2QFY20 Result Update

Welspun India

Sharp improvement in profitability

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B&K SECURITIES
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Welspun India

CMP (Rs): 53	Market cap. (Rs bn): 53.3	Target price (Rs): 59	Maintain Hold

First Cut Feel of the Results

- Revenue grew 2.5% YoY to reach Rs 18.2 bn driven by improvement in 7.2% YoY higher exchange rate realisation and 3% positive impact of export incentives. Volume de-grew 8% YoY.
- EBITDA grew 30.1% YoY to reach Rs 3,913 mn with margin of 21.4%. EBITDA margin improved 454 bps YoY due to favourable currency movement, higher export incentives coupled with lower other expenses. EBITDA margin in home textiles segment increased 509 bps YoY to 23.1% whereas loss in flooring segment stood at Rs 196 mn in 2QFY20.
- Adjusted PAT grew 57.4% YoY to reach Rs 1,985 mn led by higher EBITDA growth, lower interest cost and lower tax rate. The effective tax rate for the quarter stood at 20.7% against 23.3% in 2QFY19.
- Gross debt stood at Rs 29.9 bn against Rs 33.1 bn in 4QFY19. Net working capital declined to 83 days against 90 days in 1HFY19 led by lower inventory days and higher payable days.
- Promoter shareholding at 68.5% has remained unchanged QoQ.

Financial highlights

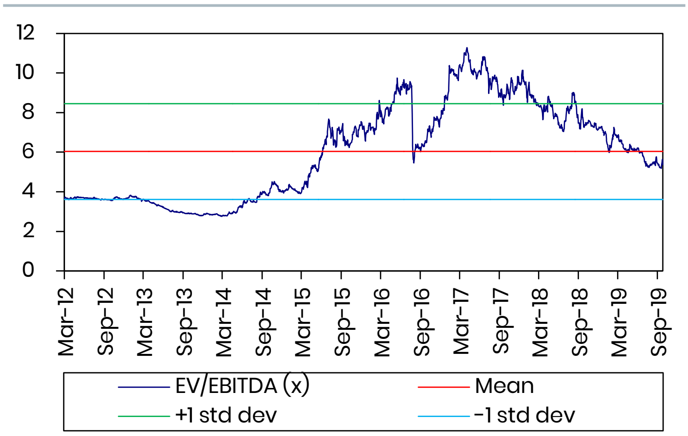
(Rs mn)	2QFY19	2QFY20	YoY (%)	1QFY20	QoQ (%)
Net sales	17,799	18,249	2.5	17,281	5.6
EBITDA	3008	3913	30.1	3,631	7.8
EBITDA margin (%)	16.9	21.4	–	21.0	–
Other income	179	122	(31.9)	82	49.2
Interest	369	336	(9.1)	374	(10.2)
Depreciation	1,083	1,145	5.7	1,094	4.6
PBT	1,734	2,554	47.2	2,244	13.8
Tax	404	528	30.6	683	(22.8)
Minority interest	69	41	(41.1)	60	(32.7)
PAT	1,261	1,985	57.4	1,500	32.3
Adjusted PAT	1,261	1,985	57.4	1,500	32.3
EPS (Rs)	1.3	2.0	57.4	1.5	32.3

Key variables

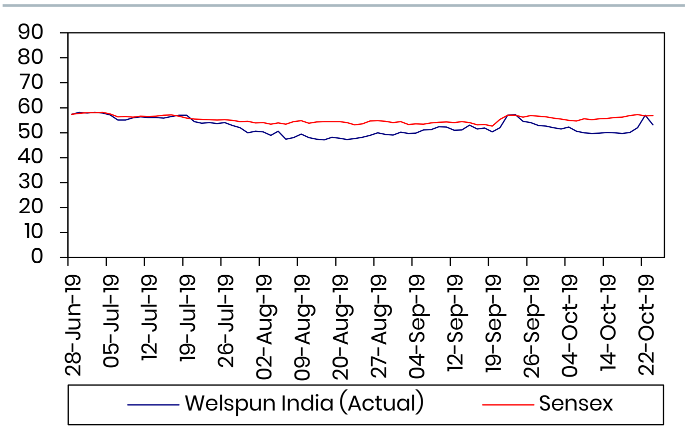
	Improvement on (%)	
	B&K est.	Consensus
Net sales	(1.4)	(2.1)
EBITDA	6.7	8.7
Adjusted PAT	26.7	25.1

	FY19	FY20E	FY21E
Valuations			
PER (x)	12.6	9.7	10.9
PBV (x)	2.1	1.8	1.6
EV/EBITDA (x)	8.4	6.1	6.1
Key ratios			
RoE (%)	17.6	19.6	15.2
Liquidity			
Net D/E (x)	1.0	0.9	0.7

One-year forward EV/EBITDA



Relative performance



Is it in the Price?

