

Welspun India

30 August 2017

Reuters: WLSP.NS; Bloomberg: WLSI IN

We had a meeting with the management of Welspun India (WIL) recently to get an insight on home-textile industry headwinds and the company's business prospects. Following are the key takeaways:

Volatility in cotton prices and Indian rupee (INR) appreciation: The home-textile industry has of late been under pressure on account of volatility in cotton prices and INR appreciation (a major chunk of WIL's revenues are export-driven as the company exports 95% of its products). In most cases, the company has been able to pass on the increase in cotton prices to the customers in the past. However, this year has been slightly tricky at the retailer-end where they are in no mood to entertain a price hike given the current state of affairs. The management maintained that India is in a strong position on the cotton front and prices are expected to stabilise once the new cotton season commences in October 2017. 2QFY18 margins will continue to be suppressed while there could be some improvement in 3QFY18. The actual impact of cotton prices will be witnessed in 4QFY18, a benefit of around 10%-12% YoY.

US retailers - the pain is real: The US retail industry is transforming before our eyes and it is proving to be a nightmare for retail companies. More than 300 retailers have filed for bankruptcy so far this year, according to data from BankruptcyData.com, a 31% increase YoY. The shift from traditional retail to e-commerce has severely affected the performance, with Amazon being their biggest competitor grabbing market share. The management stated that US retailers have been cutting down inventory by moving to weekly orders instead of monthly consignments, thereby passing on the working capital costs to suppliers.

Tackling the e-commerce threat: To tackle the e-commerce threat, most retailers have started working on their online channels. Walmart invested in its online channel more than Amazon did last year and has also revamped its portfolio, creating a more value-added one. Its performance was bad last year, but an improvement is expected in FY18. Costco has a very strong business model and has been doing fairly well. The performance of Bed, Bath & Beyond has also been decent. These three retailers are a part of WIL's Top 5 customers who contribute ~48% to its revenues. If Walmart plays the online game well, it can easily tackle Amazon given that it has more distribution points than the latter all over the US. WIL is also in talks with Amazon for launching its own private label.

Flooring solutions business to touch Rs10bn in the next five years: WIL has forayed into flooring solutions i.e. rugs, carpets, accent rugs and wall-to-wall carpets. As it is already engaged in rugs, this business will benefit from synergies with the existing product line and customer base. With domestic focus, this business will cater primarily to institutional clients. The carpet market in India is as big as US\$125mn, which is expected to touch US\$500mn in the next five years. Carpets attract an import duty of 25% currently, resulting in a direct advantage for WIL. WIL has planned a capex of Rs6bn in a phased manner over FY18 & FY19. The carpet facility is likely to be functional by 2HFY19. WIL expects Rs10bn to be generated from this business in the next five years at full capacity utilisation level.

~8% top-line growth, margins to remain at 21%-22% subject to GST announcement: The management has given guidance of 7%-8% revenue growth for FY18, given the loss of one of its biggest clients, Target, after the Egyptian cotton traceability issue. As regards margins, the company has maintained its stance of 21%-22% given the Target problem, global retailer scenario and industry headwinds like cotton price volatility and INR appreciation. Apart from these, margins could be further hit by about 3% if the duty drawback benefit is withdrawn and 2% customs duty is retained coupled with ROSL being revised to 0.4%, which is the electricity duty not provided for under the Goods and Services Tax or GST regime. (The company currently enjoys duty drawback benefit of 7.9% and ROSL of 3.9%). With sales to pick up in the US from 3QFY18 owing to the peak season, stability in cotton prices combined with the base year benefit, expectation of Walmart delivering better YoY performance and continuous growth of brands, the second-half of FY18 definitely looks brighter for WIL.

