

WELSPUN INDIA

Highest ever PAT; base affects growth

India Equity Research | Textiles

Welspun India's (WLSI) Q2FY16 revenues, up 4% YoY (1% below estimate), was impacted by high base and capacity constraints. EBITDA margin, at 25.4%, was close to its life-time high of 25.9% reported in Q1FY16. The company reported its highest-ever quarterly PAT, aided by decline in interest expenses. With enhanced capacity getting commissioned from Q3FY16, the company will extend the high growth logged in earlier quarters. While the stock remains well priced, visibility on increased capacity and ancillarisation could lead to rerating. We maintain 'HOLD' with TP of INR849 (INR832 earlier).

Revenue growth impacted; trajectory to return in ensuing quarters

Revenue growth at 4.2%, lowest in the last 6 quarters, was mainly affected by high base (22% revenue growth in Q2FY15) and constrained capacity. While volumes grew 5% and currency impacted revenues favorably by 1%, lowering of Merchandise Export for Incentive Schemes (MEIS) hit revenue growth negatively by 1% during the quarter. Going forward, with expanded sheeting capacity (20% increase) to be completely available in Q3FY16 and towels capacity to be equally ramped up over Q3FY16 and Q4FY16 (addition of 10% capacity in each quarter), growth trajectory should revert to 20% plus levels.

Expansion to continue, debt to remain under leash

Despite capex of INR2.3bn in Q2FY16 (H1FY16: INR4.5bn), WLSI further reduced gross and net debt. The company generated free cash flow of INR1.8bn and also announced dividend of INR6.5/share in line with its dividend policy of maintaining 25% payout ratio. With major portion of capex done and its capex guidance in line with depreciation, cash flows are expected to remain strong and WLSI could plan to further prune debt.

Outlook and valuations: Growth visibility awaited; maintain 'HOLD'

With capacity coming on board in the quarters ahead, WLSI's earnings are expected to be in line with estimates. We had downgraded the stock in the previous quarter on rich valuations, but capacity expansion in sheeting over the announced 72mn mtrs and planned high-RoE low-capex ancillarisation projects could provide upside on further visibility. We continue to value the stock at 6.0x FY17E EV/EBITDA, giving us a target price of INR849. **Maintain 'HOLD'**.

EDELWEISS RATINGS

Absolute Rating	HOLD
Investment Characteristics	Growth

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

CMP	: INR 760
Target Price	: INR 849
52-week range (INR)	: 963 / 271
Share in issue (mn)	: 100.5
M cap (INR bn/USD mn)	: 76 / 1,182
Avg. Daily Vol. BSE/NSE ('000)	: 224.0

SHARE HOLDING PATTERN (%)

	Current	Q1FY16	Q4FY15
Promoters *	73.5	73.5	73.5
MF's, FI's & BKs	4.8	4.8	4.9
FII's	6.1	6.1	3.5
Others	15.7	15.7	18.0
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	4.5	(12.9)	(17.4)
3 months	(0.9)	(1.4)	(0.6)
12 months	25.7	169.3	143.6

Financials

(INR mn)

Year to March	Q2FY16	Q2FY15	YoY	Q1FY16	QoQ	FY15	FY16E	FY17E
Net Revenues	14,723	14,135	4.2	13,885	6.0	53,025	59,283	69,254
EBITDA	3,743	3,169	18.1	3,598	4.0	12,742	15,523	18,227
Adjusted Profit	1,724	1,299	32.7	1,632	5.6	5,398	7,014	8,506
Adjusted Diluted EPS	17.2	12.9	32.6	16.2	5.6	53.7	69.8	84.7
Diluted P/E (x)						14.2	10.9	9.0
EV/EBITDA (x)						8.1	6.5	5.5
ROAE (%)						41.7	40.8	36.9

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Q2FY16 results

- The company reported highest-ever quarterly profit.
- Revenue growth of 4% can be broken into positive volume impact of 5%, positive currency impact of 1% (Q2FY16: INR64.35 versus INR63.6 in Q2FY15) and negative MEIS impact of 2%.
- Revenue mix: USA - 65%, Europe & RoW - 35%.
- Increase in other expenses: The company took INR100mn forex related hit. It does not expect these expenses to occur in ensuing quarters

Industry related

- The annual cotton production estimate for India is 337mn bales, which should be sufficient considering demand from China is muted.
- WLSI expects cotton prices to be stable going ahead too.
- Demand from US is expected to be steady.