The company reported results that are above our expectations as well as consensus estimates. Stock has fallen 9.2% over the last three months. Further reduction in net debt is a positive surprise. The ability of the company to manage its debt prudently despite challenging industry scenario is appreciating. In FY20E, higher export incentives and better exchange rate realisation are likely to cushion the profitability in the challenging industry scenario. However, the downward revised guidance of topline growth to high single digit from double digit earlier is a negative surprise. We expect the stock to remain under pressure unless there is improvement in demand scenario.

Connecting the Dots

Weak demand to result in single digit growth: We expect revenue to grow at 7.7% CAGR over FY19-21E due to weak demand for home textiles in the US market, lower export incentives from FY21E and gradual ramp-up in flooring business. Emerging businesses including flooring, retail and advanced textile businesses are likely to drive the growth of the company. During the quarter, emerging businesses grew 30% YoY with revenue contribution of 8%.

EBITDA margin likely to decline in FY21E: EBITDA margin improved 454 bps YoY to 21.4% led by higher export incentives and better exchange rate realisation. The company maintained its FY20E margin guidance at 19-21%, despite reporting 21.2% margin in 1HFY20, due to volatile exchange rate and likely reduction in export incentive from 4QFY20E coupled with weak demand from the US and initial losses from flooring business. Though reduction in cotton prices is likely to be positive for the company, this will be beneficial only in 2HFY20E. Initial cost of operating the new Andhra Pradesh plant is likely to impact profitability in 2HFY20 and FY21E. We expect EBITDA margin to decline to 18.3% in FY21E due to losses in flooring business, lower export incentives and continuation of weak demand in the US. Gaining scale of retail business is also likely to impact the performance of the company, though marginally.

Strong debt management: Reduction in net working capital to 83 days led to cash generation in 2QFY20. The company prepaid term loans of Rs 2,842 mn, which had weighted average interest rate of 9.8% p.a. The full impact of this reduction will be visible from 3QFY20. Gross debt in 2QFY20 stood at Rs 29.9 bn against Rs 31.6 bn in 1QFY20 and Rs 33.1 bn in 4QFY19. Net debt reduced to reach Rs 27.9 bn against Rs 28.2 bn in 1QFY20. This includes debt for flooring business of Rs 5.3 bn. We expect net debt to reduce to Rs 29 bn in FY20E and Rs 26.9 bn in FY21E.

