

WELSPUN INDIA

Good show; flooring to drive next leg of growth

India Equity Research | Midcap Textiles

Welspun India (WLSI) posted good Q1FY20 numbers with EBITDA and PAT surpassing estimate 10%/13%, respectively. Revenue growth of 12% YoY was a combination of currency (5%), RoSCTL benefits (3%) and volumes (3%). EBITDA margin at 21% was back in the guidance range (after a blip in Q4FY19) and net debt fell by ~INR2bn QoQ. Settlement of the litigation and amount payable has eliminated the overhang and key driver ahead will be ramp up of the flooring project—on track to be commissioned by Q2FY20 end. With operational performance on track, we maintain target September 2020E EV/EBITDA of 7.0x with TP of INR72. Maintain 'BUY'.

Margin back in guidance range; net debt dips further

WLSI reported stable Q1FY20 revenue growth of 12% YoY (Q4FY19: 3%). The growth was combination of currency contributing 5%, Rebate of State and Central Taxes and Levies (RoSCTL) benefits of 3% and volume growth of 3%, primarily driven by bed sheets. Emerging businesses—domestic home textile and technical textiles—sustained strong growth and jumped 30% YoY. Also, EBITDA margin improved from the average 16% in Q2/Q3FY19 to 21% driven by the RoSCTL benefit, which started accruing this quarter. There was an ~INR84mn benefit in EBITDA (0.5% on margin) due to Ind AS 116 transition. WLSI has maintained FY20 EBITDA margin guidance of 19-21%. We conservatively estimate margin closer to the lower end of guidance. WLSI's net debt repayment was also higher than expected (down from INR30.3bn in Q4FY19 and INR28.2bn in Q1FY20) aided by reduction in debtor days. Management continues to target net debt of INR27bn by FY20.

Flooring on course; targeting revenue of INR1.5-2.0bn in FY20

The company's flooring project remains on course to be commissioned by Q2FY20 end. During Q1FY20, capex on the project was INR1.6bn with INR2.5-3.0bn pending to be incurred; overall capex till date has been ~INR8.5bn. Trial runs have commenced at Welspun Flooring and the company is targeting revenue of INR1.5-2.0bn in FY20 with full scale potential revenue of INR30bn (~2x asset turn) and steady state margin of 16-20%.

Outlook and valuation: Flooring to drive growth; retain 'BUY'

Settlement of the litigation and amount payable has cleared the overhang on WLSI and key driver ahead will be ramp up of the flooring project. With operational performance and debt repayment plan on track, we maintain target September 2020E EV/EBITDA of 7.0x with an unchanged TP of INR72. We Maintain 'BUY'.

Financials

(INR mn)

Year to March	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	FY19	FY20E	FY21E
Net Revenues	17,281	15,492	11.6	15,572	11.0	65,266	74,319	86,045
EBITDA	3,631	2,965	22.5	2,087	74.0	10,649	13,612	15,754
Adjusted Profit	1,500	1,272	17.9	1,447	3.7	4,185	5,481	6,610
Adj. Dil. EPS	1.5	1.3	17.9	1.4	3.7	4.2	5.5	6.6
Diluted P/E (x)						12.4	9.5	7.9
EV/EBITDA (x)						7.8	6.1	5.2
ROAE (%)						15.8	18.4	19.1

Edelweiss Research is also available on www.edelresearch.com, Bloomberg EDEL <GO>, Thomson First Call, Reuters and Factset.



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Ideas create, values protect

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

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

CMP	: INR 52
Target Price	: INR 72
52-week range (INR)	: 78 / 46
Share in issue (mn)	: 1,004.7
M cap (INR bn/USD mn)	: 52 / 774
Avg. Daily Vol. BSE/NSE ('000)	: 1,351.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY19	Q3FY19
Promoters *	68.5	68.5	68.5
MF's, FI's & BKs	9.1	10.3	10.2
FII's	8.7	8.3	8.0
Others	13.7	12.9	13.3
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(8.5)	(9.9)	(1.4)
3 months	(9.0)	(2.9)	6.1
12 months	(15.1)	(7.9)	7.2

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Q1FY20 conference call: Key highlights

