Welspun India

View: Positive

Fundamentals remain intact; attractive valuation

CMP: Rs760

On the back of concerns related to the Chinese currency depreciation, a likely risk of heightened competition from the domestic players like Trident (entering into the bed sheet segment) and Himatsingka Seide (entering into the terry towel segment), Welspun India underperformed the market and the stock is 21% down from its all-time high (down 13% over the last month). We believe that Welspun India, over the years, on the back of consistent quality, increased innovation and FMCG-like approach in managing the client-shelf space has created a strong clientele reach in its key markets, which is difficult to replicate in a mature industry like the US home textile market. Further, with its efforts towards consistent growth; calibrated capex (in line with the ancilarisation model adopted by auto players), would pave way for sustaining margins and improving return ratios ahead. At the current price, the stock is trading at less than 10x its FY2017 estimates, which is attractive and hence we have a positive view on the stock and expect it to deliver over 22-25% returns in medium term.

Key result highlights

- For Q2FY2016, Welspun India's top-line growth was muted, it grew at 4.2% year on year (YoY), this low growth is attributable to (a) high base of last year (grew at 22% in Q2FY2015); and (b) capacity constraints for Q2FY2016; as towel and sheeting capacities are running at 105% and 96% utilisation levels respectively.

- Driven by innovation in products (innovative products contribute 30% to total sales), benefit of integration (now 70% of the yarn requirement is sourced internally as against 35% pre-capital expenditure [capex]), and lower raw material cost, the operating profit grew at 18.1% YoY. Consequently, the operating profit margin expanded by 300 basis points (BPS) YoY at 25.4% for the quarter.

- A healthy operating performance, aided by reduction in the interest cost (the interest cost was lower by 30% YoY; on account of interest subsidy of Gujarat state government; coupled with company's initiative to issue commercial paper at lower interest rates), led to a strong 32.7% year-on-year (Y-o-Y) growth in net earnings.

Q2FY16 result review Rs cr

Particulars	Q2FY16	Q2FY15	YoY %	Q1FY16	QoQ %
Net sales	1,472.3	1,413.5	4.2	1,388.5	6.0
Operating profit	374.3	316.9	18.1	359.8	4.0
Operating profit margin (%)	25.4	22.4	300BPS	25.9	(49.5)BPS
Profit after tax	172.4	129.9	32.7	163.2	5.6

Key management call highlights

- Going forward, the company remains confident of returning back to its guided level of growth in the range of 13-16% and this would be achieved on the back of available capacity in its bed sheets and terry towel plants. It expects its terry towel plant to witness a 10% Y-o-Y increase in capacity for the next two consecutive quarters. Further, its sheeting plant is also ready with 20% enhanced capacity (from 60 million metres to 72 million metres).
- Welspun India is currently in the middle of its expansion spree, towards integration and debottlenecking that would entail an additional capex of Rs850 crore to be spent in the next 12-18 months. After that the company plans to go the ancilarisation way whereby it would outsource the high capex spinning, weaving and would concentrate itself in the high value added cutting, sewing, dyeing and finishing segments that would make its business asset light resulting in higher returns. Thus, beyond FY2017, maintenance capex would be incurred by the company, implying capex equal to the deprecation charge.
- The company aims to improve its share in the domestic business (which is largely branded-*Spaces* and *Welhome*), that would fetch it higher margins. The domestic business currently contributes 6% to the total top line and the company aims to take it to 20% in the next five years.

Our take

- Aided by the confluence of various factors like stable raw material prices, the company's effort towards innovation, integration and increased focus of branded business, the margins are likely to sustain at the current level of 24-25%.
- We believe that Welspun India with its strong clientele in the global market would continue to be the key beneficiary of the consolidation in the market. Along with steady volume growth, its effort towards cost optimisation and efficient capital allocation strategy (via ancilarisation) is likely to propel the key returns metrics. Thus, we continue to like its business model and strategy.

Valuation (consolidated)

Particulars	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Net sales (Rs cr)	2,933	3,647	4,495	5,303	5,939	6,711
EBITDA (Rs cr)	557	595	921	1,369	1,485	1,644
EBITDA margin (%)	19.0	16.3	20.5	25.8	25.0	24.5
PBT	281	301	600	753	997	1,164
PAT	199	225	420	540	658	780
EPS (Rs)	19.8	22.4	41.8	53.7	65.50	77.67
RoE (%)	26.7	25.9	40.0	42.5	36.1	33.0
PER (x)	38.4	34.0	18.2	14.1	11.6	9.8

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.