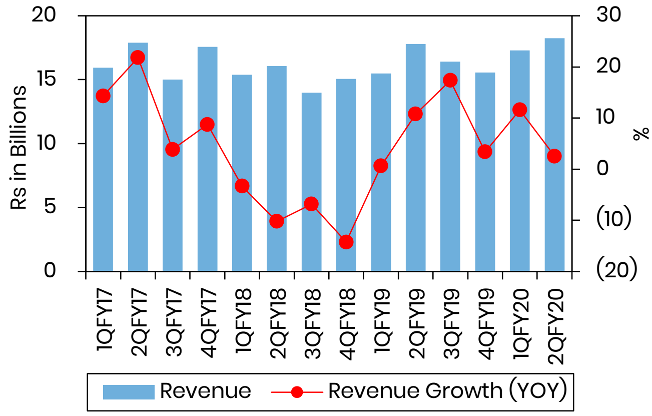
Outlook and Recommendation

FY20E is likely to be a strong year for Welspun India (WLSI) led by favourable currency movement and higher export incentives. However, we expect FY21E to witness margin contraction led by lower export incentive, losses in new flooring plant and other emerging businesses and weak demand for home textile products in the US. Though we are positive on the management strategies to improve their sales including higher focus on branded sales (Christy, Spaces and Welspun), innovation and diversifying product mix (higher domestic sales, new flooring solutions plant and advanced textiles), the uncertainties persist. Higher currency depreciation of competing countries and increasing demand for lower value-added products is impacting India's market share in the US home textile imports. The company's strategy to diversify to new products (flooring solutions plant in Andhra Pradesh) is likely to reduce dependence on traditional home textile products; however, initial costs and huge capex is likely to keep return ratios and profitability under pressure in the near-term. We maintain Hold rating on the stock with a target price of Rs 59 (valuing at 6.2x FY21E EV/EBITDA). Key risks to our estimates are steep volatility in exchange rates and higher cotton price. Key catalyst for the stock includes higher volume growth driven by US market recovery, increase in incentives by government to support exports, favourable settlement of the US class-action lawsuits and any favourable outcome from US-China trade dispute.

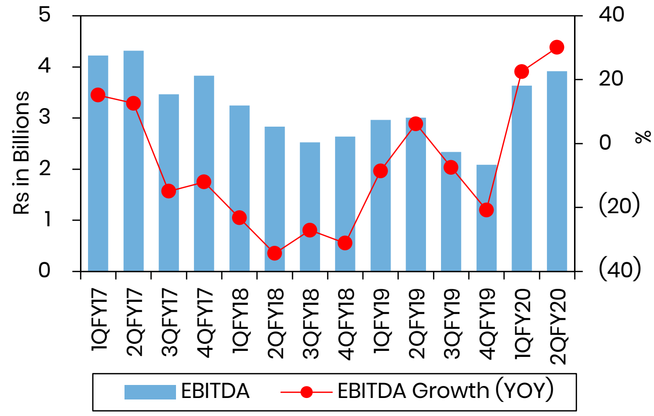
Key highlights from the conference call

- **Emerging businesses:** Retail, flooring and advanced textiles constitute emerging businesses. It contributed 1.8% to overall growth of the company. Its contribution to revenue stood at 6% in FY19 and 8% in 2QFY20. The company expects its contribution to reach 30% over the next three to four years.
- **Home textile business:** Due to postponement of promotion programmes by some US retailers, the company witnessed volume de-growth during the quarter. It focused on revenue from hospitality, e-commerce and fashion bedding to mitigate the volume pressure. The company expects core home textile business (including terry towels, cotton bed sheets and rugs and carpets) to grow at mid-single digit in FY20E.
- **Flooring business:** WLSI commenced of greenfield flooring plant in Andhra Pradesh from 13th September 2019. Out of planned capex of Rs 11 bn, the company incurred capex of Rs 8 bn till date and capitalised the same during the quarter. Of the remaining Rs 3 bn, Rs 1.5 bn is likely to be incurred in 2HFY20 and balance in FY21E. Debt for the flooring business stood at Rs 5.3 bn at the end of 2QFY20. The company has appointed 42 distributors and 450 dealers for the flooring business in the domestic market till date. The company expects larger orders from export market from FY21E. It expects revenue of Rs 1 bn in FY20E and Rs 3 bn in FY21E from this business.
- **Retail business:** The company launched mass segment product through Welspun brand during the quarter in the domestic market. It appointed Mr Amitabh Bachchan as the brand ambassador of this brand. It plans to soft launch the brand in Hyderabad or Bengaluru in the next 7-10 days. Rangana by Spaces grew 74% YoY in the quarter.
- **Export incentives:** The company expects export incentives to come down by ~4% due to change in government policies. The government has not yet started reimbursing the new scheme Remission of State and Centre Taxes and Levies (ROSCTL).
- **Cotton prices:** Cotton prices have corrected substantially in the new cotton season to ~Rs 40,000 per candy from Rs 45,000 per candy. This is likely to provide cushion to the profitability and mitigate the impact of reduction of export incentives.
- Other expenses were lower on account of lower job work and volume linked expenses.
- **Taxation:** The effective tax rate for the company has reduced to 20.7% in 2QFY20 versus 23.3% in 2QFY19. Two of its group companies namely Welspun Global Brand Ltd. and Welspun Flooring Ltd. have already migrated to the new tax regime. However, Welspun India Ltd. and Welspun Captive Power Generation Limited have not migrated on account of MAT Credit and Sec 80IA benefits, respectively. These two companies are likely to migrate to new corporate tax rate in two-three years.
- **Capex:** WLSI incurred capex of Rs 4.6 bn in 1HFY20. It plans to incur total capex of Rs 6 bn for FY20. Completion of flooring plant will complete capex cycle for the company. Cash flows will be utilised to prepay high interest cost debt and provide returns to shareholders through dividend.
- **Guidance:** WLSI lowered its revenue growth guidance from double digit earlier to high single digit. It maintained EBITDA margin guidance of ~19-21%. It maintained its vision to become net debt-free by 2022.