- Q1FY20:
 - Strong cash flow generation in Q1FY20 helped reduce borrowings. WLSI also reduced debtors.
 - Revenue growth breakdown:
 - Currency: 4.8%.
 - ROCL benefits: 3.4%.
 - Volume: 3.4%. Majority of the volume growth was driven by bed sheets.
 - USD realisation:
 - Average USD realisation was INR69.6. ~60% hedges were at INR71-72/USD, with the balance at spot rates.
 - Realisation could improve to INR71.5/USD in Q2FY20 if the current exchange rate continues.
 - While WLSI has managed to improve debtors in Q1FY20, there is a possibility of increase in coming quarters as retailers in the US are under stress.
 - Cotton price was INR49.5K/candy versus INR44.0K/candy a year ago.
- Ind AS 116:
 - WLSI had a benefit of INR84mn, which was earlier classified as rent. It has now been reclassified as interest and depreciation.

Domestic

- WLSI has not been impacted by the slowdown in the market as there is a trend of shift from unorganised to organised players.
 - Domestic home textile business grew 30% in Q1FY20. Business has crossed INR2bn revenue in FY19.
- Technical textile has already posted INR2bn revenue in FY19. WLSI can ramp this up to INR3bn without any major investment/capacity expansion.
 - Operating in hygiene and filtration segments.

Flooring project:

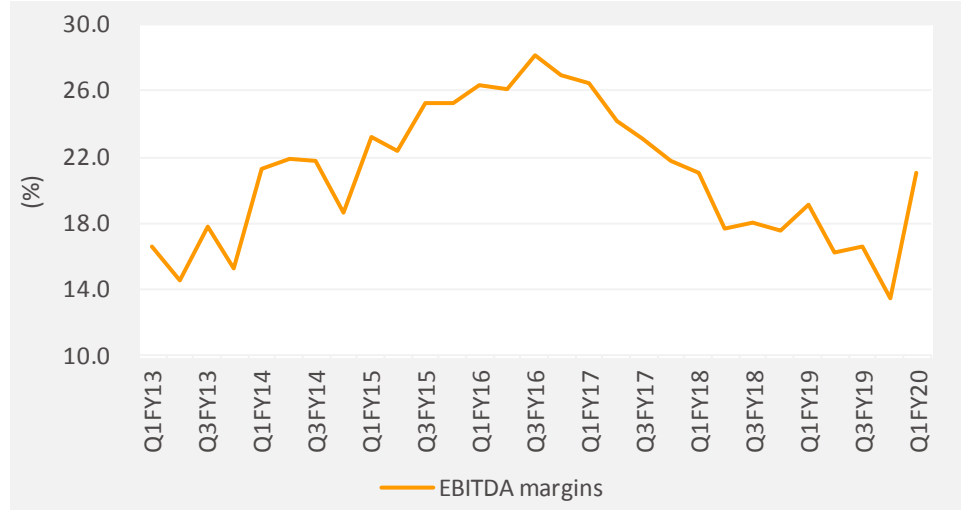
- Flooring business will be commissioned by end Q2FY20.
- In anticipation of slowdown in the core textile business, the company has invested in the flooring business.
- The primary driver of setting up of the flooring business was to drive the domestic segment in this category.
- Post the US-China trade war, even the export market has become an opportunity as the average duty on these products now ranges from 15-25%.
- Product profile
 - Wall-to-wall carpets: Will be mainly hospitality market driven.
 - Carpet tiles:

- The segment is a B2B business focused towards multinationals and IT companies.
 - Estimates of imports are USD125-150mn which the company is planning to replace. There are no domestic manufacturers.
 - Carpet tiles will be the first plant to commence production.
- Artificial grass: All of the current requirement is currently imported and this is used for landscaping and sport facilities.
- Hard flooring:
 - Will be used in residences and commercial segment.
 - This is where WLSI's distribution channel will come in to play and the product will be marketed under the *Welspun* brand.
- Growth strategy
 - The company is planning to price these products on import landed cost basis. While WLSI has got a sense of its pricing strategy, demand estimation is still a factor the company wants to get a sense of.
 - Shortening of lead times is what the company expects to drive growth and not pricing. WLSI does not want to disrupt pricing and margins in the industry.
 - Looking to reach 50 cities by FY20 end.
 - Average realisation will be INR175-200/sq Ft.
- Guidance:
 - WLSI may invest INR2-4bn more in the next three-four years. This can generate ~2x top line i.e. INR30bn of revenue.
 - Margin profile is expected to be similar to the home textile business when it is close to maturity i.e. 16-20%. At revenue run rate of INR7.5-10bn, WLSI should start achieving these margins.

