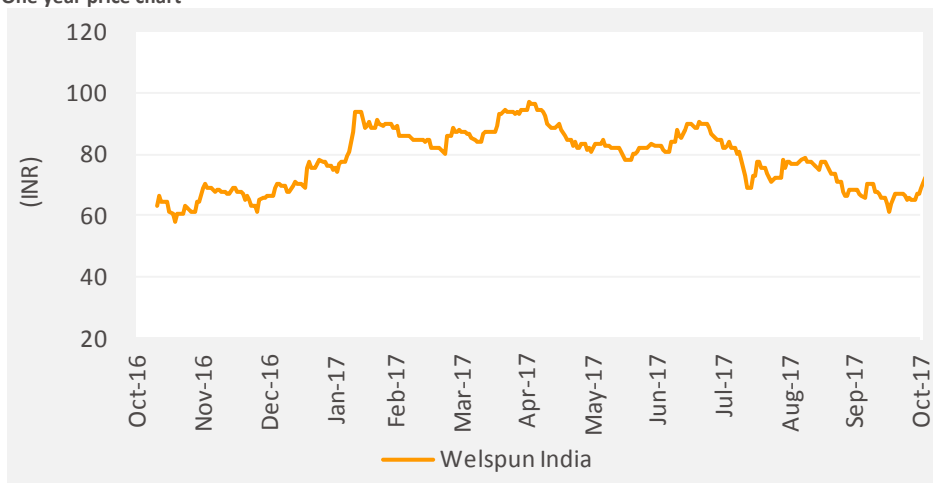
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

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

One year price chart



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