Revenue growth of 2.5% YoY

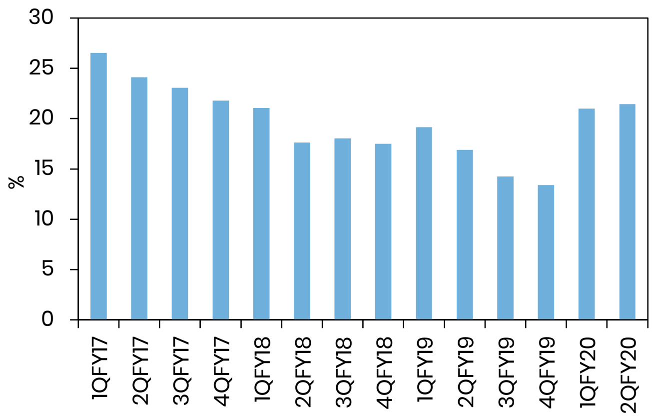


EBITDA growth of 30.1% YoY

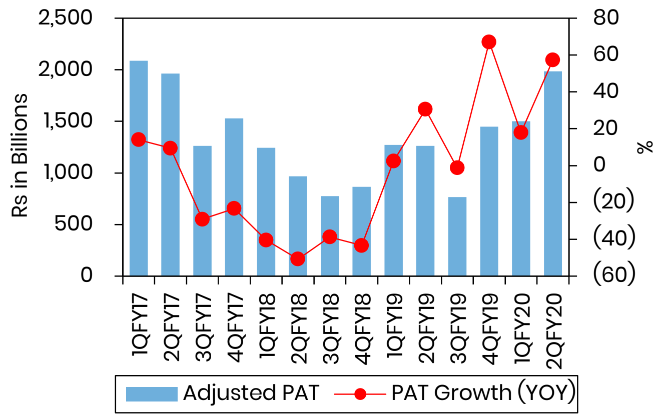


Source: Company, B&K Research

EBITDA margin at 21.4%

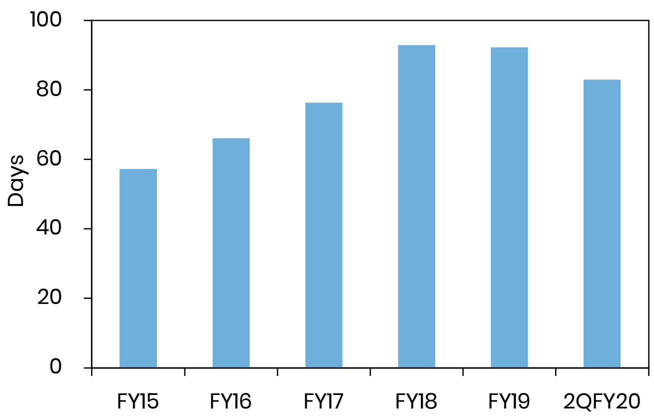


PAT growth of 57.4%YoY

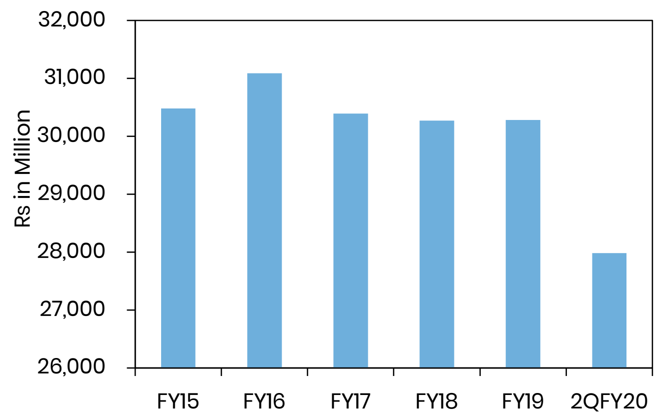


Source: Company, B&K Research

Net working capital days reduced



Net debt reduced significantly



Source: Company, B&K Research

Revised estimates

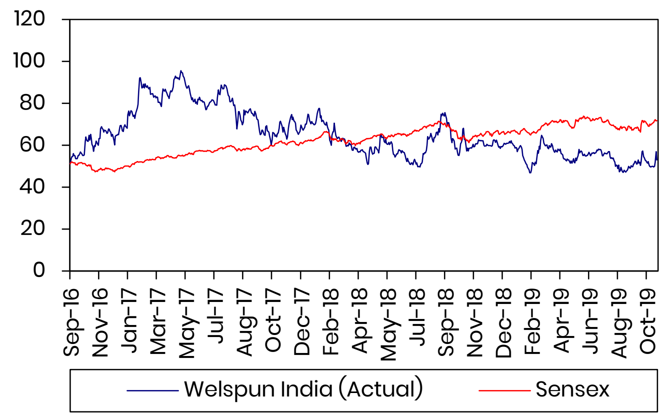
(Rs mn)	FY20E			FY21E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	71,949	69,477	(3.4)	80,289	75,696	(5.7)
EBITDA	13,560	14,133	4.2	14,543	13,818	(5.0)
EBITDA margin (%)	18.8	20.3	–	18.1	18.3	–
Adjusted PAT	4,927	5,903	19.8	5,432	5,237	(3.6)
Adjusted EPS (Rs)	4.9	5.9	19.8	5.4	5.2	(3.6)

Source: Company, B&K Research

Major shareholders (%)

	Jun 19	Sep 19	Change
Promoters	68.5	68.5	0.0
GOI	0.0	0.0	0.0
FIIs	8.7	8.6	(0.0)
MFs	8.3	7.7	(0.6)
BFSI's	0.8	2.2	1.4
Public & Others	13.7	13.0	(0.8)
Pledge	0.0	0.0	0.0

Relative to Sensex 3 Years



Income Statement (Consolidated)

Period end (Rs mn)	Mar 18	Mar 19	Mar 20E	Mar 21E
Net sales	**60,506**	**65,266**	**69,477**	**75,696**
Growth (%)	*(8.9)*	*7.9*	*6.5*	*9.0*
Operating expenses	(49,272)	(54,618)	(55,344)	(61,878)
Operating profit	**11,234**	**10,649**	**14,133**	**13,818**
EBITDA	**11,234**	**10,649**	**14,133**	**13,818**
Growth (%)	*(29.1)*	*(5.2)*	*32.7*	*(2.2)*
Depreciation	(5,042)	(4,358)	(4,736)	(5,116)
Other income	812	818	440	462
EBIT	**7,004**	**7,109**	**9,837**	**9,164**
Finance cost	(1,408)	(1,593)	(1,492)	(1,522)
Exceptional & extraordinary	0	(2,647)	0	0