Guidance

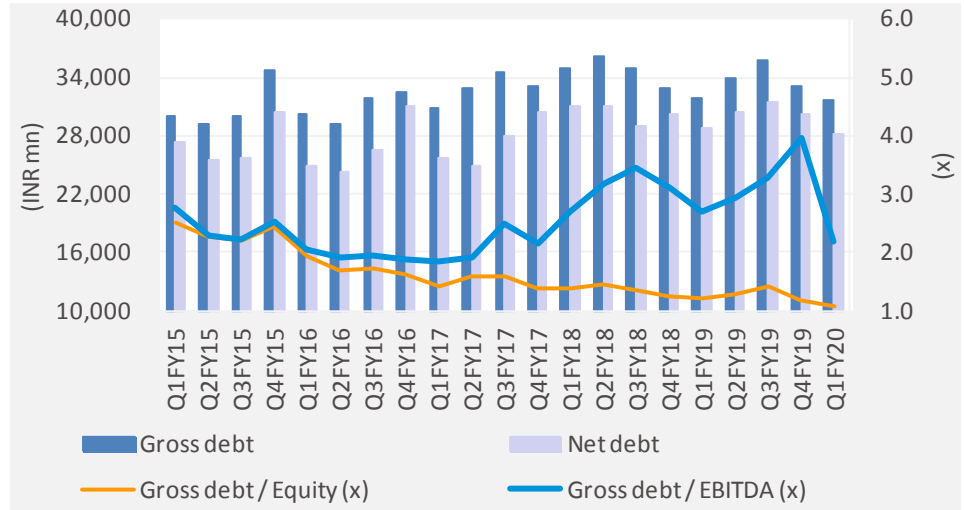
- WLSI is close to the end of its capex cycle.
 - Incremental capex towards flooring will be INR2.5-3bn. INR1.6bn has already been incurred in Q1FY20.
 - INR2bn will be towards the traditional business.
- Target to bring net debt down to INR27bn by March 2020.

Chart 1: EBITDA margin improved driven by higher RoSCTL benefits



Source: Company, Edelweiss research

Chart 2: Net debt reduced by ~INR2bn QoQ



Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q1FY20	Q1FY19	% change	Q4FY19	% change	FY19	FY20E	FY21E
Net revenues	17,281	15,492	11.6	15,572	11.0	65,266	74,319	86,045
Staff costs	1,813	1,742	4.1	1,751	3.5	7,114	7,762	8,258
Direct costs	8,572	7,614	12.6	8,179	4.8	33,500	37,626	44,164
Other expenses	3,267	3,171	3.0	3,556	(8.1)	14,003	15,320	17,869
EBITDA	3,631	2,965	22.5	2,087	74.0	10,649	13,612	15,754
Depreciation	1,094	1,059	3.3	1,098	(0.4)	4,358	4,876	5,477
EBIT	2,536	1,906	33.1	988	156.7	6,291	8,736	10,276
Interest	374	342	9.2	479	(22.0)	1,593	1,563	1,511
Other income	82	286	(71.5)	437	(81.4)	818	919	968
Add: Exceptional items						(2,647)		
Profit before tax	2,244	1,850	21.3	946	137.1	2,869	8,092	9,733
Provision for taxes	683	522	31.0	(509)	(234.2)	608	2,427	2,920
Minority interest	60	56	7.3	9	601.2	163	183	203
Reported net profit	1,500	1,272	17.9	1,447	3.7	2,098	5,481	6,610
Adjusted Profit	1,500	1,272	17.9	1,447	3.7	4,185	5,481	6,610
Diluted shares (mn)	1,005	1,005		1,005		1,005	1,005	1,005
Adjusted Diluted EPS	1.5	1.3	17.9	1.4	3.7	4.2	5.5	6.6
Diluted P/E (x)	-	-		-		12.4	9.5	7.9
EV/EBITDA (x)	-	-		-		7.8	6.1	5.2
ROAE (%)	-	-		-		15.8	18.4	19.1
Direct costs	49.6	49.2		52.5		51.3	50.6	51.3
Employee cost	10.5	11.2		11.2		10.9	10.4	9.6
Other expenses	18.9	20.5		22.8		21.5	20.6	20.8
EBITDA	21.0	19.1		13.4		16.3	18.3	18.3
Reported net profit	8.7	8.2		9.3		6.4	7.4	7.7
Tax rate	30.5	28.2		(53.8)		21.2	30.0	30.0

Company Description

Established in 1985, Welspun India (WLSI) currently 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.

