

WELSPUN INDIA

Target pullout impacts; core strong

India Equity Research | Midcap Textiles

Welspun India's (WLSI) Q3FY17 revenue, at INR15.0bn, was up only 4% YoY as performance was impacted by the pullout of Target's orders starting this quarter. However, on like-to-like basis (ex Target) revenue grew by a decent 12-15% YoY. EBITDA margin contracted ~510bps YoY due to increase in raw material, power & fuel expenses and under absorption of fixed cost. Also, spurt in depreciation expense saw PAT declining 30% YoY to INR1.3bn. Though growth was muted, the decent like-to-like growth in revenue points to fading risk from the 'Egyptian Cotton' issue. As we roll over to FY19E we build in 10% YoY growth in FY19E revenue and maintain our 7.0x EV/EBITDA target multiple giving us a revised TP of INR99 (INR90 earlier). Maintain 'BUY'.

Revenue growth drags as Target pulls out

Revenue growth slowed down to 3.9% YoY after growing in double digits in past 3 quarters, with volumes coming in flat, as Target pulled out starting this quarter. On a like-to-like basis (ex Target), revenue grew by a decent 12-15% YoY. Gross margin improved QoQ, despite the increase in cotton prices. However, EBITDA margin contracted by 509bps YoY, primarily impacted by the increase in raw material prices (~100bps), power/fuel costs (~100bps) and under absorption of fixed costs (~150bps). This led to 29.6% YoY dip in adjusted PAT to INR1.3bn, which was also impacted by higher depreciation on account of capitalisation of ongoing projects.

Flooring capex on track, but debt spikes

WLSI's new flooring product line will include rugs, decorative carpets, tile carpets, accent rugs and will be commissioned by Q2FY19/Q3FY19. During Q3FY17, net debt increased by INR3.1bn QoQ, mainly due to the rise in working capital.

Outlook and valuations: Growth to accelerate; maintain 'BUY'

The decent like-to-like growth in revenues points to increasing business from existing clients/acquisition of new clients, which mitigates any fallout risks from the 'Egyptian Cotton' issue. While growth is expected to remain muted till FY18, as we roll over to FY19E we factor in 10% YoY growth in revenues, though margins may correct to the guided range of 22-23%. We retain our 7.0x EV/EBITDA target multiple giving us a TP of INR99. Maintain 'BUY'.

Financials

(INR mn)

Year to March	Q3FY17	Q3FY16	YoY (%)	Q2FY17	QoQ (%)	FY16	FY17E	FY18E
Net Revenues	15,009	14,451	3.9	17,899	(16.2)	59,371	64,446	68,227
EBITDA	3,463	4,070	(14.9)	4,318	(19.8)	15,899	16,540	16,914
Adjusted Profit	1,325	1,783	(25.7)	2,396	(44.7)	7,400	7,363	7,259
Adj. Dil. EPS	1.3	1.8	(25.7)	2.4	(44.7)	7.4	7.3	7.2
Diluted P/E (x)						10.2	10.2	10.4
EV/EBITDA (x)						6.3	6.1	5.9
ROAE (%)						42.9	34.1	28.0

EDELWEISS RATINGS

Absolute Rating **BUY**

Investment Characteristics Growth

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

CMP	: INR 75
Target Price	: INR 99
52-week range (INR)	: 120 / 46
Share in issue (mn)	: 1,004.7
M cap (INR bn/USD mn)	: 75 / 1,113
Avg. Daily Vol. BSE/NSE ('000)	: 3,994.2

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	73.5	73.5	73.5
MF's, FI's & BKs	2.0	2.0	2.3
FII's	11.6	9.5	13.6
Others	12.9	15.0	10.7
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	8.8	11.8	3.1
3 months	(2.6)	18.3	20.9
12 months	24.9	(11.5)	(36.4)

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Q3FY17 concall: Key highlights

- Key reasons for fall in EBITDA margin
 - ~1% impact from cotton cost, which was partially mitigated by foreign exchange gain.
 - ~1% increase in energy/coal costs.
 - ~1.5% due to under absorption of fixed costs.
- Overall volumes were flat.
- Geography-wise revenue mix:
 - US: 66%, Europe: 17-19%, India: 6-7%, RoW: 9%
- WLSI has remitted 45% of the provision (exception expense) of INR5bn to the US.
- The company made its last shipment to Target towards early October and received minimal revenue from same this quarter.
- On a like-to-like basis (ex Target), revenue grew by 12-15%. This was driven by the various initiatives undertaken by the company.

