Welspun India

24 September 2015

Visit note - Not rated

IIFL Institutional Equities

Grand slam winner!

Welspun India, the largest player in the home textiles space, expects mid-teen sales growth underpinned by tailwinds from strong relationships with global retailers, leadership position in US exports across its key towels, bed sheet segments (c90% of sales), 10% capacity addition and cotton cost advantage vs China. It expects to maintain Ebitda margin at 22-23%. Further, the recent tailwind from INR depreciation (down 8% from 1Q average) and 1Q performance (26% margin) point to 30% EPS growth in FY16. Increasing vertical integration (expansion into low ROCE spinning/weaving) and high FY16 capex (Rs10bn: 70% of FY15 BV) may weigh on return ratios

- Welspun's sales growth (c15% guided) would be driven by strong growth across the key towels and bed sheet segments as Welspun continues to gain market share led by cotton cost advantage vs. global peers and loss of focus by the leader in bed sheets segment in India.
- Strong relationships with global retailers, ability to provide innovative products (currently c31% of sales), and US retail demand strength provide comfort on healthy growth over the medium term.
- The stock trades at 12x FY16 PE (discount to Indian bed sheet peers) and 4x FY16 P/B (FY16 ROCE: 25%).
- <u>Key risks</u>: Reduction in duty drawback payment following implementation of GST, possible suspension of 2% export incentive, and weakness in US demand.

IIFL's score-card for unrated companies

Key Positives	Score of 1-5 (with 5 as most positive)	Key Risks	Score of 1-5 (with 5 as most risky)
Industry growth potential	✓✓✓	Regulatory	××
Dominant position within the industry	✓✓✓✓	Corporate Governance	××
Balance-sheet strength, profitability ratios	✓✓✓	Competition (including possible foreign)	××××
Execution track record of management	✓✓	Liquidity (trading volume)	×

CMP	Rs820
Market cap (US$m)	1,247
Enterprise value(US$m)	1,723
Bloomberg	WLSI IN
Sector	Textiles

Shareholding pattern (%)

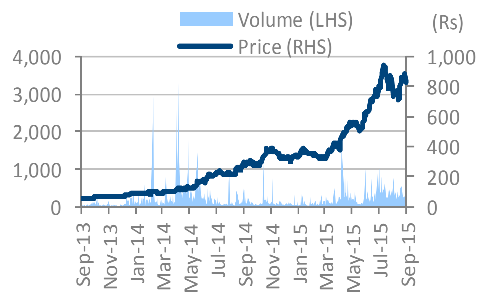
Promoter	73.5
FII	6.1
DII	4.8
Others	15.7
52Wk High/Low (Rs)	963/271
Shares o/s (m)	100
Daily volume (US$ m)	4.6
Dividend yield FY15ii (%)	1.5
Free float (%)	26.5

Price performance (%)

	1M	3M	1Y
Absolute (Rs)	(3.3)	34.2	177.7
Absolute (US$)	(3.6)	29.2	161.8
Rel. to Sensex	2.4	41.3	181.3

Cagr (%)	3 yrs
EPS	45.1

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Consolidated	FY13A	FY14A	FY15A	FY16ii
Revenues (Rs m)	36,473	43,730	53,025	59,934
Ebitda margins (%)	*16.3*	*21.1*	*24.0*	*25.7*
Pre-exceptional PAT (Rs m)	2,279	5,881	5,398	6,995
Reported PAT (Rs m)	2,248	921	5,398	6,995
Pre-exceptional EPS (Rs)	22.8	58.7	53.7	69.6
Growth (%)	*239.7*	*157.6*	*(8.4)*	*29.6*
PER (x)	**36.0**	**14.0**	**15.3**	**11.8**
ROE (%)	*26.3*	*56.0*	*42.5*	*40.9*
Net debt/equity (x)	1.8	2.4	1.8	1.6
EV/Ebitda (x)	16.8	11.8	8.5	7.4
Price/book (x)	8.3	7.4	5.8	4.2

Source: Company, IIFL Research. Priced as on 23 September 2015

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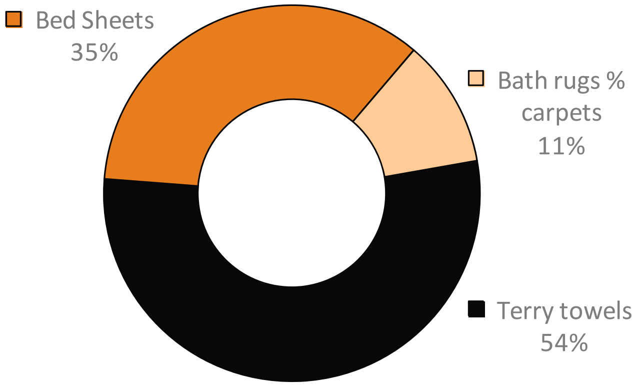
Company snapshot

- Welspun India is India's leading exporter of home textiles. Exports account for c95% of the company's sales. The US market is the key destination for exports, accounting for c65% of sales.
- The key segments in which Welspun operates are: 1) terry towels accounting for 54% of sales; 2) bed sheets (35% of sales); and 3) rugs, carpets and others (rest 11% of sales).
- In addition to supplying these products to leading global retailers (it caters to 14 of top 30 global retailers), the company also owns retail brands such as Spaces and Christy.
- In the terry towels business, Welspun is the largest Indian exporter to the US and supplier of bath towels to the US, selling roughly one out of every six towels. This reflects in the fact that capacity utilization for the 50000MTPA capacity in Anjar and Vapi is c102%.
- In the bed sheets segment, Welspun is the number two supplier of bed sheets and pillowcases selling roughly 1 in 10 bed sheets sold in the US. Here, the market is more fragmented and the leader Alok Industries is said to be losing market share.
- In the rugs and carpets segment, Welspun is a fast growing player and is slowly gaining share. Current capacity utilization is at 58%.
- Unlike traditional suppliers, Welspun does not compete for individual orders from retailers. Rather, it has marked retail spaces, where it supplies private label products on the back of its strong relationships.
- In order to maintain these spaces, it has innovated new products such as Hygro (hollow core fibres which are more water absorbent), and Flexifit (stretchable bed sheets to fit any size beds) through end-consumer surveys. The company has c12 patents (granted/ pending) for such innovations.
- To reduce inventory for retailers, Welspun also has warehouses in US and it accesses POS (point of sale) data for its products to estimate orders better.
- Over FY11-FY13, Welspun exited loss-making units (rug manufacturing business in Portugal, factories in Mexico, and retail businesses) and merged the marketing arm (Welspun Global Brands) into this company, which was earlier purely a manufacturing unit. This has helped drive recovery in margins.

Figure 1: Terry towels accounts for major share of sales



Source: Company, IIFL Research

Figure 2: Key management & other details

Name	Designation	Comments
B K Goenka	Chairman	Founding promoter, member of the Young Presidents Organisation;c30 years of experience in the textile industry
RR Mandawewala	Managing Director	He has 30 years of experience across industries (from textiles to pipes). Has been associated with Welspun since inception. Cousin of BK Goenka. CA
Dipali Goenka	Director	Wife of BK Goenka. Leads the marketing division of Welspun including retail chains of "Spaces" and "Welhome". Completed owners/ president program from Harvard
Altaf Jiwani	CFO	c25 years of experience across various industries. Has joined Welspun in Feb-15. Prior experience with RPG group for 19+ years.
J Barry Leonard	US president, CEO	More than three decade experience in home textiles
Other details		
Statutory auditors		Price Waterhouse
Credit Rating		AA- by Fitch
% of pledged shares		0%

Source: Company, IIFL Research

Promoter background

Welspun India was set by BK Goenka along with his cousin, RR Mandawewala. In addition to the textile business, the promoter group has interests in large diameter pipe manufacturing through Welspun Corp. Welspun was initially in the polyester yarn business and it branched into towels where it achieved its first breakthrough with Walmart. Since then, it has increased its presence in home textiles space.

