Welspun India --- Maintain OUTPERFORM

Some signs of recovery

EPS: ▼ TP: ▼

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- FY18 results hit volumes and margins badly—revenue declined by 9%, driven by destocking by key US customers due to pressure from online retailers, exchange rate movement, and the reduction of duty drawback. Margins consequently fell by over 500 bp.
- Some signs of recovery now for FY19—4Q saw some stabilisation with 9% revenue growth, flat margins and 12% earnings growth, sequentially. Management expects 8-10% revenue growth in FY19 with flat margins. However, growth may optically look higher in 2H, due to YoY comparisons with the pre-GST quarter.
- Enhanced capex plans for its flooring capacity—capex for its flooring offerings has increased from Rs7 bn to Rs11 bn, and the capacity from 13 msm to 27 msm. Management expects IRR of 15% and anticipates net debt to be flat in FY19, before starting to fall.
- We cut our estimates for 2018E/19E by 36%/40%; TP falls to Rs85 (from Rs115)—we update our numbers after quite some time and these cuts reflect a challenging FY18. The stock is not an expensive one and recovery in FY19 can be the trigger. We also introduce our FY20E numbers.

Bbg/RIC	**WLSI IN / WLSP.BO**	**Price (17 May 18 , Rs)**			**65.35**
Rating (prev. rating)	**O (O)**	**TP (prev. TP Rs)**			**85.00 (115.00)**
52-wk range (Rs)	90.5 - 52.0	Est. pot. % chg. to TP			30
Mkt cap (Rs/US$ mn)	65,658.8/ 969.1	Blue sky scenario (Rs)			120.00
ADTO-6M (US$ mn)	3.5	Grey sky scenario (Rs)			50.00
Free float (%)	26.5	**Performance**	**1M**	**3M**	**12M**
Major shareholders	Founder family	Absolute (%)	24.5	0.6	(26.6)
		Relative (%)	22.3	(2.7)	(41.2)

Year	03/16A	03/17A	03/18E	03/19E	03/20E
Revenue (Rs mn)	59,238	66,405	60,506	65,951	73,865
EBITDA (Rs mn)	15,926	15,834	11,234	12,531	14,404
Net profit (Rs mn)	7,363	8,223	3,850	4,534	5,641
EPS (CS adj. Rs)	7.33	8.19	3.83	4.51	5.61
- Change from prev. EPS (%)	n.a.	n.a.	(36.4)	(40.2)	
- Consensus EPS (Rs)	n.a.	n.a.	4.25	4.95	5.75
EPS growth (%)	36.2	11.7	(53.2)	17.8	24.4
P/E (x)	8.9	8.0	17.1	14.5	11.6
Dividend yield (%)	2.0	0.1	1.0	2.3	2.3
EV/EBITDA (x)	6.1	6.1	8.6	7.9	6.8
P/B (x)	3.3	2.7	2.5	2.3	2.0
ROE (%)	43.3	37.7	15.4	16.5	18.4
Net debt(cash)/equity (%)	155.3	129.4	117.4	113.9	98.2

Note 1: Welspun is a leading company in the home textile market, and derives over 90% of its revenue from exports to largely US and Europe. It also has certain brands such as Christy.

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FY18 hit volumes and margins badly

FY18 was an extremely weak year for Welspun. Revenue declined by 9%, primarily driven by destocking by key customers in the US due to pressure from online retailers. Consequently, volumes declined 5%. Additionally, exchange rate hurt revenue by 1% and the reduction of duty drawback during the year by over 2%. Margins (including operational other income) consequently fell by over 500 bp, and were also impacted by 100 bp due to brand-building spend. Due to the high leverage in Welspun's P&L, pre-tax income excluding exceptionals fell 44%.