WLSI 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: WLSI enjoys longstanding relationships with top retailers in the US and Europe and supplies to 14 of the top-30 global retailers. The company commands 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. WLSI derives ~30% of sales from innovative products.

Robust free cash flow & consistently lowering leverage: WLSI has calibrated its capex programme post the change in industry scenario. The company's confidence in generating free cash is also evident from its dividend policy of 25% payout ratio. Going forward, it is expected to generate strong free cash flows and further lower its leverage. Gross debt/equity fell from 2.2x as at FY15 end to 1.2x as of FY18. We estimate this to fall below 1.0x by FY20.

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	FY18	FY19	FY20E	FY21E
Macro				
GDP(Y-o-Y %)	7.2	6.8	6.8	7.1
Inflation (Avg)	3.6	3.4	4.0	4.5
Repo rate (exit rate)	6.0	6.3	5.3	5.0
USD/INR (Avg)	64.5	70.0	72.0	72.0
Company				
Raw Material (% net rev)	50.0	51.3	50.6	51.3
Other exp (% net rev)	20.3	21.5	20.6	20.8
Towel cap. (MT)	80,000	80,000	80,000	80,000
Bed-linen cap. (000 mts)	90,000	90,000	90,000	90,000
Rugs/carpets cap. (MT)	25,000	25,000	31,250	31,250
Towel utilis. (%)	76	88	90	95
Bed-linen utilis. (%)	80	82	84	89
Rugs/carpets utilis. (%)	63	70	64	71
Depreciation rate (%)	10.6	8.3	8.3	8.6
Dividend per share	0.7	1.0	1.2	1.6
Capex (INR mn)	3,378	6,876	5,600	5,000
Inventory % of costs	43.2	39.8	39.5	39.5
Debtors % of revenues	15.4	16.5	16.0	16.0
OCA % of revenues	9.8	9.6	18.0	18.0
Loans & adv (% net rev)	9.3	9.4	0.5	0.7
Incremental debt	(306)	296	(1,717)	(1,085)

Income statement

(INR mn)

Year to March	FY18	FY19	FY20E	FY21E
Net revenue	60,506	65,266	74,319	86,045
Materials costs	30,235	33,500	37,626	44,164
Gross profit	30,271	31,766	36,694	41,881
Employee costs	6,754	7,114	7,762	8,258
Other Expenses	12,283	14,003	15,320	17,869
EBITDA	11,234	10,649	13,612	15,754
Depreciation	5,042	4,358	4,876	5,477
EBIT	6,192	6,291	8,736	10,276
Less: Interest Expense	1,408	1,593	1,563	1,511
Add: Other income	812.00	818.2	919.28	967.55
Profit Before Tax	5,597	2,869	8,092	9,733
Less: Provision for Tax	1,615	608	2,427	2,920
Less: Minority Interest	132	163	183	203
Add: Exceptional items	-	(2,647)	-	-
Reported Profit	3,849	2,098	5,481	6,610
Exceptional Items	-	(2,086)	-	-
Adjusted Profit	3,849	4,185	5,481	6,610
Shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Basic EPS	3.8	4.2	5.5	6.6
Diluted shares o/s (mn)	1,005	1,005	1,005	1,005
Adjusted Diluted EPS	3.8	4.2	5.5	6.6
Adjusted Cash EPS	9.2	8.2	10.9	12.7
Dividend per share (DPS)	0.7	1.0	1.2	1.6
Dividend Payout Ratio(%)	20.4	20.0	20.0	25.0

Common size metrics

Year to March	FY18	FY19	FY20E	FY21E
Materials costs	50.0	51.3	50.6	51.3
Staff costs	11.2	10.9	10.4	9.6
S G & A expenses	20.3	21.5	20.6	20.8
Operating expenses	81.4	83.7	81.7	81.7
Depreciation	8.3	6.7	6.6	6.4
Interest Expense	2.3	2.4	2.1	1.8
EBITDA margins	18.6	16.3	18.3	18.3
Net Profit margins	6.6	6.7	7.6	7.9