Figure 3: Welspun India is the largest promoter group entity

Name	Description	Mcap (USDm)	FY15 Sales (Rs m)	FY15 PAT (Rs m)	FY15 net D/E (x)
Welspun India	Home Textiles player in India	1,247	53,025	5,398	1.8
Welspun Corp	Second largest manufacturer of large diameter pipes in the world	467	86,194	2,135	1.0
Welspun Enterprises	Holding company and involved in EPC contracts	147	8,907	7	0.3
Welspun Syntex	Engaged in processing and manufacture of polyester yarns	69	8,927	428	1.2
Welspun Investments & Commercials	Investment & financial services provider	3	9	1	NA
Welspun Steel	Manufacturing of Ingots/billets/TMT bars. Has c40% stake in RMG Alloy Steel (manufacturer of steel products)				
Welspun Renewables	Has 400MW operational solar capacity (largest in India) and 50MW operating wind capacity				
Welspun Natural Resources	Owns 35% stake in exploration JV with Adani group. Has interest in oil & gas exploration blocks in India and abroad.				

Source: Company, IIFL Research

Bed sheets business to drive near-term sales

Welspun, the leading exporter of home textiles to the US, is likely to see sales growth driven by the bed sheets segment (35% of sales) in the near term as it gains share from Alok Industries, the leader. Further, increase in exports to new markets such as Europe along with increasing share of high-margin innovative products such as Hygro, Flexifit should aid sales growth. Management expects mid-teen sales growth over the medium term from these tailwinds.

Cost competitiveness, capacity addition to aid growth in towels segment

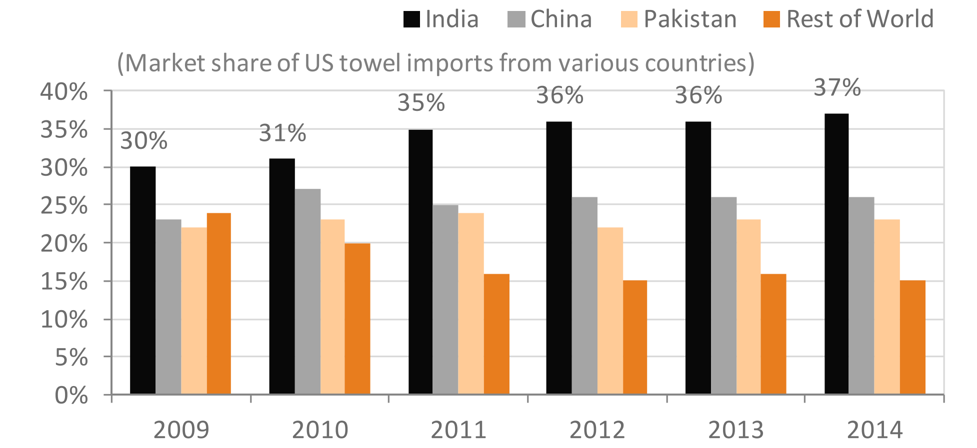
Welspun has traditionally been a towel player (c54% of sales) and is the largest Indian player supplying to the US. The market for towel exports from India to US is largely fragmented among the top three players. Hence, growth rates would depend on market share gains from other players/ geographies. The consolidated nature of the industry also reflects from the fact that Welspun has c17% market share for US exports vs. all India share of 37%.

Following global volatility in cotton prices in 2010-11, the Chinese government started buying cotton at c35-40% premium to international prices. This led to build-up of a large inventory (c60% of global level) and pushed up cotton prices for Chinese textile players. In contrast, Indian players benefited from access to cheaper cotton.

However, in the current year, the Chinese government changed the methodology and instead of buying cotton directly from the farmer, it started providing direct subsidies equal to the difference between market and reserve price. Further, it started reducing inventory and it lowered reserve price for 2015-16 from its 2014-15 levels. As a result, the differential between Indian cotton prices and China cotton prices started to moderate. However, with farmer-level economics favorable for other crops in China, India remained a major production centre for cotton and a source of exports for Chinese textile mills. As a result, Indian prices continued to be lower than Chinese prices.

Consequently, in the US towel imports market, India gained market share vs. other countries. We expect this trend to sustain as procurement from China remains weak and there is no major revival in consumption. Hence, Indian textile players will likely continue to benefit from lower cotton costs in the medium term.

Figure 4: India has been gaining market share in overall terry towel imports by US



Source: Company, Otexa

Further, although players from Pakistan and Bangladesh (where labor and manufacturing costs are among the lowest) dominate the price-sensitive towels segment, Indian players have invested in production and sales processes, which have allowed them to gain share in the medium price segments in the towel space. This, along with benefits of lower cotton costs has allowed Indian players to maintain healthy market share in the exports of terry towels to the US.

Strong tailwinds to aid volume growth

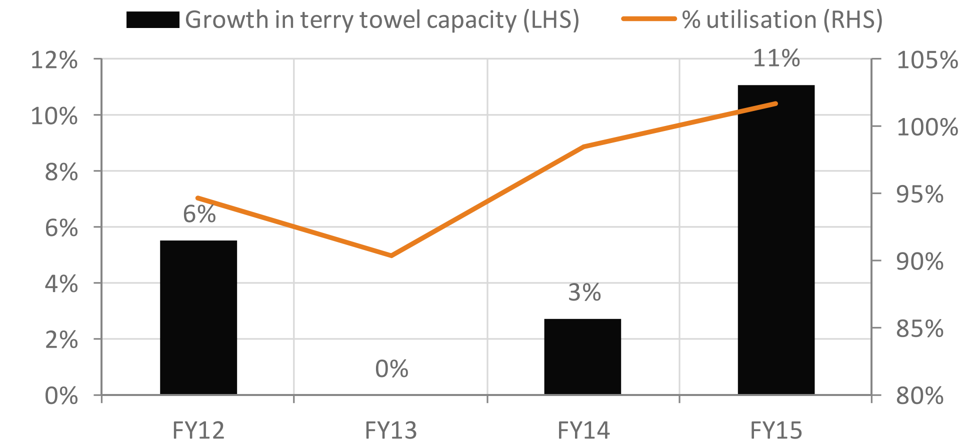
Welspun is well placed among Indian textile players in this space, given the healthy relationships it enjoys with leading US retailers such as “Bed, Bath & Beyond”, “Macy’s”, and “Walmart”. Further, it benefits from its access to specific retail space where it supplies products to be sold under the private label brand and hence is not exposed to the price-sensitive bidding market where each order needs to be competed with based on price.

To sustain this advantage of access to a specific retail space, Welspun provides value added services to help reduce retailer’s inventory, which ensures healthy revenue per sq ft. To reduce retailer-level inventory, it accesses POS (point of sale) data of its products along with orders currently in shipping, to suggest the required order level and order frequency.

Further, to help improve sales per sq ft, it suggests new products/ designs when sales of the existing products at the shelves start moderating. It does this by understanding the needs of the end consumer (through research/ consumer surveys). Diversity in retailers (between various positioning) allows Welspun to utilize and apply product learnings from one retailer to another i.e. it would see the designs that are moderating at a premium retailer such as Bed, Bath & Beyond and offer a modified version to a mid-segment player such as Walmart. This allows it to maintain a healthy lead over peers.

With capacity utilization of the existing unit already at c100%+ and Welspun looking to increase capacity from 45,000MT to 60,000MT over FY16/17, we believe volume growth would be broadly similar to capacity addition at c10% Cagr.