Profit before tax	**5,597**	**2,869**	**8,344**	**7,642**
Tax (current + deferred)	(1,615)	(608)	(2,270)	(2,216)
P/(L) for the period	**3,982**	**2,262**	**6,075**	**5,426**
P/L of Associates, Min Int, Pref Div	(132)	(163)	(172)	(189)
Reported Profit/(Loss)	3,849	2,098	5,903	5,237
Adjusted net profit	3,849	4,745	5,903	5,237
Growth (%)	*(53.2)*	*23.3*	*24.4*	*(11.3)*

Balance Sheet (Consolidated)

Period end (Rs mn)	Mar 18	Mar 19	Mar 20E	Mar 21E
Share capital	1,005	1,005	1,005	1,005
Reserves & surplus	25,052	26,788	31,412	35,474
Total Shareholders Funds	**26,056**	**27,793**	**32,417**	**36,479**
Minority interest and others	467	709	881	1,070
Non-current liabilities	**20,660**	**19,386**	**18,938**	**17,707**
Long-term borrowings	17,028	15,537	14,844	13,344
Other non-current liab.	3,632	3,850	4,094	4,362
Current liabilities	**24,686**	**28,935**	**26,903**	**27,826**
ST borrowings, Curr maturity	15,779	16,688	16,681	16,553
Other current liabilities	8,907	12,247	10,222	11,273
Total (Equity and Liab.)	**71,870**	**76,824**	**79,139**	**83,081**
Non-current assets	**36,762**	**40,518**	**41,560**	**40,832**
Fixed assets (Net block)	33,641	36,154	36,857	35,741
Non-current Investments	278	272	272	272
Long-term loans and adv.	967	2,173	2,499	2,874
Other non-current assets	1,876	1,918	1,931	1,944
Current assets	**35,108**	**36,306**	**37,579**	**42,249**
Cash & current investment	2,661	2,728	2,445	3,019
Other current assets	32,447	33,578	35,134	39,229
Total (Assets)	**71,870**	**76,824**	**79,139**	**83,081**
Total debt	32,807	32,224	31,525	29,897
Capital employed	62,962	64,576	68,917	71,808