Production/ utilisation**Table 1: Capacity utilization**

Capacity Utilisation (%)	FY15	Q1FY16	Q2FY16
Towels	102.0	105.0	105.0
Sheets	97.0	102.0	96.0
Rugs	58.0	64.0	70.0

*Source: Company***Growth plans & competition**

- WLSI expects future growth to come from new verticals like hospitality, smart textiles, eCommerce, etc., and increasing its product range in bedding segment.
- **Hospitality**
 - Looking at expanding in hospitality segment, which is a USD1bn market.
 - At present, 3-4% of revenues comes from hospitality (USD35mn in FY16 and expects to do USD70mn in FY17).
- **Bedding market**
 - The company's share of the US market in sheets in volume terms is 7-8%; India's share is ~33%.
 - While sheeting market is penetrated, bedding is a much larger market than sheets. India has garnered major share of the sheets market. Sheets segment is only 1/3rd of the bedding market.
 - WLSI does not believe increased capacity of competition will impact its realisation as this is a quality focused product segment and the company is known for its quality.
 - This is a touch and feel product which stays in the room for a long time.
 - If vendors were looking for cheaper products they would have gone to Pakistan.

Welspun brands and innovative products

- Innovative products contributed 30% of revenues and branded products contributed 11% of revenues.
- Welspun's new web site is not a market place, but an omni-channel web site.
- Brands are growing at 35% QoQ, WLSI's share is 5%.
- The company has plans to go global with *Christy's*. It logged 25% plus growth in the Middle East
- Company expects Hygro Cotton revenues to grow by 15% YoY.
- Hygro Cotton by itself has turned into a branded franchise. WLSI has further gone ahead and removed a TV commercial to brand the product.

Capex

- Unlike competition, WLSI has been chasing capacity and not investing in anticipation of demand.
- The company has always had around 100% utilisation and hence the need to invest has come.
- WLSI incurred capex of INR2.3bn in Q2FY16. This takes total capex to INR4.5bn in H1FY16.
- Overall towel capacity is expected to increase by 20% over next 2 quarters with 10% improvement in Q3FY16 and the remaining 10% in Q4FY16.
- The entire increased sheeting capacity of 72mn mtrs (current 60mn mtrs) will be available in Q3FY16.
- The company is also working on further enhancing its sheeting capacity by de-bottlenecking. There was mention of taking this to 90-100mn mtrs.
- It expects future increase in capex post this round to be in line with depreciation.

Debt

- All of the company's INR25-26bn investment is TUF guaranteed, despite any talks of TUF being taken off.
- Only 20% of borrowings are non TUF, which is in the power plant.
- Receivables from Gujarat for interest benefit stood at INR100cr. WLSI expects this to continue.

Impact of Trans Pacific Partnership (TPP)

- Vietnam is not into home textiles. Therefore, the company believes possible impact of TPP will be on apparels and not on home textiles.
- Also, home textiles only attract 5-9% duty as compared to apparels, which attract 15-32% duty. This 5-9% is just the cost of moving cotton.

Guidance

- Annual guidance of 13-17% revenue growth has been maintained.
- Growth in Q3 and Q4 will be substantially higher.
- The company expects retail brands to contribute 25% of total revenues by FY20.

Margin improvement driven by increased backward integration, better product mix and lower raw material prices.

Company's focus on debt reduction is visible

Chart 1: EBITDA margins at 25.4% were close to life time high margins seen in Q1FY16