Figure 5: Welspun has seen strong capacity addition in FY15 – a trend likely to continue over FY16/17



Source: Company, IIFL Research

Sheets segment to be key growth driver for volumes

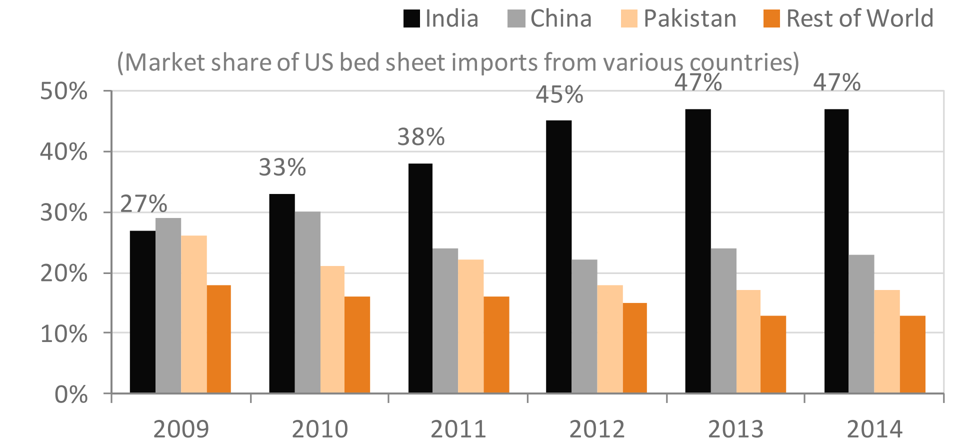
In the sheets segment (c35% of sales), Welspun is a relatively newer entrant vs. towels, having entered this space in FY06. India has a much stronger raw material cost advantage in the sheets segment vs. that in terry towels. This is because India is the largest producer of long-staple cotton fibre used in sheets. This raw material advantage is a key reason why India has gained market share in overall sheet exports to the US from other countries, in particular China. We expect this trend to continue going forward as India continues to retain its raw material cost advantage in long-staple cotton.

Further, this segment is more fragmented, reflected in the fact that Welspun has a market share of c10% for all sheet exports to the US vs. all-India share of 47%. In addition, global retailers have 10-12 vendors for sheets vs. only 5-6 vendors for towels. This fragmented nature of the bed sheet industry provides scope for Welspun to gain share from Indian as well as foreign players.

Welspun, with its strong relationships with global retailers (on back of its strong terry towels business) and healthy position in the sheets industry (second largest exporter of sheet to US), is well placed to benefit from this opportunity.

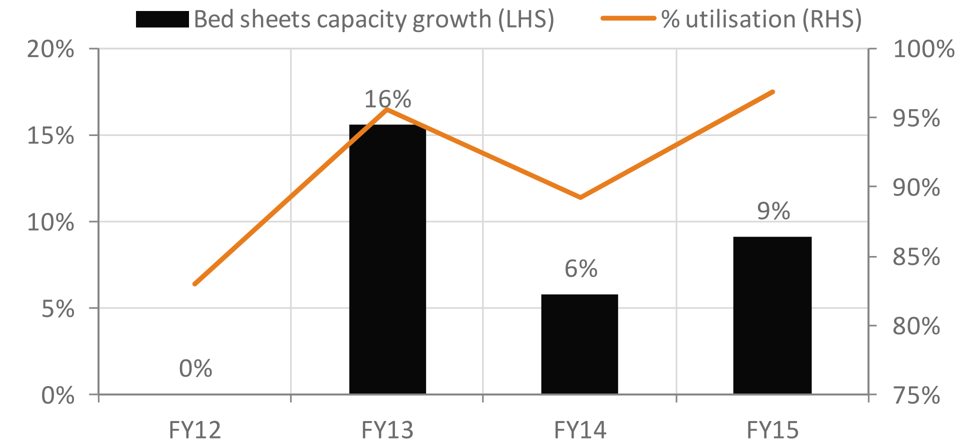
Further, industry sources suggest that the leader Alok Industries (having highest share of exports to the US from India) has been losing market share. This gives us confidence that Welspun would increase growth rates in this segment.

Figure 6: India's gains in bed sheet imports by US have been stronger



Source: Company, IIFL Research

Figure 7: Capacity addition for Welspun likely to be healthy in FY16



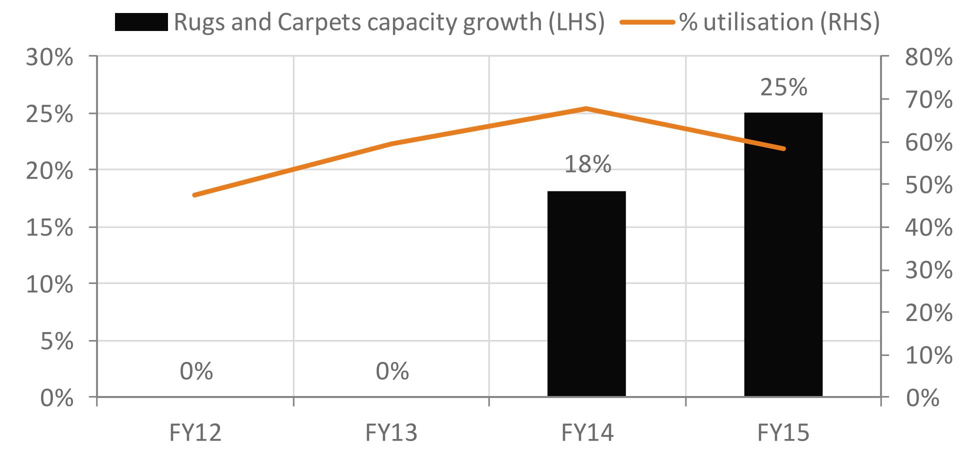
Source: Company, IIFL Research

Capacity utilization of the existing units is already at c100% and hence volume growth is likely to depend on capacity addition (c9% Cagr expected over next two years). Welspun management indicated that given the healthy growth opportunity, it is looking to increase capacity addition fast and reach 72m metre capacity by FY16 instead of FY17 (20% addition).

Rugs segment a strong growth opportunity over medium term
The rugs, carpets and others segment (11% of sales) is a relatively nascent category in which Welspun uses its towels and bed sheet businesses to cross-sell these products. Capacity utilization of existing facilities is at 58% only, suggesting room for growth. Further, Welspun is looking to increase capacity from 15,000MT currently to 20,000MT over FY16/17 (18% Cagr over the next two years).

Although this segment may take time to grow, it offers a healthy growth opportunity over the medium term. That said, stronger growth in flooring would require Welspun to consider setting up service centres to offer wall-to-wall carpeting solutions. This is a large opportunity in the US, although the company is not evaluating entry into this segment currently.

Figure 8: Capacity utilization provides room for stronger volume growth vs. other segments



Source: Company, IIFL Research

Healthy demand in a weak input cost environment to aid realization growth
As highlighted earlier, instead of bidding for each contract, Welspun has access to a specified retail area where it is supposed to supply private label brands. Its contracts with the retailers are structured as fixed price contracts (in USD terms) with a renegotiation clause, should input costs vary more than 5%. These pricing contracts are typically of 2-3 years duration with a right to negotiate every six months.

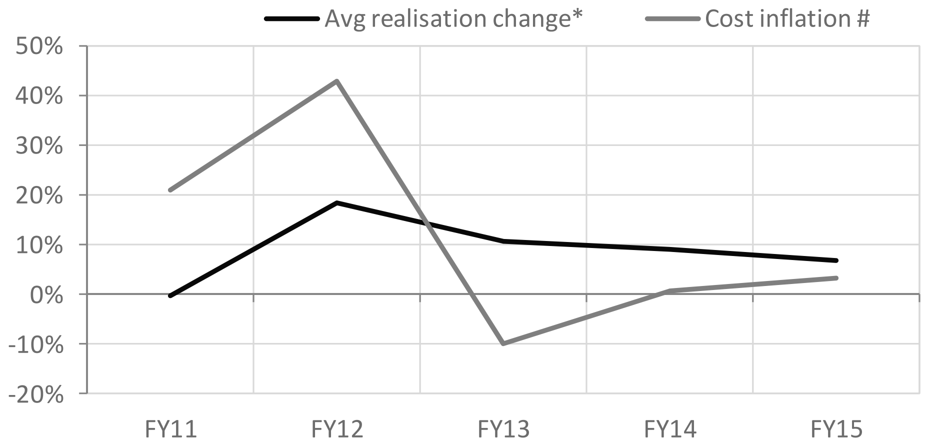
To determine whether input costs have moved more than 5%, an index is created using cotton prices, currency, and crude (proxy for power). If the index moves more than 5% in a six-month interval, either party can approach for renegotiation. The final price is set based on the demand conditions. Thus, input cost variations along with likely demand strength determine the likely realization growth