Industry

- In past 2-3 years, despite the duty disadvantages, India has been growing at a better rate in Europe versus other geographies.
- The new scheme of rebate of state levies has been announced. However, details are awaited, which will most likely come post the state election results.

Flooring

- Flooring is an extension of the bath rugs business and will be a vertically integrated operation.
- New flooring facility will be available by Q2FY19/Q3FY19.
- Can expect asset turn of 1.5x on optimum basis.
- Looking at domestic and export markets.
- Looking at a 20% RoIC which is the guiding principle for any capex

Debt:

- Net debt is higher by INR3bn due to bunched up remittances and higher working capital.

Others

- Hygro is clocking annualised revenue of USD200mn.
- Growth in innovative and branded products remains strong.
- WLSI is importing coal from Indonesia and South Africa. At current prices too, impact on margins could be 1.5%.

Guidance

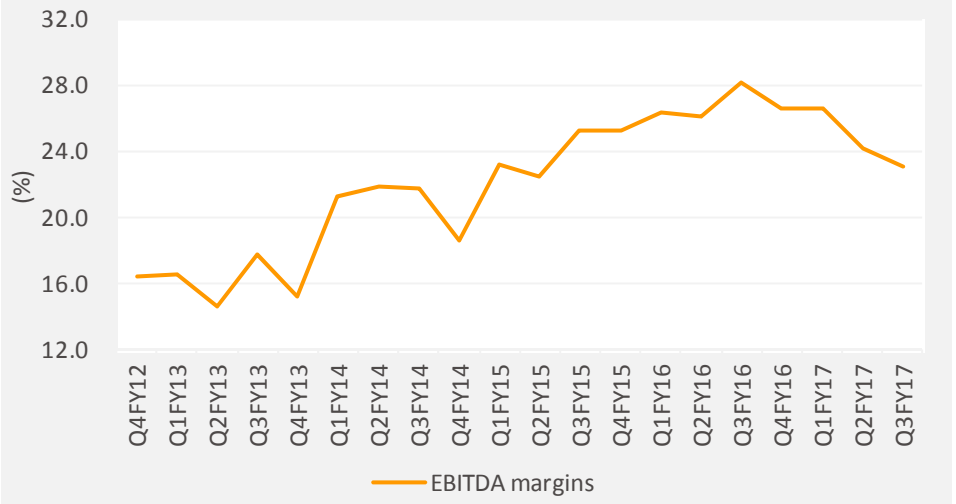
- Looking at double-digit growth from the new base.
- On bath sides utilisation will remain high at 90% plus.
- The company expects India's market share to keep expanding driven by better cost structure.

- WLSI will continue to sharpen focus on domestic market, which is as profitable as the international segment.
- Capex
 - FY17: Capex will be marginally lower than the guided INR8bn as there will be some spill over to FY18.
 - FY18: Will include maintenance capex and capex for flooring expansion.