Cash Flow Statement (Consolidated)

Period end (Rs mn)	Mar 18	Mar 19	Mar 20E	Mar 21E
Profit before tax	**5,597**	**2,869**	**8,344**	**7,642**
Depreciation	5,042	4,358	4,736	5,116
Change in working capital	(3,850)	1,005	(3,772)	(3,270)
Total tax paid	(1,715)	(565)	(2,270)	(2,216)
Others	1,408	1,593	1,492	1,522
Cash flow from oper. (a)	**6,481**	**9,260**	**8,531**	**8,794**
Capital expenditure	(2,970)	(6,871)	(5,439)	(4,000)
Change in investments	(25)	13	0	0
Others	(32)	(35)	(13)	(14)
Cash flow from inv. (b)	**(3,027)**	**(6,893)**	**(5,452)**	**(4,014)**
Free cash flow (a+b)	**3,454**	**2,367**	**3,079**	**4,780**
Debt raised/(repaid)	(307)	(583)	(699)	(1,628)
Dividend (incl. tax)	(786)	(786)	(1,279)	(1,176)
Others	(2,333)	(923)	(1,384)	(1,402)
Cash flow from fin. (c)	**(3,426)**	**(2,292)**	**(3,362)**	**(4,206)**
Net chg in cash (a+b+c)	**28**	**75**	**(283)**	**574**

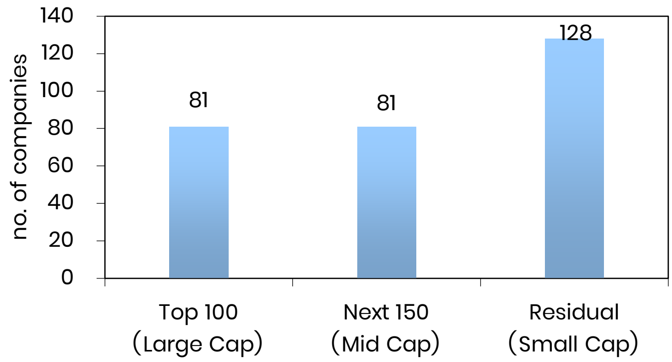
Key Ratios (Consolidated)

Period end (%)	Mar 18	Mar 19	Mar 20E	Mar 21E
Adjusted EPS (Rs)	3.8	4.7	5.9	5.2
Growth	(53.2)	23.3	24.4	(11.3)
CEPS (Rs)	8.8	9.1	10.6	10.3
Book NAV/share (Rs)	25.9	27.7	32.3	36.3
Dividend/share (Rs)	0.7	0.6	1.1	1.0
Dividend payout ratio	20.4	37.5	21.7	22.5
EBITDA margin	18.6	16.3	20.3	18.3
EBIT margin	11.6	10.9	14.2	12.1
Tax rate	28.9	11.0	27.2	29.0
RoCE	11.3	11.1	14.7	13.0
Net debt/Equity (x)	1.1	1.0	0.9	0.7
Net debt/EBITDA (x)	2.7	2.8	2.1	1.9
Du Pont Analysis - ROE				
Net margin	6.4	7.3	8.5	6.9
Asset turnover (x)	0.8	0.9	0.9	0.9
Leverage factor (x)	2.9	2.8	2.6	2.4
Return on equity	15.4	17.6	19.6	15.2

Valuations (Consolidated)

Period end (x)	Mar 18	Mar 19	Mar 20E	Mar 21E
PER	14.9	12.6	9.7	10.9
PCE	6.5	6.5	5.4	5.5
Price/Book	2.2	2.1	1.8	1.6
Yield (%)	1.1	1.1	1.9	1.7
EV/EBITDA	7.8	8.4	6.1	6.1

B&K Universe Profile – by AMFI Definition



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