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Sector: Home Textiles

CMP: Rs76

Akhil Parekh

Research Analyst

akhil.parekh@nirmalbang.com

+91-22-3926 8093

Sara Jaffer

Research Associate

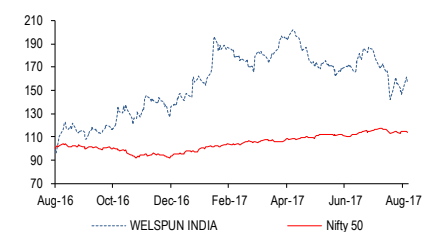
sara.jaffer@nirmalbang.com

+91-22-3926 8239

Key Data

Current Shares O/S (mn)	1,004.7
Mkt Cap (Rsbn/US\$bn)	78.5/1.2
52 Wk H / L (Rs)	100/46
Daily Vol. (3M NSE Avg.)	937,133

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Welspun India	(7.7)	(12.3)	67.5
Nifty Index	(2.2)	10.3	12.0

Source: Bloomberg

Domestic business to contribute 20% in the next five years: WIL plans to increase the contribution of its domestic business to 20% in the next five years, which currently stands at 5%. With the carpet business in India having immense potential, the company is also planning to launch a new and more affordable brand in the domestic market. 'Spaces' is the brand that currently caters to the premium segment.

Brands contributes 16% to revenues: Branded business of WIL currently contributes 16% to revenues. Among other brands, WIL's Christy, a £35mn brand (UK brand acquired in 2006) now accounts for 5% of its revenues and has been witnessing a healthy growth, especially in China and the Middle East.

Innovation: Under its innovative umbrella (36% of revenues), WIL's Hygro is a US\$200mn business. Under Hygro, the bedsheets regulate temperature in the range of three degree Celsius while the towels augment absorption and softness with each wash.

De-risking with hospitality and e-commerce segments: The company has enhanced its focus on hospitality and e-commerce segments. The hospitality segment now contributes ~6% to revenues and is expected to witness a healthy growth going forward. WIL has tied up with leading hotel chains and wellness centres. The US hospitality and healthcare market stands at US\$1.5bn (for towels & sheets) signaling huge potential. On the e-commerce front, the company has been witnessing good traction. WIL has created a drop-ship facility in the US, UK and India. It is leveraging the distribution infrastructure to serve the customers of the online channel of brick & mortar retailers, online marketplaces and also has its own e-commerce portal shopwelspun.in for Indian market and shopwelspun.com for the US market.

Capacity and utilisation levels: Its towel/sheet/rug and carpet capacities stood at 72,000mt/90mn mtrs/10mn sqm as of FY17-end with effective utilisation level of 97%/86%/85%, respectively. Currently, towels have similar utilisation level while the capacity utilisation of sheets is running slightly lower because of capacity expansion last year coupled with loss of business from Target, which was predominantly sheets. Sheet volume expected this year could be similar to last year or even higher, depending on the traction from the hospitality space.

Capex: The company incurred a capex of Rs7.2bn in FY17 and has planned Rs7bn capex for FY18.

Reduced supply to US retailers: A few retailers are in an extremely bad shape and with the ECGC cover being withdrawn recently, WIL has decreased the quantity supplied to them as it does not want to risk its consignments in the absence of insurance.

Egyptian cotton business: Egyptian cotton accounted for 6% of WIL's revenues of which 1% was contributed by Target,. 2.0%-2.5% of this 6.0% was under the Gold Seal and is still selling without any problem. The company has collaborated with the Egyptian Cotton Association recently and acquired the Gold Seal licence for the next five years.

WIL's proprietary, industry-defining, multi-level traceability process 'Wel-Trak': WIL has installed a system called 'Wel-Track' which traces cotton from the source to the point of sale. While the system tracks physical verification on the floor, the radio-frequency identification device (RFID)-based technology allows tracing of cotton from farm to the gin, from spinning to weaving as well as the point of sale. Once the clients get their respective audit done for the same and are convinced about the traceability, there could be more specialty cotton business coming in.