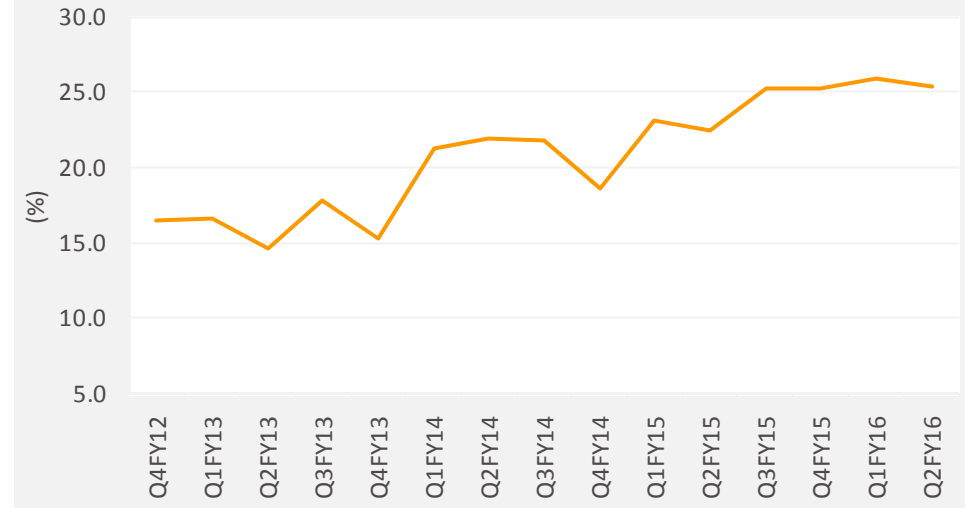


Chart 2: Stable Gross Debt/EBITDA and Gross debt/Equity levels

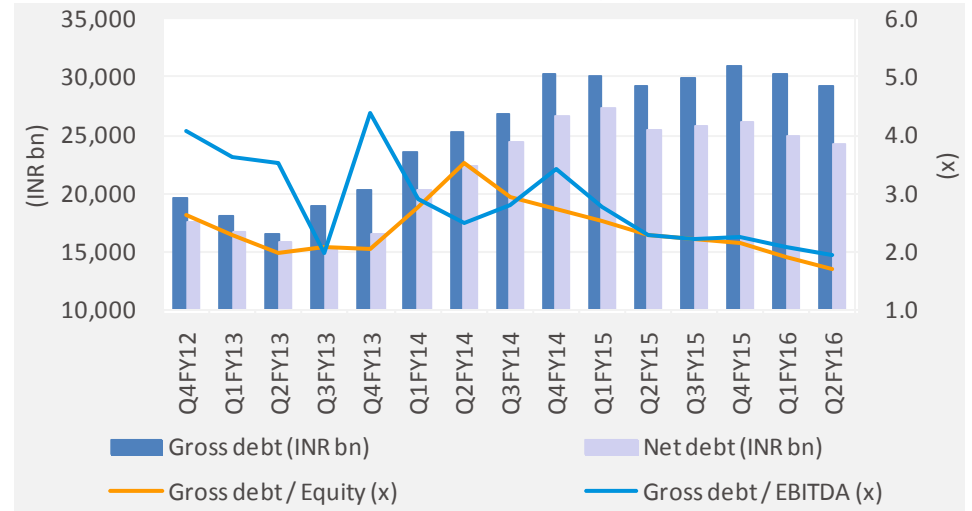
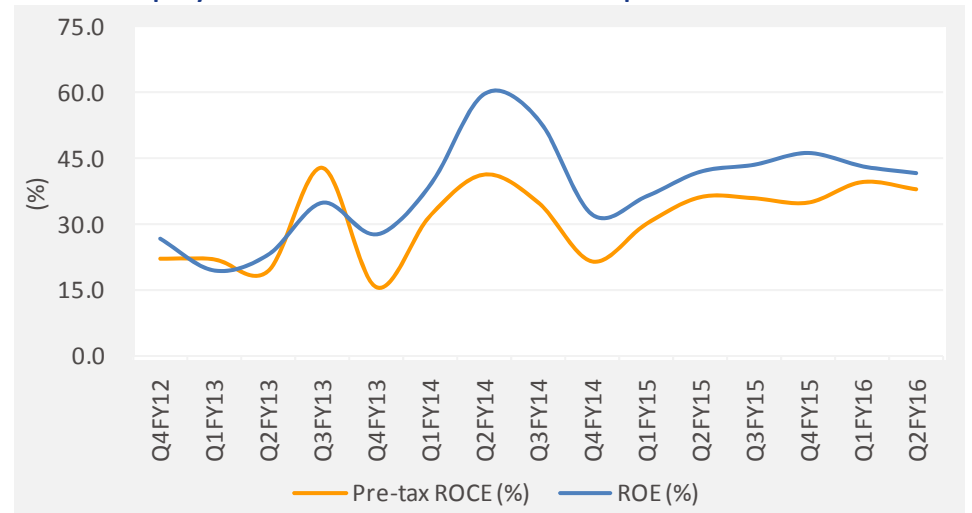