Figure 9: Realization growth across segments linked to demand as well as cost inflation across key inputs, albeit realized with a six-month lag

	FY11	FY12	FY13	FY14	FY15
Segment wise realisation growth					
Terry Towels	8%	19%	10%	13%	2%*
Bed Linen	-11%	12%	13%	3%	14%*
Bath rugs & carpets	-10%	44%	3%	6%	4%*
Cost inflation #					
USD cotton prices	41%	99%	-43%	-6%	-2%
USD/INR (negative implies INR depreciation)	-6%	-2%	17%	8%	8%
USD crude oil (Brent)	33%	20%	3%	0%	4%

Source: Company, IIFL Research; *IIFL estimates assuming production to sale volume ratio is similar to FY14 levels; #Cost inflation determine for a period ending six month s prior to FY-ending

Figure 10: Realization growth across segments has broadly been based on per-unit cost inflation, although weak demand has weighed on ability to negotiate increases



Source: IIFL Research; *Revenue weighted realization growth; # assumed 40% weightage in index for USD cotton prices and currency and rest 20% for USD crude price change

In the towels segment, the leading competitor to Welspun, Trident, has undertaken massive addition in capacity. While this poses a risk to realization growth in the towels segment, the additional services provided by Welspun could moderate the impact on realization growth. In the bed sheets segment, with the leader (Alok Industries) losing market share and India having a sustainable cost advantage in the key raw material (long-staple cotton), realization growth could be healthy.

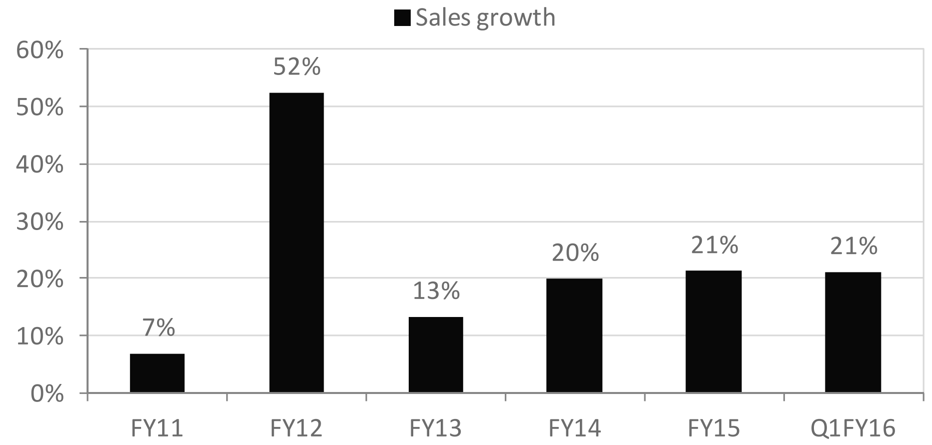
Figure 11: Trident's capacity addition has not weighed materially on Welspun's realization growth in towels segment historically

	FY12	FY13	FY14	FY15
Capacity addition (%)				
Trident	0%	0%	77%	0%
Welspun	6%	0%	3%	11%
Towel realisation change	19%	10%	13%	2%
Per unit cost inflation	43%	-10%	1%	3%

Source: Company, IIFL Research

Welspun expects such realization growth along with healthy volume growth (driven by bed sheet segment) to drive mid-teens sales growth.

Figure 12: Welspun expects mid teen sales growth going forward

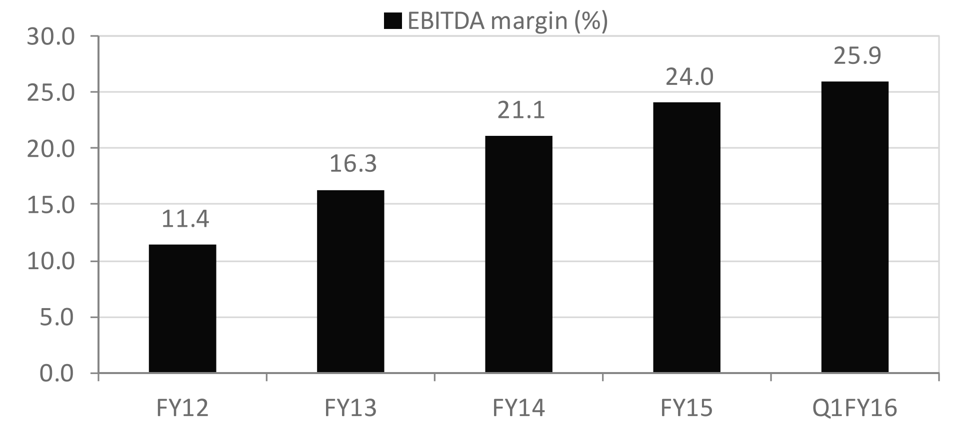


Source: Company, IIFL Research

Ebitda margin to sustain close to current levels

Welspun's divestment of its loss-making retail businesses has helped drive improvement in Ebitda margin in FY13. Further, Welspun's ability to retain input cost benefits in an improving demand environment has helped drive further expansion from 16.3% in FY13 to 24% in FY15 and 25.9% in 1QFY16. The recent currency depreciation (INR-USD) in a relatively healthy demand environment should drive further help Ebitda margin expansion from 1Q level. Welspun expects Ebitda margin in FY16 to remain broadly similar to FY15 levels. The recent INR depreciation along with 1Q performance and continued strength in US demand makes us believe that Ebitda margin is likely to be closer to 1Q level of 26%.

Figure 13:Ebitda margin have seen healthy expansion over the last few years



Source: Company, IIFL Research

Figure 14: US retail sales showing signs of moderate improvement

Source: Company, IIFL Research

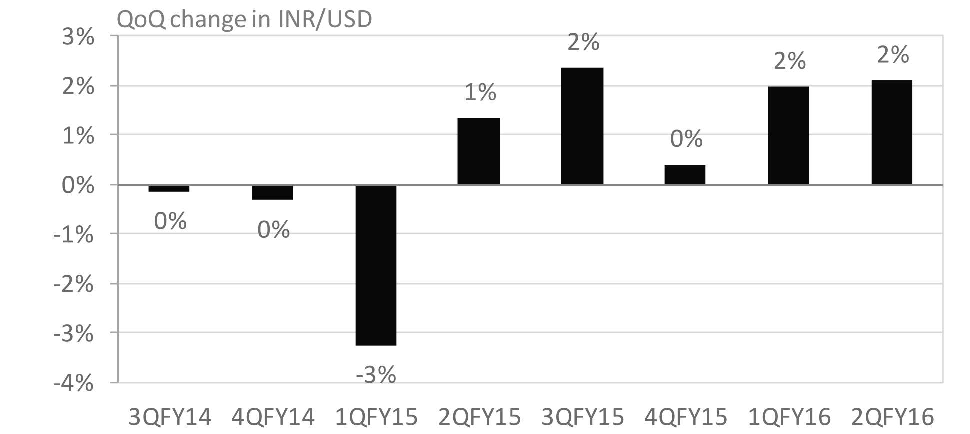
Healthy US demand growth to aid margins

Welspun's pricing contracts mean that realization growth is a function of retail demand and input cost changes. Hence, Welspun's margins are likely to face pressures should input costs move up sharply while underlying retail demand remains weak. In contrast, healthy retail demand in a weak input cost environment should help aid margins. This impact was visible in FY15, when despite a sharp decline in cotton prices, Welspun's realizations did not see such a sharp decline driving healthy 300bps expansion in Ebitda margin. With US retail demand showing signs of strength and moderation in input costs (in particular cotton) continuing, Welspun should be able to retain part of the input costs benefits, driving continued strength in Ebitda margins. Further, Welspun's recent move to increase the share of vertical integration from 35% to 70% has helped drive margin expansion.