The return of Target: WIL also expects Target to start afresh, albeit with smaller orders, once the class action suits are dealt with and Target conducts the required audit to convince itself about the traceability.

Average cost of debt at 6%: As of June 2017, WIL's gross debt stood at Rs340mn of which Rs210mn consist of long-term loans and Rs130mn consists of short-term loans. The effective cost of old long-term loans, which come under the Technology Upgradation Fund or TUF & Gujarat scheme is 1% while new loans only get the Gujarat benefit of 5%. The short-term loans get an interest subvention of 3% under the Interest Equalization Scheme and so the effective cost of short-term loans stands at 7% currently. Power plant loans are not under any TUF or benefit. Therefore, the average cost of debt, including short-term loans, stands at 6%.

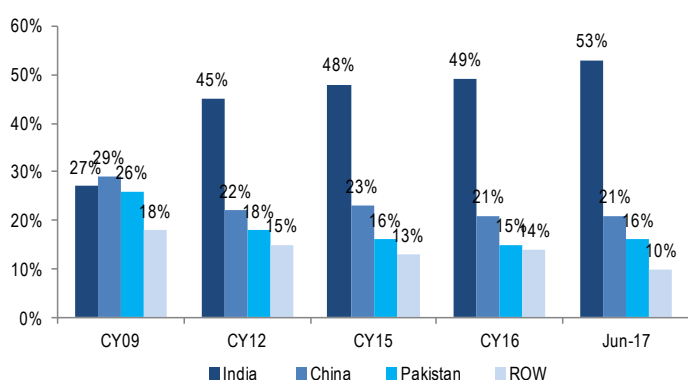
Decision on continuation/withdrawal of Gujarat subsidy: The carpet facility, involving a capex of Rs6bn, comes under the Gujarat scheme. The government is likely to take a decision regarding the continuation or withdrawal of this scheme in September 2017. Withdrawal of the same is unlikely to have an adverse impact, considering that post the carpet facility capex, the company has no major capex plan beyond Rs3bn-Rs4bn going forward.

Well-defined dividend distribution policy: The company has a clear and defined dividend-distribution policy which consists of the total payout (including the dividend tax) to be 25% of standalone PAT.

1QFY18 highlights:

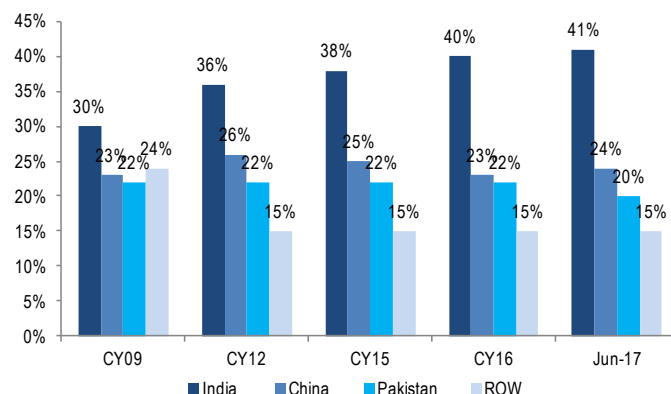
- WIL's revenues declined 3% in the previous quarter despite Target cutting ties. Under the normal course of business with Target, the growth would have been in the 12% to 15% range.
- WIL's proprietary, industry-defining, multi-level traceability Process 'Wel-Trak' receives patent.
- Awarded licence for FIFA World Cup 2018.
- Hospitality segment gained further traction with a major client addition.
- 'Spaces' brand grew 43%, while 'Christy' brand grew 24%.