Q2FY17 analyst meet: Key highlights

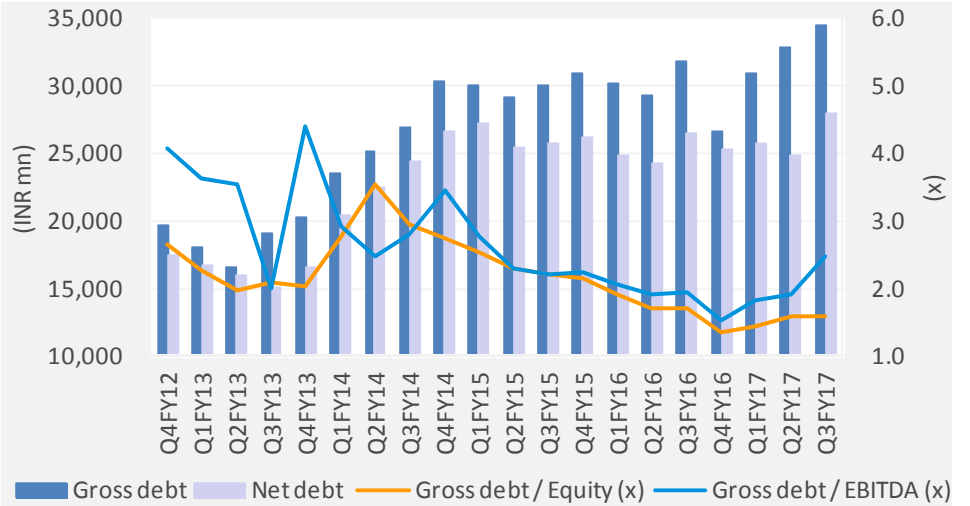
- **Egyptian cotton issue**
 - The sole issue was traceability of the cotton. It was never about quality or safety.
 - WLSI went ahead and reached out to every customer.
 - Going forward, it has decided not to outsource intermediate processes relating to Egyptian cotton.
 - The company mentioned it is business as usual with majority of its customers.
 - Also, its business with Bed, Bath & Beyond remains intact.
 - Overall, 12-15% impact on revenues (including Target).
 - Class action suits are at very preliminary stage. WLSI has provided for legal fees relating to same but not any penalty.
- **Q2FY17**
 - Of the 22% revenue growth reported in Q2FY17, 18% was volume led and the balance 4% came from exchange gains.
- **Flooring**
 - WLSI will spend INR6bn on new venture.
 - This market is expected to grow at a CAGR of 20-25%.
 - The company is targeting IRR of 16-20% from this new capex.
 - The new capex may be eligible for government's adjusted TUF scheme. It will definitely be eligible for the state incentive scheme.
- **Debt**
 - Of the INR32.8bn debt, INR17bn is eligible for TUFs.
- **Others**
 - WLSI has filed 27 global patents of which 9 have been granted.
 - Post capex completion, the company expects to be the largest and lowest cost home textile manufacturer globally.
- **Guidance**
 - WLSI expects revenue growth to be muted in FY18.
 - The company expects increase in raw material prices to impact margins at least in the interim. It expects 2-3% impact.
 - FY17 tax rate will be 30-32%.

Chart 1: EBITDA margin was impacted by higher cotton and energy costs



Source: Company, Edelweiss research

Chart 2: Debt is expected to increase driven by the INR6bn capex in flooring



Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q3FY17	Q3FY16	% change	Q2FY17	% change	YTD17	FY17E	FY18E
Net revenues	15,009	14,451	3.9	17,899	(16.2)	48,834	64,446	68,227
Staff costs	1,644	1,421	15.6	1,513	8.6	4,696	5,987	6,574
Direct costs	6,306	5,977	5.5	8,173	(22.8)	21,719	29,298	31,585
Other expenses	3,596	2,982	20.6	3,896	(7.7)	10,414	12,622	13,154
EBITDA	3,463	4,070	(14.9)	4,318	(19.8)	12,005	16,540	16,914
Depreciation	1,305	989	31.9	1,264	3.2	3,689	4,821	5,607
EBIT	2,158	3,081	(30.0)	3,054	(29.3)	8,316	11,719	11,307
Other income	210	181	16.0	251	(16.6)	650	850	1,182
Interest	480	593	(19.0)	320	50.1	1,153	1,608	1,651
Add: Exceptional items	239	-	-	(4,895)	(104.9)	(4,656)	(4,895)	-
Profit before tax	2,127	2,669	(20.3)	(1,910)	(211.4)	3,157	6,066	10,838
Provision for taxes	624	853	(26.8)	(400)	(256.3)	1,078	1,911	3,414
Minority interest	9	34	(74.3)	(35)	(124.5)	42	145	165
Reported net profit	1,494	1,783	(16.2)	(1,475)	(201.3)	2,037	4,010	7,259
Adjusted Profit	1,325	1,783	(25.7)	2,396	(44.7)	5,739	7,363	7,259
Diluted shares (mn)	1,005	1,005	-	1,005	-	1,005	1,005	1,005
Adjusted Diluted EPS	1.3	1.8	(25.7)	2.4	(44.7)	5.7	7.3	7.2
Diluted P/E (x)	-	-	-	-	-	-	10.2	10.4
EV/EBITDA (x)	-	-	-	-	-	-	6.1	5.9
ROAE (%)	-	-	-	-	-	-	34.1	28.0
Direct costs	42.0	41.4	-	45.7	-	44.5	45.5	46.3
Employee cost	11.0	9.8	-	8.5	-	9.6	9.3	9.6
Other expenses	24.0	20.6	-	21.8	-	21.3	19.6	19.3
EBITDA	23.1	28.2	-	24.1	-	24.6	25.7	24.8
Reported net profit	8.8	12.3	-	13.4	-	11.8	11.4	10.6
Tax rate	29.4	32.0	-	20.9	-	34.1	31.5	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.

