Welspun India -- Maintain OUTPERFORM

No surprises in 1Q FY18 **EPS: ◄► TP: ◄►**

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- No surprise in 1Q FY18 results: Revenue declined 3% YoY—reasonable given the 13% loss of revenue in the middle of FY17 due to the Egyptian cotton traceability issue. EBITDA margins contracted by about 500 bp YoY due to higher cotton prices and INR appreciation, 70 bp on a QoQ basis.
- Management has maintained its FY18 outlook of mid-single-digit revenue growth and margins in the range of 21% to 22%.
- Multiple revenue drivers shaping up well: The Spaces brand grew 43% YoY, the Christy brand grew 24%, and the domestic e-commerce business grew 5x. Welspun reported that it has added a significant client in the hospitality segment. And its new flooring solution range should be ready by the end of FY19.
- Management is comfortable with current margins: Cotton futures have started correcting and Welspun is hedged until 4Q FY18 at Rs69/USD. GST creates some eventual uncertainties for duty rebates but the gov't may not hurt the industry. The stock continues to remain attractively valued and growth triggers appear on track.

Bbg/RIC	WLSI IN / WLSP.BO	Price (07 Aug 17, Rs)			80.55
Rating (prev. rating)	**O (O) [V]**	**TP (prev. TP Rs)**			**115.00 (115.00)**
52-wk range (Rs)	106.7 - 46.8	Est. pot. % chg. to TP			43
Mkt cap (Rs/US$ mn)	80,930.6/ 1,270.3	Blue sky scenario (Rs)			130.00
ADTO-6M (US$ mn)	2.2	Grey sky scenario (Rs)			70.00
Free float (%)	26.5	**Performance**	**1M**	**3M**	**12M**
Major shareholders	Founder family	Absolute (%)	(4.3)	(13.3)	(21.7)
		Relative (%)	(7.2)	(21.2)	(36.6)

Year	**03/15A**	**03/16A**	**03/17E**	**03/18E**	**03/19E**
Revenue (Rs mn)	53,481	59,814	66,405	69,000	79,275
EBITDA (Rs mn)	12,742	15,575	15,834	15,008	17,282
Net profit (Rs mn)	5,398	7,029	8,223	6,046	7,575
EPS (CS adj. Rs)	5.38	7.00	8.19	6.02	7.54
- Change from prev. EPS (%)	n.a.	n.a.	0	0	0
- Consensus EPS (Rs)	n.a.	n.a.	8.19	6.51	8.01
EPS growth (%)	(4.7)	30.1	17.0	(26.5)	25.3
P/E (x)	15.0	11.5	9.8	13.4	10.7
Dividend yield (%)	1.3	1.6	0.8	1.6	1.9
EV/EBITDA (x)	8.7	7.0	7.0	7.3	6.2
P/B (x)	5.6	4.1	3.4	2.8	2.4
ROE (%)	42.5	41.1	37.5	23.0	24.1
Net debt (cash)/equity (%)	205.4	141.5	124.4	99.5	77.3

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.

Click here for detailed financials

No surprises in 1Q FY18 results

Welspun reported a 3% YoY decline in revenue, reasonable given the 13% loss of revenue in the middle of FY17 on account of the Egyptian cotton traceability issue. EBITDA margins contracted by about 500 bp YoY due to higher cotton prices and INR appreciation, offset by the implementation of ROSL (rebate of state levies). Margins fell slightly by 70 bp on a QoQ basis. Management maintained its FY18 outlook of mid-single-digit revenue growth and margins in the 21- 22% range.

Debt remains at about Rs31 bn and net debt-equity ratio is around 1.2x. Capex plans for FY18 remain at Rs7 bn, a major proportion of which will be towards the new flooring solutions capacity.

Figure 1: Welspun India—1Q FY18 results summary

	1Q FY18	**1Q FY17**	**Chg YoY**
Revenue	12,912	13,865	-7%
Other operating income	2,483	2,061	20%
Total revenue	**15,394**	**15,926**	**-3%**
Raw material cost	7,436	7,240	3%
% of revenue	48.3%	45.5%	280 bps
Gross profit	7,958	8,686	-8%
Gross margins	51.7%	54.5%	-280 bps
EBITDA	3,242	4,225	-23%
EBITDA margin	21.1%	26.5%	-550 bps
PBT	1,835	2,940	-38%
Tax	550	853	-36%
Tax rate	29.9%	29.0%	90 bps
NPAT	1,243	2,019	-38%
EPS (Rs)	1.2	2.0	-38%

Source: Company data, Credit Suisse estimates

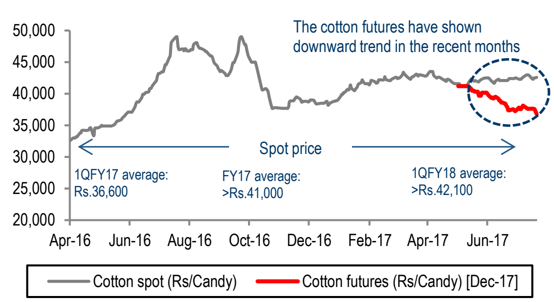
Multiple revenue drivers shaping up well

Besides the current business, Welspun has identified its brands, new channels and new products as additional revenue drivers. Its domestic Spaces brand grew 43% YoY and its Christy brand grew 24%. Its domestic e-commerce business grew 5x. It has won the license to supply for the FIFA World Cup 2018. While all the above currently constitute only a small proportion of revenue, the growth momentum in them appears to be strong. The Hygro range now generates US$200 mn of revenue annually. In terms of new segments, the company reported that it has added a significant client in the hospitality one. And its new flooring solution range appears to be on track to be ready by end-FY19.

Management is comfortable with current margins

Cotton futures have started correcting and the company is hedged until 4Q FY18 at Rs69/USD. The introduction of GST creates some uncertainties as well. The only uncertainty is around the fate of duty rebates enjoyed by the industry under the GST regime as there is some extent of over-compensation currently. Given the attention to this sector from the government, management does not expect any significant changes. There will be a 100 bp impact, however, in 2Q due to the reduced extent of over-compensation, given the GST rates on inputs.

Figure 2: Spot cotton prices have remained high. However, cotton futures have started correcting and if the trend were to continue, Welspun could benefit in 2H FY18 (it has inventory until September)



Note: The future price above is based on MCX cotton future contracts expiring in Dec-17. While this is not exactly comparable to the spot price of Shankar-6 cotton, we have used it as a proxy. Source: Bloomberg, MCX, Credit Suisse estimates

Companies Mentioned *(Price as of 07-Aug-2017)*

Welspun India (WLSP.BO, Rs80.55, OUTPERFORM[V], TP Rs115.0)

Disclosure Appendix

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

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

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

Method: Our target price of Rs115 for Welspun is based on DCF (discounted cash flow) model, with 12.8% cost of equity and a 8% post-tax cost of debt with a target D/E of 0.25x. 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 FY17 is likely to be around 1x, net working capital around 60-70 days and even with conservative assumptions such as a slightly higher working capital requirement and lower asset turns as compared to FY16 levels, we estimate the company to generate attractive free cash post capex.

Risk: The key risks to our target price of Rs115 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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This research report is authored by:

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