Exhibit 1: India's share in the US sheet market



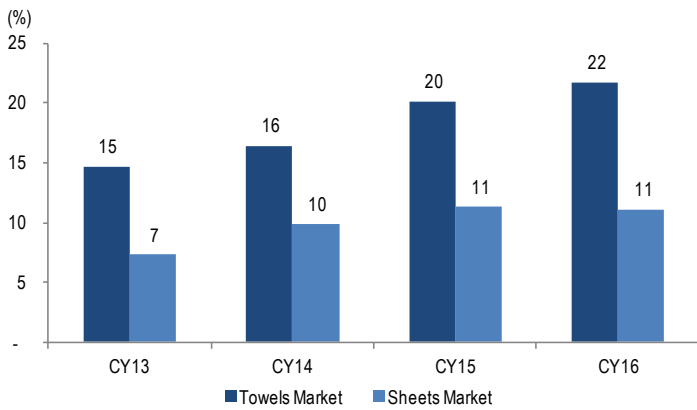
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: India's share in the US towel market



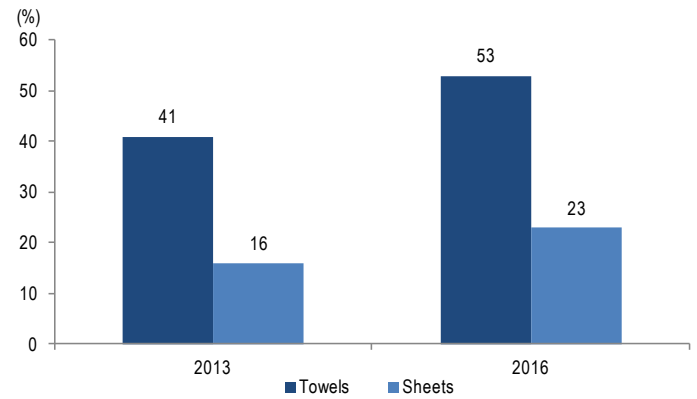
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: WIL's market share in the US (%)



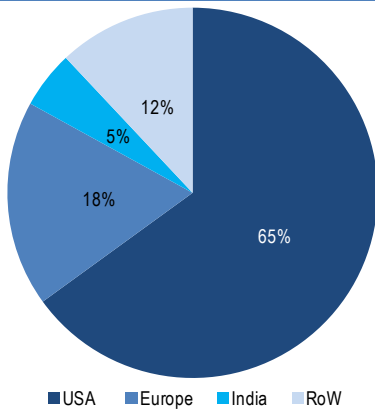
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: WIL's share in exports to the US (%)



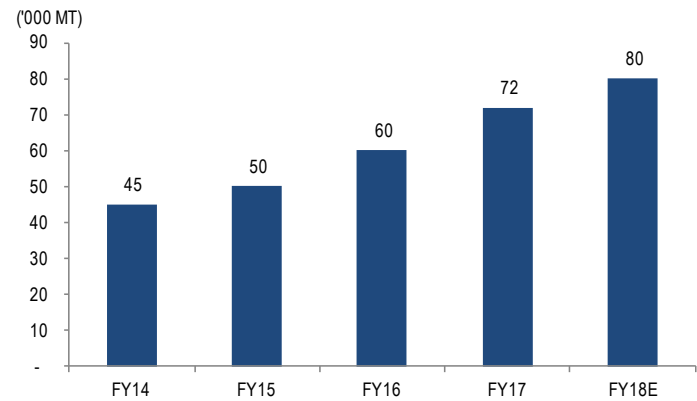
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Global presence



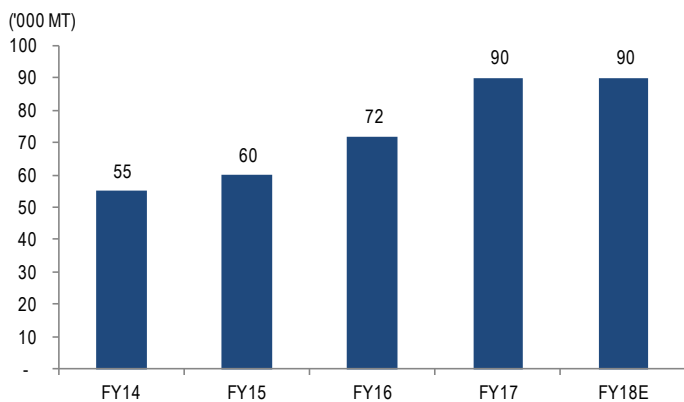
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Towels ('000 mt)