Chart 3: Company continues to maintain its RoE at 40% plus



Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q2FY16	Q2FY15	% change	Q1FY16	% change	YTD16	FY16E	FY17E
Net revenues	14,723	14,135	4.2	13,885	6.0	28,607	59,283	69,254
Staff costs	1,325	1,143	15.9	1,239	6.9	2,564	5,406	6,578
Direct costs	6,637	7,223	(8.1)	6,426	3.3	13,063	26,621	30,928
Other expenses	3,019	2,600	16.1	2,621	15.2	5,639	11,732	13,521
EBITDA	3,743	3,169	18.1	3,598	4.0	7,341	15,523	18,227
Depreciation	918	717	28.0	793	15.7	1,711	3,750	4,248
EBIT	2,825	2,452	15.2	2,805	0.7	5,630	11,773	13,979
Other income	197	191	3.1	277	(28.9)	474	756	454
Interest	515	731	(29.6)	593	(13.2)	1,107	2,195	1,892
Add: Exceptional items								
Profit before tax	2,508	1,913	31.1	2,490	0.7	4,997	10,334	12,542
Provision for taxes	747	591	26.3	840	(11.1)	1,586	3,255	3,951
Minority interest	38	23	65.6	19	102.2	56	65	85
Reported net profit	1,724	1,299	32.7	1,632	5.6	3,355	7,014	8,506
Adjusted Profit	1,724	1,299	32.7	1,632	5.6	3,355	7,014	8,506
Diluted shares (mn)	100	100		100		100	100	100
Adjusted Diluted EPS	17.2	12.9		16.2		33.4	69.8	84.7
As % of net revenues								
Direct costs	45.1	51.1		46.3		48.0	44.7	-
Employee cost	9.0	8.1		8.9		8.4	9.5	-
Other expenses	20.5	18.4		18.9		19.6	19.5	-
EBITDA	25.4	22.4		25.9		24.0	26.3	-
Reported net profit	11.7	9.2		11.8		10.2	12.3	-
Tax rate	29.8	30.9		33.7		27.7	31.5	-

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 FY15 with a net debt/equity of 1.8x. It is in the midst of a capex programme with a remaining outlay of INR6bn. 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
Macro				
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	64.5	65.0
Company				
Towel cap. (MT)	45,000	50,000	60,000	60,000
Bed-linen cap. (000 mts)	55,000	60,000	72,000	72,000
Rugs/carpets cap. (MT)	12,000	15,000	20,000	20,000
Towel utilis. (%)	99	102	88	93
Bed-linen utilis. (%)	89	97	86	93
Rugs/carpets utilis. (%)	68	58	61	75
Raw Material (% net rev)	51.8	48.0	44.9	44.7
Other exp (% net rev)	19.3	19.6	19.8	19.5
Depreciation rate (%)	5.5	7.6	7.3	7.3
Dividend per share	3.0	10.5	14.5	17.6
Capex (INR mn)	7,186	5,795	9,815	3,563
Inventory % of costs	44.5	43.3	44.0	44.0
Debtors % of revenues	9.4	8.4	8.5	8.5
OCA % of revenues	7.0	2.8	5.0	5.0
Loans & adv (% net rev)	12.3	14.1	12.0	12.0
Incremental debt	8,939	558	(1,285)	(2,992)

Income statement

Year to March	(INR mn)			
	FY14	FY15	FY16E	FY17E
Net revenue	43,730	53,025	59,283	69,254
Materials costs	22,673	25,443	26,621	30,928
Gross profit	21,057	27,582	32,662	38,326
Employee costs	3,400	4,460	5,406	6,578
Other Expenses	8,446	10,380	11,732	13,521
EBITDA	9,211	12,742	15,523	18,227
Depreciation	6,863	3,329	3,750	4,248
EBIT	2,348	9,412	11,773	13,979
Add: Other income	1,042	949	756	454
Less: Interest Expense	2,352	2,829	2,195	1,892
Profit Before Tax	1,037	7,533	10,334	12,542
Less: Provision for Tax	199	2,090	3,255	3,951
Less: Minority Interest	(82)	45	65	85
Reported Profit	921	5,398	7,014	8,506
Adjusted Profit	921	5,398	7,014	8,506
Shares o/s (mn)	100	100	100	100
Adjusted Basic EPS	9.2	53.7	69.8	84.7
Diluted shares o/s (mn)	100	100	100	100
Adjusted Diluted EPS	9.2	53.7	69.8	84.7
Adjusted Cash EPS	63.0	89.3	110.5	131.0
Dividend per share (DPS)	3.0	10.5	14.5	17.6
Dividend Payout Ratio(%)	38.3	23.5	25.0	25.0