Ebitda margin to expand further on currency depreciation gains

With currency depreciating further in 2Q, Ebitda margin could expand further from 1Q levels as Welspun is able to retain these gains until the next negotiation. Further, a healthy demand environment should allow Welspun to retain part of the benefits even after the renegotiation.

Figure 15: Further currency depreciation to aid Ebitda margin in 2Q vs 1Q levels



Source: Company, IIFL Research

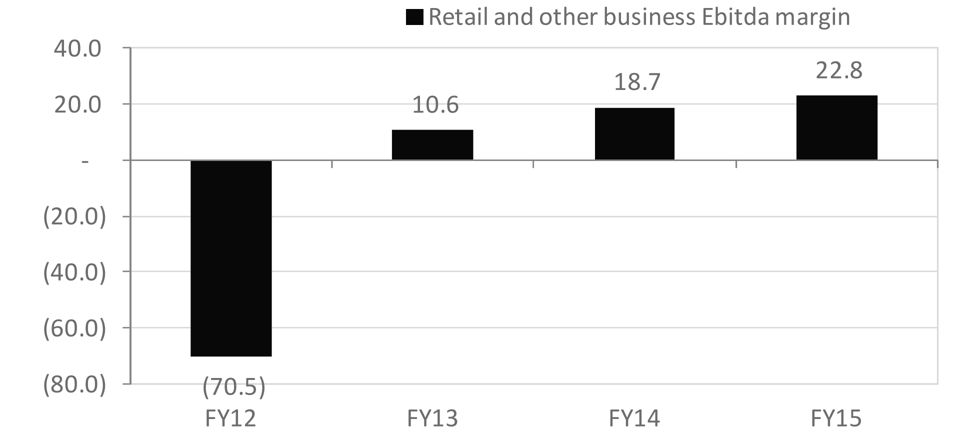
In addition to benefits from currency depreciation, Welspun would also benefit from increasing share of sales from innovative products such as Hygro and Flexifit. Our interactions with the industry suggest that these products have 300-400bps higher margins than other products. Note that these innovations have a life-cycle before they are replicated by peers. Welspun believes that its culture of fostering innovation should help drive continuous innovations and in turn increase the share of such high-margin innovative products, going forward. This remains an additional upside risk to Ebitda margins sustaining at 1Q levels.

In addition, further increase in the share of vertical integration should reduce raw material costs and drive further expansion in margin.

Margin expansion in FY13 driven by divestment of loss marking entities

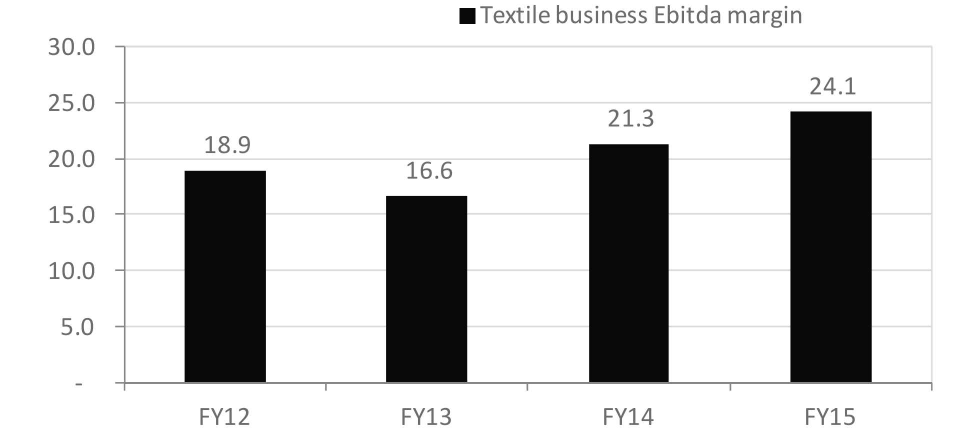
Ebitda margin saw a sharp c500bps expansion in FY13. This was driven primarily by divestment of loss-making entities. Further, the underlying textile business has seen structural change in margin as Welspun's cost control initiatives and improving product mix (increasing share of high margin branded sales) aid margins.

Figure 16: Divestment of loss making entities helped drive improvement in Ebitda margin for retail and other businesses



Source: IIFL Research

Figure 17: Underlying textile business has seen margin expansion driven by improving product mix, cost control initiatives and input cost moderation



Source: Company, IIFL Research

Medium-term risks to margins exist

Although near-term margins are likely to remain close to the current levels, there are a few risks of Ebitda margin moderating from their 1QFY16 level. These include:

- **Implementation of GST:** Under the existing tax regime, Welspun receives 7.1% duty drawback for export sales. This is paid to offset input taxes levied on production. Under the GST regime, Welspun would not receive a blanket 7.1% drawback but would instead drawback an amount equal to the input taxes paid. Our industry interactions suggest that the current input tax paid on production is at c5-5.5%. Hence, GST implementation may result in a 150-200ps impact on margins.
- **Possible suspension of export incentive after FY17:** Currently, Welspun receives 2% export incentives on its export sales. The government has assured continuity of these receipts in FY16 and FY17. Nevertheless, suspension of this incentive in FY18 and beyond would weigh on margins.
- Any weakness in the US market remains a risk to margins.

Figure 18: Higher gross margin and lower power and fuel costs allow Welspun to enjoy sector leading Ebitda margins

% of sales	FY14	FY15
Gross margin		
Welspun	48%	52%
Trident	47%	49%
Himatsingka Seide	35%	36%
Indo Count	41%	47%
Employee cost		
Welspun	8%	8%
Trident	7%	10%
Himatsingka Seide	10%	10%
Indo Count	4%	4%
Power & Fuel		
Welspun	3%	2%
Trident	8%	9%
Himatsingka Seide	3%	4%
Indo Count	4%	4%
Freight		
Welspun	3%	2%
Trident	3%	3%
Himatsingka Seide	1%	1%
Indo Count	1%	2%
Other expenses		
Welspun	14%	16%
Trident	10%	9%
Himatsingka Seide	11%	11%
Indo Count	18%	19%
Ebitda margin		
Welspun	21%	24%
Trident	19%	18%
Himatsingka Seide	10%	11%
Indo Count	13%	18%

Source: Company, IIFL Research

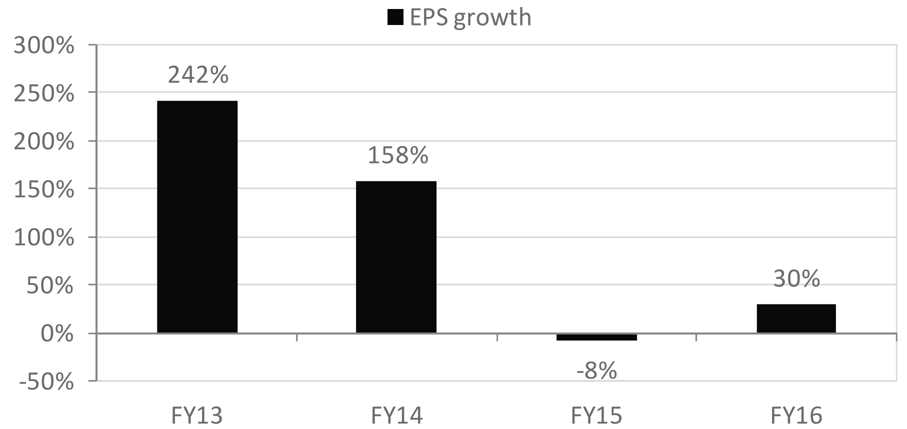
FY16 EPS growth likely to be c30%

Welspun expects mid-teen (c15% level) sales growth in FY16, driven by the bed sheet segment. It expects Ebitda margin to remain similar to FY15 levels at c22-23%. However, 1QFY16 performance along with INR depreciation post 1Q suggest upside risks to this estimate. We believe FY16 Ebitda margin is likely to be similar to the 1Q level of c26%, suggesting Ebitda growth of c21%.