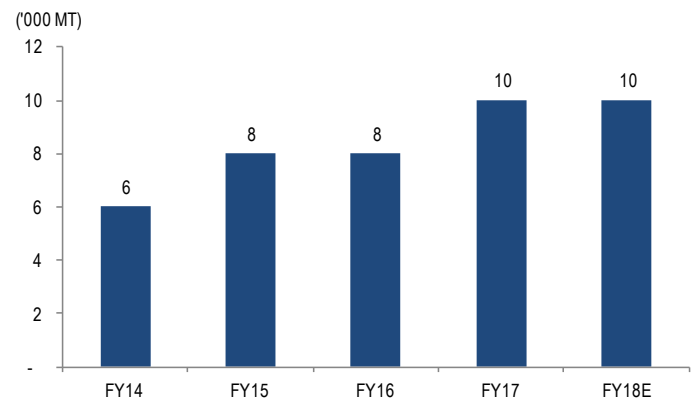
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Bed linen (mn mtrs)



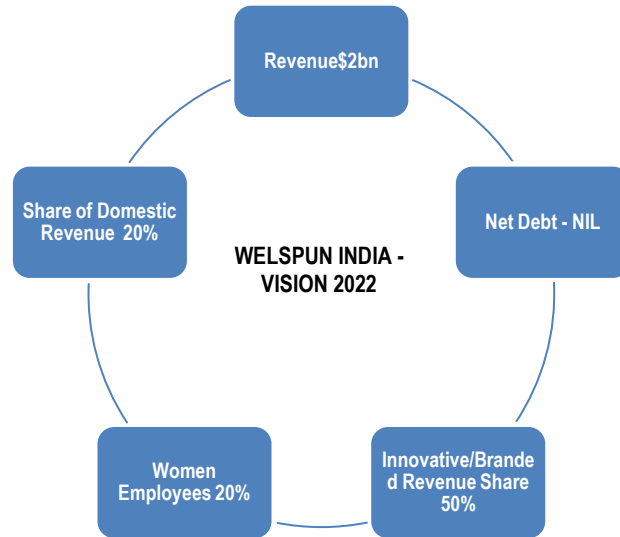
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Rugs (mn sq.mtrs)



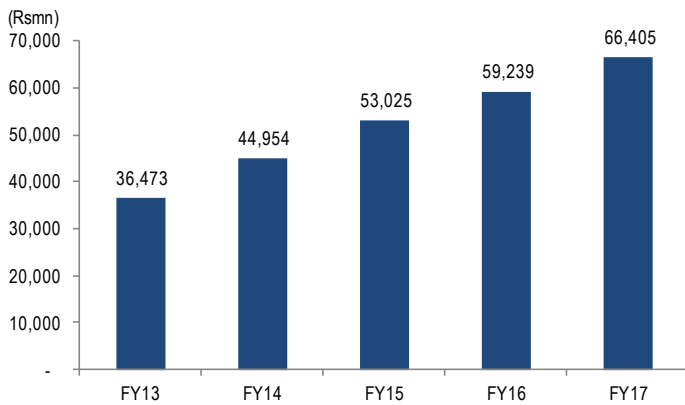
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: WIL's VISION 2022