Growth ratios (%)

Year to March	FY18	FY19	FY20E	FY21E
Revenues	(8.9)	7.9	13.9	15.8
EBITDA	(29.1)	(5.2)	27.8	15.7
PBT	4.5	(48.7)	182.0	20.3
Adjusted Profit	(42.7)	8.7	31.0	20.6
EPS	(42.7)	8.7	31.0	20.6

Balance sheet		(INR mn)			
As on 31st March	FY18	FY19	FY20E	FY21E	
Share capital	1,005	1,005	1,005	1,005	
Reserves & Surplus	25,052	26,788	31,173	36,130	
Shareholders' funds	26,057	27,793	32,178	37,135	
Minority Interest	467	709	893	1,096	
Long term borrowings	17,029	15,536	15,000	15,000	
Short term borrowings	15,779	17,567	16,386	15,302	
Total Borrowings	32,807	33,103	31,386	30,302	
Long Term Liabilities	2,266	2,441	2,628	2,733	
Def. Tax Liability (net)	1,745	2,008	2,574	3,256	
Sources of funds	63,341	66,055	69,660	74,521	
Gross Block	45,938	48,482	58,320	63,414	
Net Block	32,529	30,717	35,681	35,300	
Capital work in progress	629	4,862	624	530	
Intangible Assets	2,270	2,367	2,375	2,383	
Total Fixed Assets	35,428	37,946	38,680	38,213	
Non current investments	278	273	273	273	
Cash and Equivalents	2,661	2,728	1,174	1,492	
Inventories	13,054	13,342	14,862	17,445	
Sundry Debtors	9,310	10,768	11,891	13,767	
Loans & Advances	5,612	6,105	372	602	
Other Current Assets	5,907	6,260	13,377	15,488	
Current Assets (ex cash)	33,882	36,476	40,502	47,302	
Trade payable	6,447	7,041	7,848	9,145	
Other Current Liab	2,461	4,326	3,121	3,614	
Total Current Liab	8,907	11,368	10,969	12,759	
Net Curr Assets-ex cash	24,975	25,108	29,533	34,544	
Uses of funds	63,341	66,055	69,660	74,521	
BVPS (INR)	25.9	27.7	32.0	37.0	
Contingent Liability	414.3	414.3	414.3	414.3	

Free cash flow		(INR mn)			
Year to March	FY18	FY19	FY20E	FY21E	
Reported Profit	3,849	2,098	5,481	6,610	
Add: Depreciation	5,042	4,358	4,876	5,477	
Interest (Net of Tax)	1,001	1,255	1,094	1,058	
Others	(300)	119	116	167	
Less: Changes in WC	4,143	(42)	4,237	4,906	
Operating cash flow	5,450	7,872	7,330	8,405	
Less: Capex	3,378	6,876	5,600	5,000	
Free Cash Flow	2,072	996	1,730	3,405	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Welspun India	774	9.5	7.9	6.1	5.2	18.4	19.1
Arvind	202	4.9	4.3	5.0	4.6	9.5	9.8
Himatsingka Seide	204	4.7	4.1	5.5	4.6	18.3	17.8
Median	-	4.9	4.3	5.5	4.6	18.3	17.8
AVERAGE	-	6.4	5.4	5.5	4.8	15.4	15.6

Source: Edelweiss research

Cash flow metrics		FY18	FY19	FY20E	FY21E
Year to March					
Operating cash flow		5,450	7,872	7,330	8,405
Financing cash flow		(2,500)	(1,553)	(4,193)	(4,045)
Investing cash flow		(3,015)	(6,045)	(4,691)	(4,042)
Net cash Flow		(64)	274	(1,554)	318
Capex		(3,378)	(6,876)	(5,600)	(5,000)
Dividend paid		(783)	(420)	(1,096)	(1,652)