Further, additional debt used to fund capex has interest subsidies from state governments, in addition to the existing Central-level subsidy. With increasing share of debt now from this low-cost debt, overall interest rates should moderate. As a result, despite increase in debt levels, interest costs would be flattish/ marginally down.

Tax rate is expected to increase in FY16 as one-off investment allowance moderates from the FY15 levels. Investment allowance is linked to capacity commissioned during the year. Since this would moderate in FY16 from FY15 levels, investment allowance is expected to decline. This reduction along with increasing share of profits from the high-taxation US subsidiary would result in tax rate increasing from 28% to c30-32% in FY16. This could drive c30% growth in EPS in FY16.

Figure 19: Expect 30% EPS growth in FY16

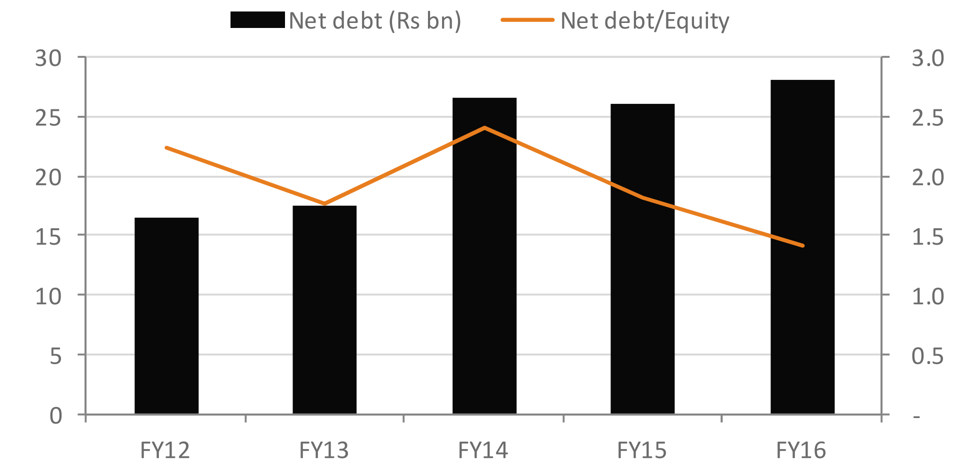


Source: Company, IIFL Research

Debt to rise in near term to fund capex; expect reduction in subsequent years

Welspun's current D/E stands at 1.8x as it has invested in new capacity and vertical integration using debt funding (cRs14bn spent in FY14 and Rs5bn in FY15). Net debt level is likely to increase further in FY16, given Rs10bn (Rs2bn already done in Q1) capex planned to increase capacity across each of the segments. Further, increasing vertical integration has meant investments into spinning and weaving capacity. These investments yield lower asset turnover and hence they are ROCE dilutive (ROCE for spinning companies is 250-300bps lower than Welspun). Thus, increasing vertical integration is likely to weigh on ROCE levels.

Figure 20: Expect net debt levels to rise in FY16 albeit net D/E would moderate



Source: Company, IIFL Research

Investing Rs13bn in capacity addition and vertical integration of which Rs10bn to be spent in FY16

Welspun used to invest only in weaving and processing in case of terry towels segment and only in processing facilities in sheets segment over the past five years. However, it has decided to vertically integrate operations in these segments and accordingly, it is investing in spinning and weaving facilities across these segments.

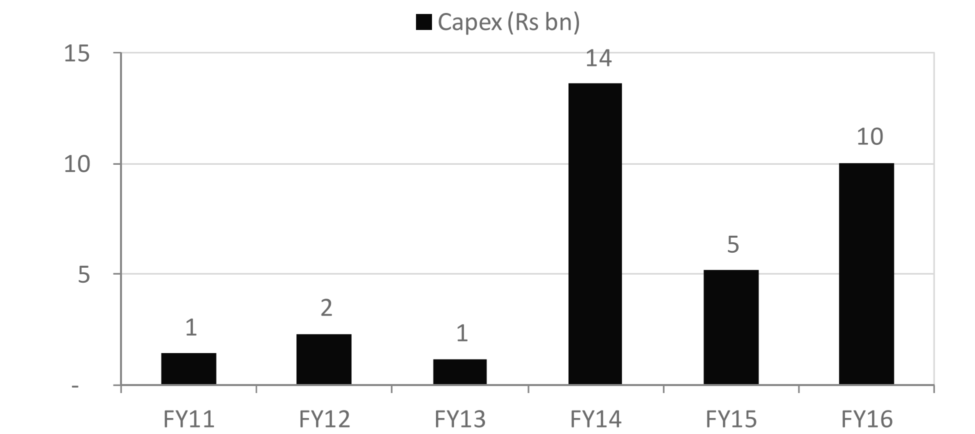
Further, it has sharply increased capacity over the past two years, a process that is expected to continue in FY16/17. As a result, Welspun expects to spend Rs10bn capex in FY16 of which it has already incurred cRs2bn in 1Q.

Figure 21: Intend to spend Rs13bn capex over FY16-17…

Product	Current capacity	Production	Utilisation (%)	Expected capacity (FY16/FY17)	% expansion
Towels	50,000 MT	50,852 MT	102%	60,000 MT	20%
Sheets	60 m mtrs	58 m mtrs	97%	72 m mtrs	20%
Rugs & Carpets	15,000 MT	8,755 MT	58%	20,000 MT	33%

Source: Company, IIFL Research

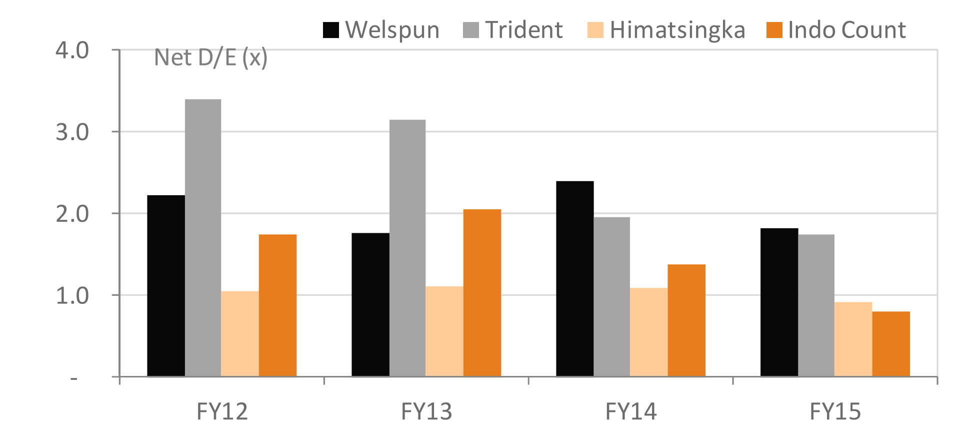
Figure 22: ..of which Rs10bn would be incurred in FY16 (front-ended)



Source: Company, IIFL Research

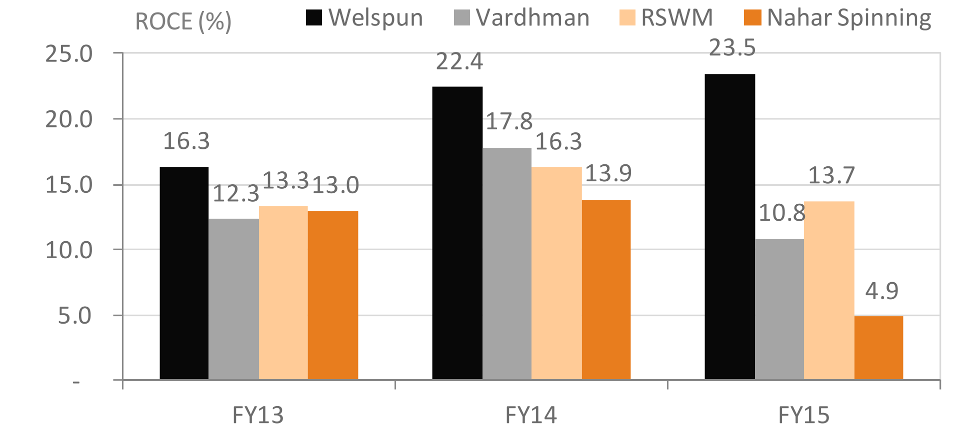
Such aggressive capex plan is likely to move net debt levels from FY15 levels although net D/E would remain marginally down. Note that net D/E for Welspun is broadly similar to peers. Interest subsidies from central and state governments, which reduce interest cost to low single-digit levels, have resulted in all textile companies looking at debt-based funding for capacity addition.