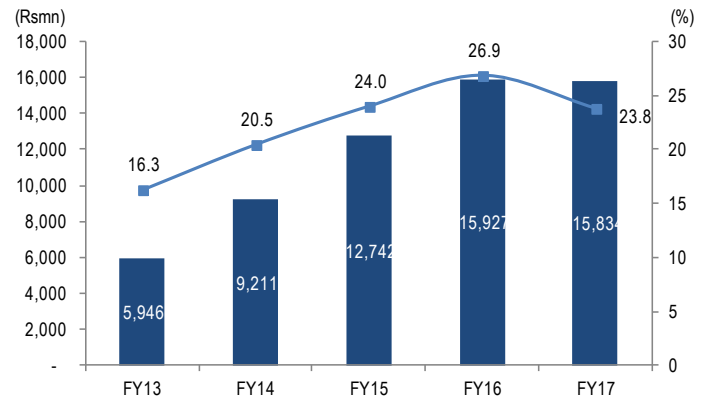
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Net sales (Rsmn)



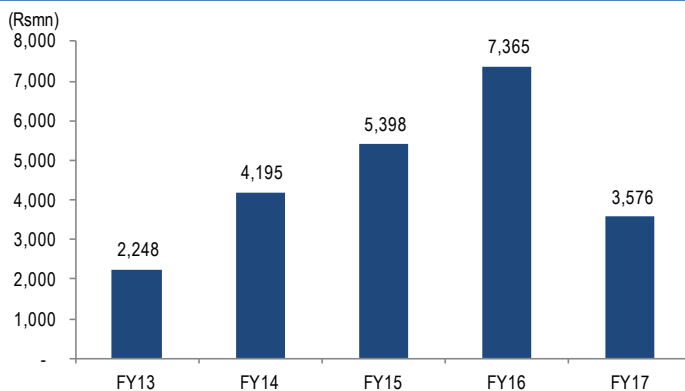
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: EBITDA (Rsmn) & EBITDA margin (%)



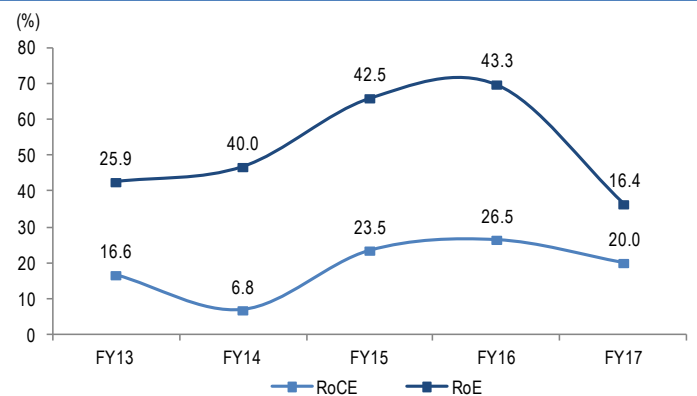
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: PAT (Rsmn)