Figure 1: Welspun India—4Q FY18 results summary

	4QFY18	4QFY17	Chg YoY	FY18	FY17	Chg YoY
Revenue	15,062	17,572	-14%	60,506	66,405	-9%
Gross margin	51.3%	50.6%	70bps	50.0%	54.2%	-420bps
EBITDA	2,635	3,829	-31%	11,234	15,834	-29%
EBITDA margin	17.5%	21.8%	-430bps	18.6%	23.8%	-530bps
Depreciation	1,301	1,365	-5%	5,042	5,054	0%
Other income	287	156	85%	812	806	1%
Interest expenses	381	430	-11%	1,408	1,583	-11%
PBT	1,241	2,190	-43%	5,597	10,003	-44%
Tax	342	653	-48%	1,615	1,731	-7%
Tax rate	27.6%	29.8%	-230bps	28.9%	17.3%	1150bps
PAT	899	1,536	-42%	3,982	8,271	-52%
Minority	32	6	414%	132	132	0%
NPAT (adjusted)	866	1,530	-43%	3,850	8,139	-53%
EPS (Rs, adjusted)	0.9	1.5	-44%	3.8	7.9	-51%

Source: Company data, Credit Suisse estimates

Some signs of recovery now for FY19

4Q saw some stabilisation, however, with 9% sequential revenue growth, flat margins and 12% earnings growth. Management views the destocking process by clients to be nearly complete and expects 8-10% revenue growth in FY19 with flat margins. However, growth may optically look higher in 2H, due to YoY comparisons with the pre-GST quarter where revenue was differently recognised. While the INR has depreciated significantly in recent weeks and 93% of Welspun's revenue is from exports, management does not anticipate any significant gains as it hedges 60% of its sales and many of its inputs are USD denominated.

Enhanced capex plans for its flooring capacity

The capex plans for its flooring offerings (mainly tile carpets) has been increased from Rs7 bn to Rs11 bn and the capacity increased from 13 msm to 27 msm. It expects commercial production to now start in 4Q FY20. This will be largely focused on the domestic market which management estimates to be a Rs300-500 bn market. It expects asset turns of 1.5x to 2x eventually and IRR of 15%. It anticipates net debt to remain flat at current levels of Rs30 bn but has pushed back its targeted date of becoming a debt-free company by a couple of years to FY23.

Changes to estimates and TP

We have cut our estimates and TP significantly—we cut our estimates for 2018E/19E by 36%/40%; TP falls to Rs85 (from Rs115)—we update our numbers after quite some time and these cuts reflect a challenging FY18. The stock is not an expensive one and recovery in FY19 can be the trigger.

Companies Mentioned *(Price as of 17-May-2018)*

Welspun India (WLSP.BO, Rs65.35, OUTPERFORM, TP Rs85.0)

Disclosure Appendix

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3-Year Price and Rating History for Welspun India (WLSP.BO)

WLSP.BO	Closing Price	Target Price	
Date	(Rs)	(Rs)	Rating
10-Apr-17	86.90	115.00	O *

** Asterisk signifies initiation or assumption of coverage.*

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Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.

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Underperform/Sell*	12%	(52% banking clients)
Restricted	2%	

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Target Price and Rating
Valuation Methodology and Risks: (12 months) for Welspun India (WLSP.BO)

Method: Our target price of Rs85 for Welspun is based on DCF (discounted cash flow) model, with 13.4% cost of equity and a 6% post-tax cost of debt with a target D/E of 0.4x. Our OUTPERFORM rating is based on the following arguments: We find the fundamentals of the business attractive. While the market share of the Welspun and the Indian industry in the US is reasonably high now, increasing penetration in Europe, new segments in the US such as hospitality and healthcare, growth in the Indian market and a greater focus on brands and higher value-add products can drive attractive EBITDA growth. We see the balance sheet as being in a comfortable position. Net D/E at the end of FY18 is likely to be around 1x.

Risk: The key risks to our target price of Rs85 and OUTPERFORM rating for Welspun India include: (1) any trade barriers (such as border tax in the US), (2) high customer concentration, (3) volatility in cotton prices/currency and (4) execution of new segment expansion strategy.

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