Figure 23: Net D/E for Welspun broadly in line with peers



Source: Company, IIFL Research

Figure 24: Spinning company ROCE are significantly lower than Welspun



Source: Company, IIFL Research

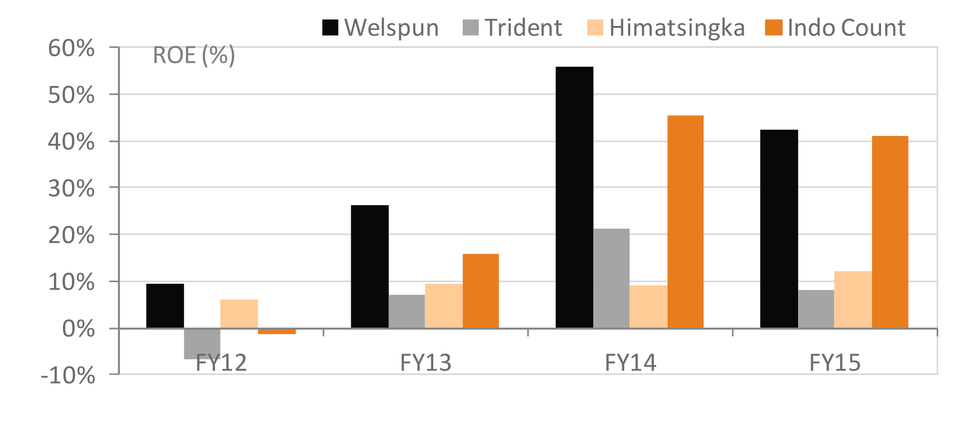
Investment in vertical integration to weigh on ROCE

Welspun used to invest only in weaving and processing lines in its towels business and only in the processing line for the sheets business and used to source the required yarn and fabric from other players. This was primarily from small manufacturers in south India. However, the power situation in South India meant that Welspun started facing issues in procuring the required raw materials, in turn resulting in delays in fulfilment of client orders.

This spurred Welspun into investing in vertical integration and increasing the share of capacity for which the supporting spinning and weaving capacity is in house. Welspun has increased the share of vertically integrated capacity (which has supporting weaving/ spinning units) from 35% to c70%.

However, an analysis of listed spinning companies shows that ROCE for spinning is lower than the company's current levels of c22-23%. This is because asset turnover for Welspun's fully integrated unit is c1x (including working capital requirement) vs. c1.9x for the outsourced model earlier. As a result, increasing vertical integration is likely to weigh on Welspun's ROCE going forward.

Figure 25: Welspun has the highest ROE among peers



Source: Company, IIFL Research

Figure 26: DuPont analysis

	FY12	FY13	FY14	FY15	FY16ii
Ebitda margin (%)	11.4	16.3	21.1	24.0	25.7
Non operating effect (PBT/Ebitda)	0.23	0.51	0.65	0.59	0.64
Tax effect (PAT/PBT)	0.81	0.76	0.98	0.72	0.72
Asset Turnover (Sales/ Assets)	1.18	1.19	1.17	1.20	1.19
Equity multiplier (Assets/ Equity)	3.9	3.5	3.5	3.5	3.0
Return on equity (%)	9.4	26.3	56.0	42.5	41.0

Source: Company, IIFL Research

Exploring an ancillary model similar to auto industry

Going forward, the company intends to develop an ancillary based development model for its weaving and spinning requirements. Under this approach, the supporting weaving and spinning units would be located close to the Welspun's facilities (similar to the model seen in automobiles where ancillary factories are located close to the OMCs). This would reduce the packaging and logistics cost for the spinning and weaving companies while allowing Welspun to function with lower working capital as well as lower capex, thus improving the RoCE.

Reasonable valuations

Welspun trades at a premium to other peers in the terry towel business. However, it is at a discount to other players in the bed sheets space. With growth increasingly led by the bed sheets business, we expect Welspun's multiples to move towards its bed sheet peers.

Figure 27: Trading at premium to towel companies but at a discount to bed sheet peers

Company	CMP	Mcap	ROE	Net D/E	P/E		EV/EBITDA		P/B	
	(Rs)	(USDm)	FY16	FY15	FY15	FY16	FY15	FY16	FY15	FY16
Welspun	820	1,247	41.0	1.8	15.3	11.8	8.5	7.2	5.8	4.2
Trident	42	325	9.9	1.8	11.4	8.0	6.8	5.5	1.5	1.3
Himatsingka	202	301	17.0	0.7	20.9	13.1	12.7	7.2	2.9	2.1
Indo Count	938	560	41.5	0.8	16.8	14.5	15.2	10.1	9.2	6.0

Source: Company, IIFL Research

Other details

Figure 28: Contingent Liabilities

Contingent liabilities (Rs m)	FY12	FY13	FY14	FY15
Excise, Customs and Service Tax Matters	674	701	344	341
Stamp Duty Matter	6	7	5	5
Sales Tax Matters	42	49	38	56
Income Tax Matters	30	168	168	141
Claims against the group not acknowledged as debts	6	55	51	51
Bill discounted in respect of export debtors	1,538	1,478		
Bank guarantees	984	125		
Corporate guarantees	900	900		
Dividend arrears	3	4		
Total contingent liabilities	**4,182**	**3,486**	**605**	**594**
%of PBT	**506%**	**116%**	**10%**	**8%**

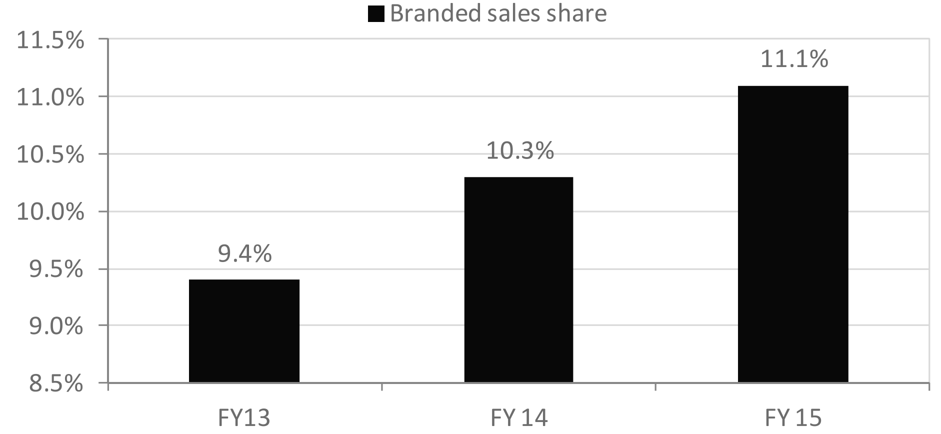
Source: Company, IIFL Research

Figure 29: No material related-party transactions; purchase of goods linked to purchase of synthetic yarn from promoter group entity

Related party transaction (Rs m)	FY12	FY13	FY14	FY15
Sales of Goods/DEPB Licenses (incl taxes)	28	94	516	62
% of sales	0%	0%	1%	0%
Sale of services/Expenses incurred	114	35	25	21
% of sales	0%	0%	0%	0%
Purchase of Goods (incl taxes)	1150	1529	773	777
% of COGS	7%	9%	3%	3%
Purchase of Services/Expenses incurred	97	118	119	59
% of COGS	1%	1%	1%	0%
Loans, Advances & Deposits given	0	0	0	206
% of total loans & advances	0%	0%	0%	2%
Purchase of fixed Assets/Capital Goods	16	23	668	301
% of net block	0%	0%	3%	1%