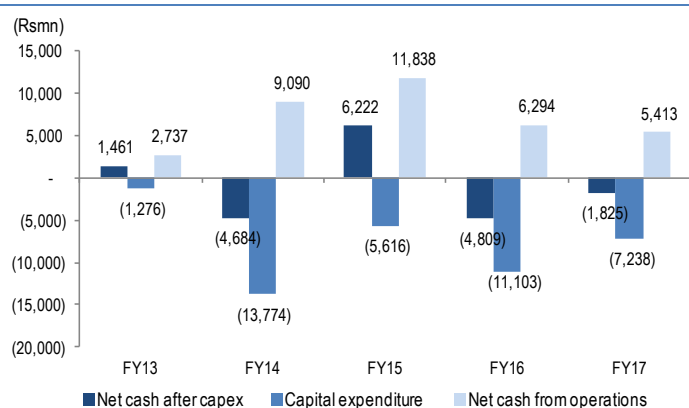


Source: Company, Nirmal Bang Institutional Equities Research

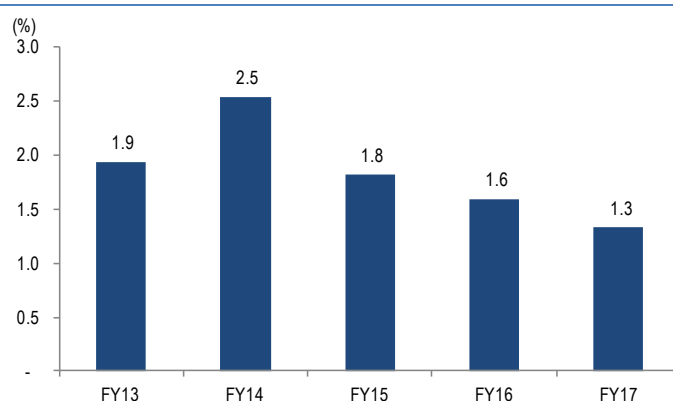
Exhibit 13: RoCE & RoE (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: CFO versus FCF (Rsmn)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Debt-equity ratio


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Peer comparison

Company	CMP	Mkt. cap. (USD mn)	P/E (x)			EV/EBITDA (x)			*Sales CAGR (%)	*EBITDA CAGR (%)	*EPS CAGR (%)
			FY17	FY18E	FY19E	FY17	FY18E	FY19E			
Welspun India	76.0	1,192.2	21.3	11.9	9.8	7.4	6.8	5.9	17%	6%	47%
Indo Count	112.9	348.2	9.6	9.9	8.4	9.9	6.3	5.5	8%	4%	7%
Trident	94.2	750.0	14.2	12.6	9.4	7.7	7.2	6.2	12%	15%	23%

Note: *2-year CAGR over FY17-FY19E

Source: Bloomberg

Financials

Exhibit 17: Income statement

Y/E March (Rsmn)	FY13	FY14	FY15	FY16	FY17
Net sales	36,473	44,954	53,025	59,239	66,405
Growth (%)	13.3	23.3	18.0	11.7	12.1
Raw materials expenses	17,684	22,673	25,443	26,594	30,396
Employee expenses	2,766	3,400	4,460	5,367	6,373
Other expenses	10,077	9,670	10,380	11,352	13,803
Total expenditure	30,527	35,743	40,283	43,312	50,572
EBITDA	5,946	9,211	12,742	15,927	15,834
Growth (%)	62.4	54.9	38.3	25.0	(0.6)
EBITDA margin (%)	16.3	20.5	24.0	26.9	23.8
Other income	492	1,042	949	904	806
Interest costs	1,977	2,352	2,829	2,368	1,583
Depreciation	1,449	6,863	3,329	3,718	5,054
Exceptional items	31	4,738	-	-	4,648
PBT	2,982	5,775	7,533	10,745	5,355
Tax	733	1,498	2,090	3,254	1,731
Effective tax rate (%)	24.6	25.9	27.7	30.3	32.3
PAT	2,248	4,277	5,443	7,491	3,624
Share in profit of an associate co.	-	-	-	-	-
Minority Interest	-	82	45	126	48
PAT after share in profit of an associate co. & minority interest	2,248	4,195	5,398	7,365	3,576
Growth (%)	-	86.6	28.7	36.4	(51.5)
EPS (Rs)	2.2	4.2	5.4	7.3	3.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Balance sheet