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	FY17E	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.0	5.8	5.8
USD/INR (Avg)	65.0	67.5	69.0	69.0
Company				
Towel cap. (MT)	55,000	60,000	72,000	72,000
Bed-linen cap. (000 mts)	66,000	72,000	90,000	90,000
Rugs/carpets cap. (MT)	15,000	17,500	25,000	25,000
Towel utilis. (%)	101	94	79	85
Bed-linen utilis. (%)	101	88	70	76
Rugs/carpets utilis. (%)	76	82	62	72
Raw Material (% net rev)	44.8	45.5	46.3	47.1
Other exp (% net rev)	19.4	19.6	19.3	19.5
Depreciation rate (%)	7.2	7.9	8.0	7.7
Dividend per share	1.3	0.8	1.4	1.5
Capex (INR mn)	10,597	8,785	8,829	7,373
Inventory % of costs	41.5	41.0	41.0	41.0
Debtors % of revenues	10.3	10.3	10.3	10.3
OCA % of revenues	2.8	2.8	2.8	2.9
Loans & adv (% net rev)	10.8	10.8	10.8	11.0
Incremental debt	(4,219)	2,419	(2,188)	(1,117)

Income statement

(INR mn)

Year to March	FY16	FY17E	FY18E	FY19E
Net revenue	59,371	64,446	68,227	74,776
Materials costs	26,589	29,298	31,585	35,211
Gross profit	32,782	35,149	36,642	39,565
Employee costs	5,364	5,987	6,574	7,160
Other Expenses	11,518	12,622	13,154	14,589
EBITDA	15,899	16,540	16,914	17,817
Depreciation	3,718	4,821	5,607	6,064
EBIT	12,181	11,719	11,307	11,753
Add: Other income	950	850	1,182	1,135
Less: Interest Expense	2,368	1,608	1,651	1,795
Add: Exceptional items	-	(4,895)	-	-
Profit Before Tax	10,763	6,066	10,838	11,092
Less: Provision for Tax	3,238	1,911	3,414	3,494
Less: Minority Interest	125	145	165	185
Reported Profit	7,400	4,010	7,259	7,413
Exceptional Items	-	(3,353)	-	-
Adjusted Profit	7,400	7,363	7,259	7,413
Shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Basic EPS	7.4	7.3	7.2	7.4
Diluted shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Diluted EPS	7.4	7.3	7.2	7.4
Adjusted Cash EPS	11.1	12.1	12.8	13.4
Dividend per share (DPS)	1.3	0.8	1.4	1.5
Dividend Payout Ratio(%)	21.1	23.0	23.0	25.0

Common size metrics

Year to March	FY16	FY17E	FY18E	FY19E
Operating expenses	73.2	74.3	75.2	76.2
Materials costs	44.8	45.5	46.3	47.1
Staff costs	9.0	9.3	9.6	9.6
S G & A expenses	19.4	19.6	19.3	19.5
Depreciation	6.3	7.5	8.2	8.1
Interest Expense	4.0	2.5	2.4	2.4
EBITDA margins	26.8	25.7	24.8	23.8
Net Profit margins	12.7	11.7	10.9	10.2