Common size metrics

Year to March	FY14	FY15	FY16E	FY17E
Operating expenses	78.9	76.0	73.8	73.7
Materials costs	51.8	48.0	44.9	44.7
Staff costs	7.8	8.4	9.1	9.5
S G & A expenses	19.3	19.6	19.8	19.5
Depreciation	15.7	6.3	6.3	6.1
Interest Expense	5.4	5.3	3.7	2.7
EBITDA margins	21.1	24.0	26.2	26.3
Net Profit margins	1.9	10.3	11.9	12.4

Growth ratios (%)

Year to March	FY14	FY15	FY16E	FY17E
Revenues	19.9	21.3	11.8	16.8
EBITDA	54.9	38.3	21.8	17.4
PBT	(65.2)	626.3	37.2	21.4
Adjusted Profit	(59.5)	486.3	29.9	21.3
EPS	(59.6)	485.6	29.9	21.3

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	18,574	24,954	
Shareholders' funds	11,096	14,318	19,579	25,958	
Minority Interest	316	378	443	528	
Short term borrowings	13,498	14,905	12,558	12,373	
Long term borrowings	16,795	15,946	17,008	14,201	
Total Borrowings	30,293	30,851	29,566	26,574	
Long Term Liabilities	1,553	1,020	6,128	2,318	
Def. Tax Liability (net)	434	641	976	1,383	
Sources of funds	43,693	47,208	56,692	56,762	
Gross Block	34,049	42,980	53,612	57,253	
Net Block	18,395	24,442	31,326	30,722	
Capital work in progress	5,324	1,564	747	669	
Intangible Assets	1,890	1,828	1,836	1,844	
Total Fixed Assets	25,609	27,834	33,909	33,235	
Non current investments	473	15	500	500	
Cash and Equivalents	2,974	4,657	5,415	3,382	
Inventories	10,094	11,006	11,713	13,608	
Sundry Debtors	4,117	4,467	5,039	5,887	
Loans & Advances	5,376	7,474	7,114	8,310	
Other Current Assets	3,041	1,500	2,964	3,463	
Current Assets (ex cash)	22,628	24,447	26,830	31,268	
Trade payable	6,144	6,910	7,439	8,675	
Other Current Liab	1,846	2,835	2,524	2,949	
Total Current Liab	7,990	9,745	9,963	11,623	
Net Curr Assets-ex cash	14,638	14,702	16,867	19,645	
Uses of funds	43,693	47,208	56,692	56,762	
BVPS (INR)	110.6	142.5	194.9	258.4	

Free cash flow		(INR mn)			
Year to March	FY14	FY15	FY16E	FY17E	
Reported Profit	921	5,398	7,014	8,506	
Add: Depreciation	6,863	3,329	3,750	4,248	
Interest (Net of Tax)	1,576	2,044	1,504	1,296	
Others	(4,672)	161	(577)	(10,034)	
Less: Changes in WC	(3,974)	(2,399)	(1,928)	(6,588)	
Operating cash flow	5,510	9,243	10,611	8,011	
Less: Capex	7,186	5,795	9,815	3,563	
Free Cash Flow	(1,676)	3,449	796	4,448	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Welspun India	1,182	10.9	9.0	6.5	5.5	40.8	36.9
Arvind	1,152	20.3	15.4	10.1	8.2	12.6	14.8
Himatsingka Seide	338	12.0	8.6	10.4	8.6	20.4	23.4
Median	-	12.0	9.0	10.1	8.2	20.4	23.4
AVERAGE	-	14.4	11.0	9.0	7.4	24.6	25.0