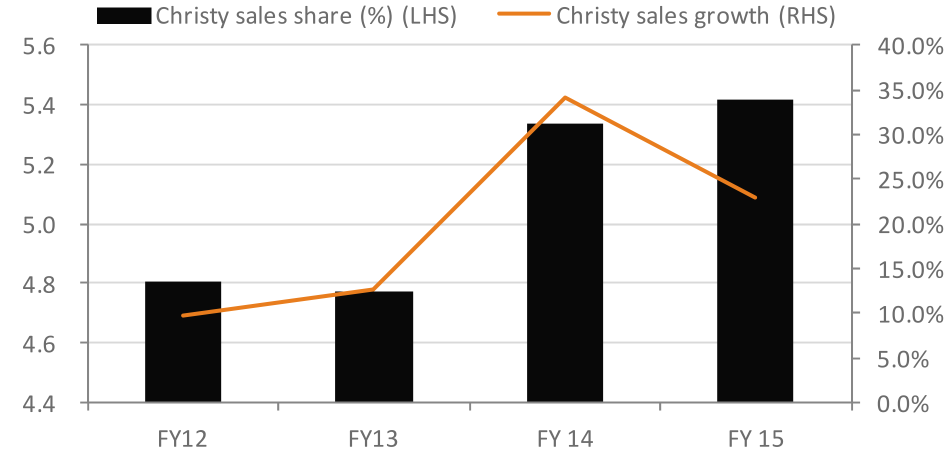
Source: Company, IIFL Research

Figure 30: 11% of sales through own label brands



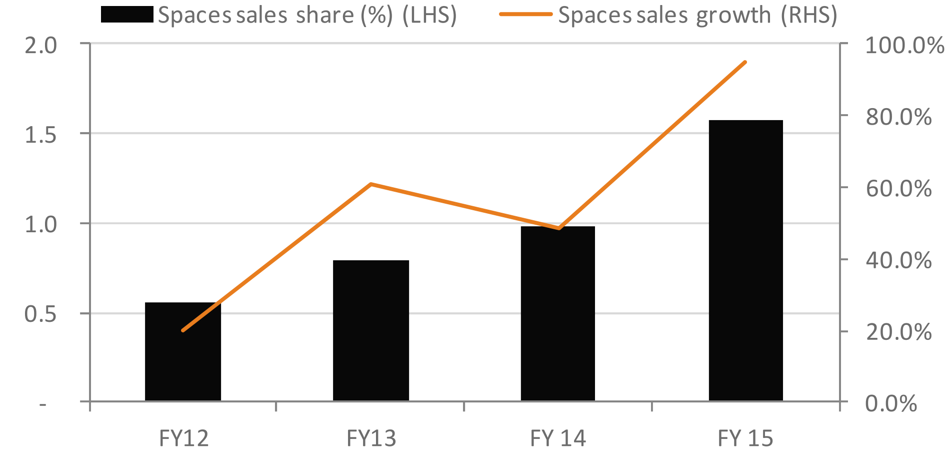
Source: Company, IIFL Research

Figure 31: Share of sales from retail chain "Christy" has gradually increased over the years



Source: Company, IIFL Research

Figure 32: ...a trend witnessed in "Spaces" domestic chain as well



Source: Company, IIFL Research

Key innovative products by Welspun

To maintain and enhance retail space available to Welspun, it constantly creates new products that fulfill a functional requirement. Innovative products have grown at 42% Cagr over FY11-15 to c31% of sales. Explained below are the two key innovations:

'Hygro Cotton' products have a hollow cotton core, which ensures that the product regulates temperature and become softer after each wash. Thus, towels made from this material get softer and loftier after few washes and dry up faster. Bed sheets made from this material maintain temperature and consistency

'Flexifit' is another sheet product technology, which allows the sheets to fit on a range of mattress sizes, given their elastic nature towards the ends.

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Consolidated	FY13A	FY14A	FY15A	FY16ii
Revenues	**36,473**	**43,730**	**53,025**	**59,934**
Ebitda	5,946	9,211	12,742	15,380
Depreciation and amortisation	(1,449)	(1,903)	(3,329)	(3,867)
Ebit	4,497	7,308	9,413	11,513
Non-operating income	492	1,042	949	855
Financial expense	(1,977)	(2,352)	(2,829)	(2,588)
PBT	3,013	5,998	7,533	9,780
Exceptionals	(31)	(4,960)	0	0
Reported PBT	2,982	1,037	7,533	9,780
Tax expense	(733)	(199)	(2,090)	(2,738)
PAT	2,248	838	5,443	7,042
Minorities, Associates etc.	0	82	(45)	(47)
Attributable PAT	**2,248**	**921**	**5,398**	**6,995**

Ratio analysis

Y/e 31 Mar, Consolidated	FY13A	FY14A	FY15A	FY16ii
Per share data (Rs)				
Pre-exceptional EPS	22.8	58.7	53.7	69.6
DPS	3.8	3.0	10.5	12.5
BVPS	98.9	110.7	142.5	197.6
Growth ratios (%)				
Revenues	13.3	19.9	21.3	13.0
Ebitda	62.4	54.9	38.3	20.7
EPS	239.7	157.6	(8.4)	29.6
Profitability ratios (%)				
Ebitda margin	16.3	21.1	24.0	25.7
Ebit margin	12.3	16.7	17.8	19.2
Tax rate	24.6	19.2	27.7	28.0
Net profit margin	6.2	1.9	10.3	11.7
Return ratios (%)				
ROE	26.3	56.0	42.5	40.9
ROCE	16.3	22.4	23.5	24.5
Solvency ratios (x)				
Net debt-equity	1.8	2.4	1.8	1.6
Net debt to Ebitda	2.9	2.9	2.0	2.0
Interest coverage	2.3	3.1	3.3	4.4

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar, Consolidated	FY13A	FY14A	FY15A	FY16ii
Cash & cash equivalents	2,803	3,666	4,766	2,812
Inventories	8,205	10,094	11,006	12,440
Receivables	2,750	4,117	4,467	4,926
Other current assets	5,674	7,733	8,874	10,030
Creditors	4,929	6,144	6,910	7,811
Other current liabilities	1,303	3,399	3,855	4,652
Net current assets	**13,200**	**16,067**	**18,348**	**17,746**
Fixed assets	16,861	23,770	26,049	35,228
Intangibles	1,754	1,839	1,785	1,785
Investments	533	465	6	6
Other long-term assets	0	0	0	0
Total net assets	**32,348**	**42,141**	**46,188**	**54,764**
Borrowings	20,279	30,293	30,851	33,851
Other long-term liabilities	2,167	750	1,019	1,066
Shareholders' equity	**9,902**	**11,097**	**14,318**	**19,847**
Total liabilities	**32,347**	**42,140**	**46,188**	**54,764**

Cash flow summary (Rs m)

Y/e 31 Mar, Consolidated	FY13A	FY14A	FY15A	FY16ii
Ebit	4,497	7,308	9,413	11,513
Tax paid	(420)	(309)	(1,767)	(2,738)
Depreciation and amortization	1,449	1,903	3,329	3,867
Net working capital change	(1,928)	(3,974)	(2,399)	(1,958)
Other operating items	111	581	668	0
Operating cash flow before interest	3,709	5,510	9,243	10,684
Financial expense	(1,979)	(2,576)	(2,979)	(2,588)
Non-operating income	286	168	237	855
Operating cash flow after interest	**2,015**	**3,101**	**6,501**	**8,951**
Capital expenditure	**(2,686)**	**(7,163)**	**(5,672)**	**(13,046)**
Long-term investments	858	(2,459)	(362)	0
Others	(905)	607	773	653
Free cash flow	**(718)**	**(5,913)**	**1,240**	**(3,441)**
Equity raising	19	12	4	0
Borrowings	664	7,002	568	3,000
Dividend	(207)	(238)	(711)	(1,513)
Net chg in cash and equivalents	(241)	863	1,100	(1,954)

Source: Company data, IIFL Research

Disclosure : Published in 2015, © India Infoline Ltd 2015

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