Growth ratios (%)

Year to March	FY16	FY17E	FY18E	FY19E
Revenues	12.0	8.5	5.9	9.6
EBITDA	24.8	4.0	2.3	5.3
PBT	42.9	(43.6)	78.7	2.3
Adjusted Profit	37.1	(0.5)	(1.4)	2.1
EPS	37.1	(0.5)	(1.4)	2.1

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17E	FY18E	FY19E	
Share capital	1,005	1,005	1,005	1,005	
Reserves & Surplus	18,872	21,960	27,549	33,109	
Shareholders' funds	19,877	22,964	28,554	34,114	
Minority Interest	503	648	813	998	
Short term borrowings	8,755	12,052	11,864	11,997	
Long term borrowings	17,877	17,000	15,000	13,750	
Total Borrowings	26,632	29,052	26,864	25,747	
Long Term Liabilities	1,296	1,413	1,499	1,710	
Def. Tax Liability (net)	1,178	1,178	1,178	1,178	
Sources of funds	49,486	55,255	58,908	63,747	
Gross Block	53,110	61,465	70,488	78,027	
Net Block	31,487	35,023	38,441	39,918	
Capital work in progress	1,832	2,262	2,068	1,902	
Intangible Assets	1,892	1,900	1,908	1,916	
Total Fixed Assets	35,211	39,185	42,417	43,736	
Non current investments	30	30	30	30	
Cash and Equivalents	1,777	3,168	2,737	4,514	
Inventories	11,046	12,012	12,950	14,436	
Sundry Debtors	6,114	6,637	7,026	7,700	
Loans & Advances	6,419	6,968	7,377	8,225	
Other Current Assets	1,676	1,819	1,926	2,169	
Current Assets (ex cash)	25,255	27,436	29,278	32,531	
Trade payable	10,080	11,018	11,802	13,101	
Other Current Liab	2,706	3,545	3,752	3,963	
Total Current Liab	12,786	14,563	15,554	17,064	
Net Curr Assets-ex cash	12,470	12,873	13,724	15,467	
Uses of funds	49,486	55,255	58,908	63,747	
BVPS (INR)	19.8	22.9	28.4	34.0	
Contingent Liability	414.3	414.3	414.3	414.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17E	FY18E	FY19E	
Reported Profit	7,400	4,010	7,259	7,413	
Add: Depreciation	3,718	4,821	5,607	6,064	
Interest (Net of Tax)	1,656	1,102	1,131	1,230	
Others	1,010	(343)	(661)	(569)	
Less: Changes in WC	(2,754)	287	765	1,532	
Operating cash flow	16,538	9,303	12,570	12,606	
Less: Capex	10,597	8,785	8,829	7,373	
Free Cash Flow	5,940	518	3,741	5,233	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Welspun India	1,113	10.2	10.3	6.1	5.9	34.1	28.0
Arvind	1,441	51.4	52.1	24.5	23.8	34.1	28.0
Himatsingka Seide	501	16.8	15.0	11.5	9.1	18.7	17.8
Median	-	16.8	15.0	11.5	9.1	34.1	28.0
AVERAGE	-	26.1	25.8	14.0	13.0	29.0	24.6

Source: Edelweiss research

Cash flow metrics		FY16	FY17E	FY18E	FY19E
Year to March					
Operating cash flow		16,538	9,303	12,570	12,606
Investing cash flow		(8,012)	(7,945)	(7,657)	(6,249)
Financing cash flow		(9,455)	34	(5,344)	(4,581)
Net cash Flow		(929)	1,391	(431)	1,777
Capex		(10,597)	(8,785)	(8,829)	(7,373)
Dividend paid		(2,443)	(922)	(1,670)	(1,853)