Source: Edelweiss research

Cash flow metrics		FY14	FY15	FY16E	FY17E
Year to March					
Operating cash flow		5,510	9,243	10,611	8,011
Investing cash flow		(9,671)	(6,071)	(9,554)	(3,119)
Financing cash flow		4,200	(3,102)	(298)	(6,925)
Net cash Flow		39	71	758	(2,033)
Capex		(7,186)	(5,795)	(9,815)	(3,563)
Dividend paid		(238)	(711)	(1,753)	(2,127)

Profitability and efficiency ratios

Year to March	FY14	FY15	FY16E	FY17E
ROAE (%)	7.8	41.7	40.8	36.9
ROACE (%)	9.4	23.8	26.3	28.1
Inventory Days	121	122	124	119
Debtors Days	29	30	29	29
Payable Days	89	94	98	95
Cash Conversion Cycle	60	58	55	53
Current Ratio	3.2	3.0	3.2	3.0
Gross Debt/EBITDA	3.3	2.4	1.9	1.5
Gross Debt/Equity	2.7	2.1	1.5	1.0
Adjusted Debt/Equity	2.7	2.1	1.5	1.0
Net Debt/Equity	2.4	1.8	1.2	0.9
Interest Coverage Ratio	1.0	3.3	5.4	7.4

Operating ratios

Year to March	FY14	FY15	FY16E	FY17E
Total Asset Turnover	1.1	1.2	1.1	1.2
Fixed Asset Turnover	2.3	2.3	2.0	2.1
Equity Turnover	4.1	4.1	3.4	3.0

Valuation parameters

Year to March	FY14	FY15	FY16E	FY17E
Adj. Diluted EPS (INR)	9.2	53.7	69.8	84.7
Y-o-Y growth (%)	(59.6)	485.6	29.9	21.3
Adjusted Cash EPS (INR)	63.0	89.3	110.5	131.0
Diluted P/E (x)	82.8	14.1	10.9	9.0
P/B (x)	6.9	5.3	3.9	2.9
EV / Sales (x)	2.4	1.9	1.7	1.4
EV / EBITDA (x)	11.3	8.1	6.5	5.5
Dividend Yield (%)	0.4	1.4	1.9	2.3

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
Goldman Sachs Group	2.66	Reliance Capital	1.90
HSBC Asset Mgmt India	0.74	Prudential ICICI	0.73
Frank Russell Rrust	0.41	Dimensional Fund Advisors	0.38
Mirae Global Asset Mgmt	0.31	Capital Securities	0.30
BNP Paribas Asset Mgmt	0.26	Birla Sun Life Insurance	0.23

**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
19 Mar 2015	Krishiraj Trading Limited	Buy	185000.00

**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
17-Oct-15	Himatsingka Seide	Packs in a positive punch; <i>Result Update</i>	212	Buy
06-Aug-15	Arvind	Awaiting revival kicker; <i>Result Update</i>	310	Hold
29-Jul-15	Himatsingka Seide	Exceptional operating show; on take-off mode; <i>Result Update</i>	169	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	155	45	8	208

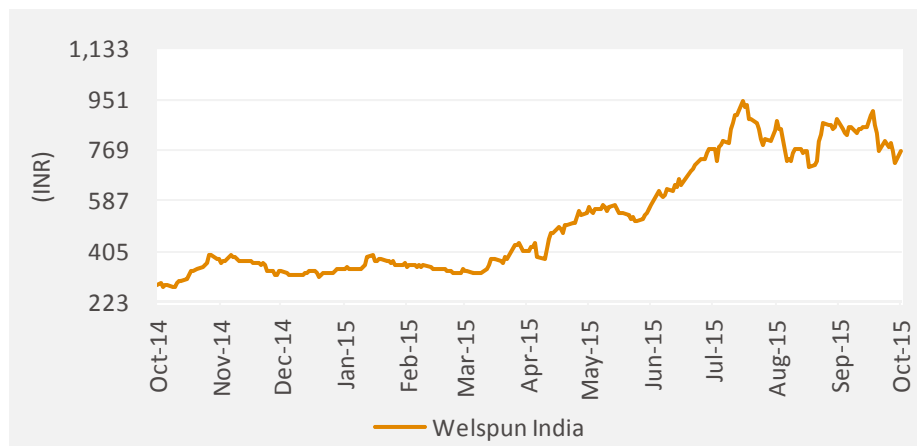
* stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	151	54	3

Rating Interpretation

Rating	Expected to
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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