Profitability and efficiency ratios

Year to March	FY18	FY19	FY20E	FY21E
ROAE (%)	15.7	15.8	18.4	19.1
ROACE (%)	12.0	11.8	15.3	16.9
Inventory Days	126	116	111	108
Debtors Days	57	56	56	54
Payable Days	84	73	72	70
Cash Conversion Cycle	99	98	94	92
Current Ratio	4.1	3.4	3.8	3.8
Gross Debt/EBITDA	2.9	3.1	2.3	1.9
Gross Debt/Equity	1.2	1.2	0.9	0.8
Adjusted Debt/Equity	1.3	1.2	1.0	0.8
Net Debt/Equity	1.1	1.1	0.9	0.8
Interest Coverage Ratio	4.4	3.9	5.6	6.8

Operating ratios

Year to March	FY18	FY19	FY20E	FY21E
Total Asset Turnover	1.0	1.0	1.1	1.2
Fixed Asset Turnover	1.7	1.9	2.1	2.3
Equity Turnover	2.4	2.4	2.4	2.4

Valuation parameters

Year to March	FY18	FY19	FY20E	FY21E
Adj. Diluted EPS (INR)	3.8	4.2	5.5	6.6
Y-o-Y growth (%)	(42.7)	8.7	31.0	20.6
Adjusted Cash EPS (INR)	9.2	8.2	10.9	12.7
Diluted P/E (x)	13.6	12.5	9.5	7.9
P/B (x)	2.0	1.9	1.6	1.4
EV / Sales (x)	1.4	1.3	1.1	1.0
EV / EBITDA (x)	7.4	7.8	6.1	5.2
Dividend Yield (%)	1.3	1.9	2.3	3.1

Additional Data

Directors Data

Mr. B K Goenka	Chairman	Mr. R. R. Mandawewala	Managing Director
Ms. Dipali Goenka	Executive Director	Mr. Arun Todarwal	Independent Director
Mr. Ram Gopal Sharma	Independent Director	Pradeep Poddar	Independent Director
Arvind Kumar Singhal	Independent Director	Padma Betai	Nominee Director-IDBI Bank

Auditors - SRBC & Co LLP

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
DSP Investment	5.03	Wasatch Advisors Inc	0.79
L&T Mutual Fund	2.51	HSBC Holdings PLC	0.71
Aditya Birla Sun Life Asset Management	2.08	Birla Sun Life Insurance Co Ltd	0.63
Vanguard Group Inc	1.36	BlackRock Inc	0.57
Dimensional Fund Advisors	1.04	Franklin Resources Inc	0.44

**as per last available data*

Bulk Deals

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

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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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, Welspun India

Recent Research

Date	Company	Title	Price (INR)	Recos
24-May-19	Welspun India	Stable year; litigation overhang nearly done; <i>Result Update</i>	58	Buy
20-May-19	Arvind	Stable quarter; full-year frays; <i>Result Update</i>	80	Buy
07-Feb-19	Arvind	Denim wears out performance; <i>Result Update</i>	82	Buy

Distribution of Ratings / Market Cap

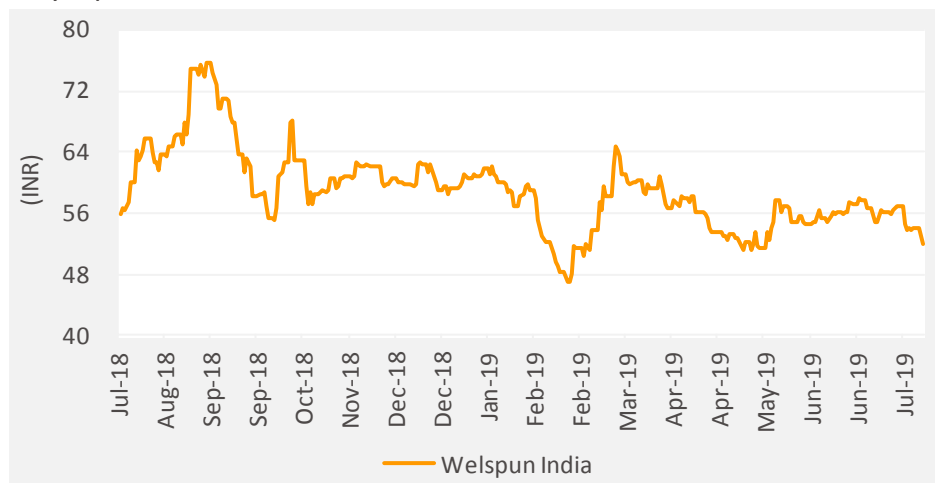
Edelweiss Research Coverage Universe

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