Profitability and efficiency ratios

Year to March	FY16	FY17E	FY18E	FY19E
ROAE (%)	42.9	34.1	28.0	23.6
ROACE (%)	28.4	25.2	22.9	22.0
Inventory Days	122	115	116	115
Debtors Days	33	36	37	36
Payable Days	117	131	132	129
Cash Conversion Cycle	37	20	21	21
Current Ratio	2.1	2.1	2.1	2.2
Gross Debt/EBITDA	1.7	1.8	1.6	1.4
Gross Debt/Equity	1.3	1.2	0.9	0.7
Adjusted Debt/Equity	1.3	1.2	0.9	0.7
Net Debt/Equity	1.2	1.1	0.8	0.6
Interest Coverage Ratio	5.1	7.3	6.8	6.5

Operating ratios

Year to March	FY16	FY17E	FY18E	FY19E
Total Asset Turnover	1.2	1.2	1.2	1.2
Fixed Asset Turnover	2.0	1.8	1.8	1.8
Equity Turnover	3.4	2.9	2.6	2.3

Valuation parameters

Year to March	FY16	FY17E	FY18E	FY19E
Adj. Diluted EPS (INR)	7.4	7.3	7.2	7.4
Y-o-Y growth (%)	37.1	(0.5)	(1.4)	2.1
Adjusted Cash EPS (INR)	11.1	12.1	12.8	13.4
Diluted P/E (x)	10.1	10.2	10.3	10.1
P/B (x)	3.8	3.3	2.6	2.2
EV / Sales (x)	1.7	1.6	1.5	1.3
EV / EBITDA (x)	6.3	6.1	5.9	5.5
Dividend Yield (%)	1.7	1.0	1.9	2.1

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
Mgn agro properties	72.59	Mgn agro prop pl	72.59
Wasatch advisors inc	2.33	Alliance bernstein	1.59
Vanguard group	1.08	Reliance capital tru	0.86
Dimensional fund adv	0.68	Welspun tradewel lim	0.54
Birla sun life asset	0.38	Birla sun life insur	0.31

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
01 Sep 2016	Wasatch Emerging Markets Small Cap Fund	Buy	6362881	50.89

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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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
25-Jan-17	Arvind	Demonetisation impact limited; Unlimited shines bright; <i>Result Update</i>	373	Buy
16-Nov-16	Welspun India	Operationally strong; Egyptian cotton issue behind; <i>Result Update</i>	61	Buy
11-Nov-16	Himatsingka	Retail margin spurts ;	288	Buy

Distribution of Ratings / Market Cap

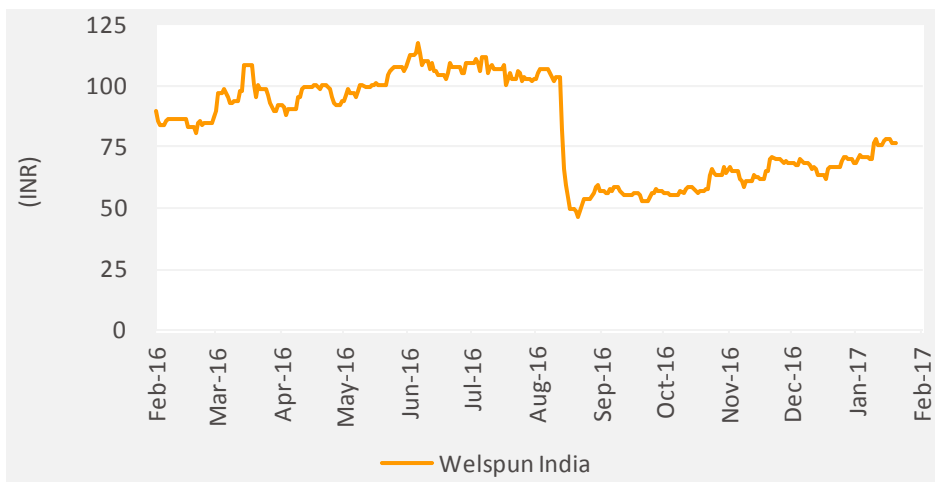
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1 stocks 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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