Y/E March (Rsmn)	FY13	FY14	FY15	FY16	FY17
Equity	1,000	1,003	1,005	1,005	1,005
Reserves	8,901	10,093	13,314	18,696	22,967
Net worth	9,902	11,097	14,318	19,701	23,972
Minority interest	250	316	378	412	355
Short-term loans	9,166	11,349	10,034	13,533	11,721
Long-term loans	10,039	16,795	15,946	17,922	20,160
Total loans	19,205	28,144	25,980	31,455	31,881
Deferred tax liabilities	1,917	434	641	1,328	2,168
Other non-current liabilities	74	1,553	1,020	1,932	2,354
Total liabilities	31,347	41,544	42,338	54,826	60,729
Net block	16,267	18,395	24,442	31,559	35,011
Capital WIP	542	5,324	1,564	1,832	564
Goodwill	1,754	1,839	1,785	1,809	1,741
Long-term investments	537	473	15	39	29
Other non-current assets	3,008	2,305	1,590	2,277	1,647
Current investments	394	641	1,405	247	1,229
Inventories	8,205	10,094	11,006	11,046	12,810
Debtors	2,750	4,117	4,467	8,499	9,601
Cash & bank balances	1,724	2,332	3,252	1,243	1,628
Cash and cash equivalents	-	-	-	1,061	1,238
Bank balance	-	-	-	183	390
Other current assets	3,398	6,163	7,427	6,941	9,025
Total current assets	16,471	23,348	27,557	27,976	34,292
Creditors	4,929	6,144	6,910	6,652	7,517
Other current liabilities/provisions	2,303	3,995	7,705	4,013	5,037
Total current liabilities	7,232	10,140	14,615	10,665	12,554
Net current assets	9,239	13,208	12,942	17,311	21,738
Total assets	31,347	41,544	42,338	54,826	60,729

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Cash flow

Y/E March (Rsmn)	FY13	FY14	FY15	FY16	FY17
EBIT	4,958	8,127	10,362	13,113	6,938
(Inc.)/dec. in working capital	(2,445)	(3,361)	1,187	(6,379)	(4,042)
Cash flow from operations	2,514	4,766	11,549	6,734	2,896
Other income	(492)	(1,042)	(949)	(904)	(806)
Depreciation	1,449	6,863	3,329	3,718	5,054
Tax paid	(733)	(1,498)	(2,090)	(3,254)	(1,731)
Net cash from operations	2,737	9,090	11,838	6,294	5,413
Capital expenditure	(1,276)	(13,774)	(5,616)	(11,103)	(7,238)
Net cash after capex	1,461	(4,684)	6,222	(4,809)	(1,825)
Other investment activities	(1,975)	1,724	2,176	171	1,513
Cash from financial activities	757	3,567	(7,478)	2,629	697
Opening cash balance	1,482	1,724	2,332	3,252	1,243
Closing cash balance	1,724	2,332	3,252	1,243	1,628
Change in cash balance	243	608	920	(2,009)	385

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: Key ratios

Y/E March	FY13	FY14	FY15	FY16	FY17
Per share (Rs)					
EPS	2	4	5	7	4
Book value	10	11	14	20	24
Valuation (x)					
P/E	34	18	14	10	21
P/sales	2	2	1	1	1
P/BV	8	7	5	4	3
EV/EBITDA	16	11	8	7	7
EV/sales	3	2	2	2	2
Return ratios (%)					
RoCE	16.6	6.8	23.5	26.5	20.0
RoE	25.9	40.0	42.5	43.3	16.4
Margins (%)					
EBITDA margin	16.3	20.5	24.0	26.9	23.8
EBIT margin	12.3	5.2	17.8	20.6	16.2
PBT margin	8.2	12.8	14.2	18.1	8.1
PAT margin	6.2	9.5	10.3	12.6	5.5
Turnover ratio					
Asset turnover ratio (x)	1.2	1.1	1.3	1.1	1.1
Inventory turnover ratio (x)	56	93	96	93	86
Avg. collection period (days)	26	28	30	40	50
Avg. payment period (days)	61	57	59	57	51
Solvency ratios (x)					
Debt-equity	1.9	2.5	1.8	1.6	1.3
Growth (%)					
Sales	13.3	23.3	18.0	11.7	12.1
EBITDA	62.4	54.9	38.3	25.0	-0.6
PAT	-	86.6	28.7	36.4	-51.5

Source: Company, Nirmal Bang Institutional Equities Research

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 3926 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830
Atul Vitha	Dealing Desk	atul.vitha@nirmalbang.com	022-3926 8071 / 022 -3926 8226

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park,
 Lower Parel (W), Mumbai-400013.
 Board No. : 91 22 3926 8000/1; Fax. : 022 3926 8010